Customised Solutions – COVID-19

Willis Re International
Customised Solutions

6th April 2020

Potential Impact on Solvency and Earnings

While COVID-19 is causing a lot of disruption to the day to day operations of insurers, we believe there will be also be longer term financial impacts. In Europe, EIOPA recently declared that this was a market changing event and as a consequence, insurers need to comment in their upcoming solvency returns on the impact of COVID-19 and any actions they are exploring. Clearly solvency will be impacted by the drop in equities and an increase in corporate bond spreads. Moody's has estimated that the European insurance sector's solvency has fallen from 210% at year-start to 190%.

For some insurers the drop in solvency may take them below their desired minimum capital and they will need to consider what action to take. In addition to regulatory capital, insurers will also need to consider how the rating agency capital models are impacted and ensure they have enough buffer to avoid any unwanted downgrades. For other insurers the issue may be less around solvency and more a desire to protect 2020 earnings. They may feel they can manage the earnings impact to date coming from some mixture of:

- lower premium from decreased business activity
- expense ratio creeping up as premium decrease exceeds expense reductions
- some direct COVID-19 claim activity, although this may be offset by reduced claims in motor and other portfolios

However they may well have a lower risk tolerance for further hits to earnings for the rest of 2020 – and we are only a quarter of the way through the year so a lot can still happen. Furthermore, in the last few years, the investment side has been a source of stability to the earnings, offsetting volatility on the liability side, but going forward insurers will have to contend with both volatile investments and liabilities.

Planning for the day after

Raise more equity & debt

Purpose: Improve Solvency

+ By having ability to adjust the dividend pay-out, insurer has flexibility in the annual financing cost of the equity

× Markets volatile / costly
Caps on debt in solvency calculations

Actively write less business

Purpose: Improve Solvency

+ May happen anyway as business activity shrinks (temporarily anyway)

× Not easy to change business volume that quickly for many insurers
Once lost, hard to win back

Buy more traditional reinsurance

Purpose: Improve Solvency, Protect Earnings

+ Relatively straightforward to do
Pricing is currently relatively stable

× Need to find budget to fund the extra expense for any non-proportional RI

Specific customised RI options

Purpose: Improve Solvency, Protect Earnings, Provide Liquidity

+ Can be designed to specifically meet goals of insurer

× Retrospective deals can take a while to execute

Maintain Status Quo

Purpose: Highlight robustness of existing capital/risk policies

+ Potentially sends positive message in the short term to investors and stakeholders

× What if your peers are all taking action….

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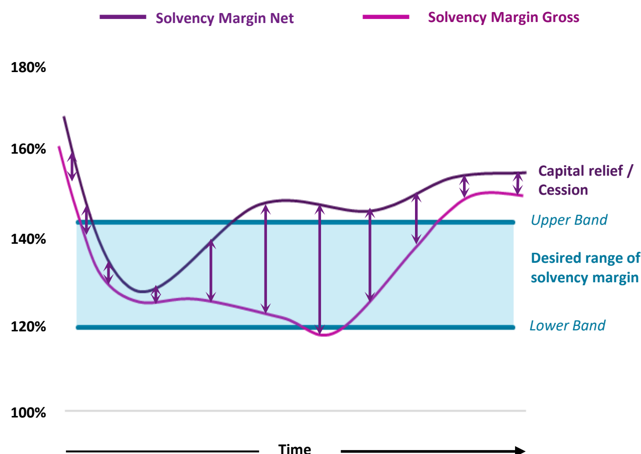
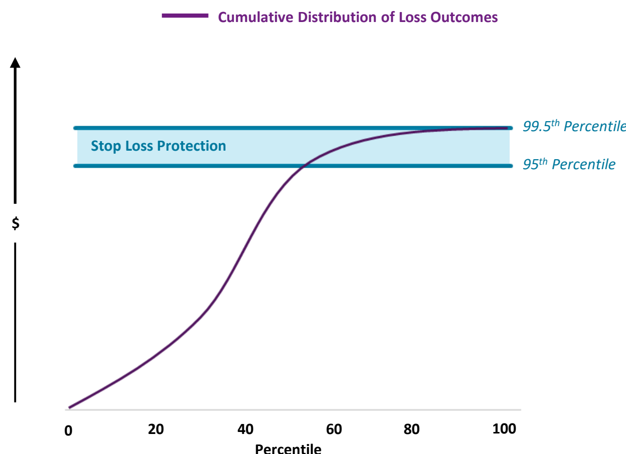
The Customised “Toolkit”

Proportional	Non-Proportional
Variable LPT / QS	*ADC / Stop Loss*





Variable LPT / QS
For those on a standard model, a capped QS or an LPT is normally quite cost effective. Cession can increase if necessary over the course of the year or cession % can be contingent and tied to a trigger which could be solvency or investment related.

ADC / Stop Loss
An adverse development cover or a prospective stop loss (or a combination of both) attaching ‘out of the money’ with a limit stretching up to the 1 in 200 outcome is an effective way of reducing capital requirements for those on an internal model.

Similar types of solutions can be applied to life portfolios where they could cover extreme risks such as mortality, longevity , lapses or investment guarantee risks.

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