COVID-19 & (re)insurers’ financial health

Willis Re
Strategic & Financial Analytics
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Summary
- Willis Re’s Strategic and Financial Analytics teams continue to monitor the financial impact on the global (re)insurance sector due to the COVID-19 pandemic.
- The negative impact of investment markets on capital positions has nearly erased. For the global reinsurance industry, having hit -30% when markets were bottoming in March, we estimate the impact on capital is now only -7%.
- Bottom-up COVID-19 loss announcements now stand at $6b, or $13b if companies’ projections of full-year losses are included. Either way, this is a long way from top-down industry loss estimates of $30-100b, and we expect the bottom-up versus top-down gap to take a long time (likely years not months) to close.
- Capital raising is the new hot topic, and we put COVID-related capital raising at $16b. Investors are seemingly supportive, with a number of companies posting strong share price performance upon announcing a capital raise.
- Putting together current asset-side hits and potential loss recognition, we do not see COVID as a capital event for the industry. If investment markets stay at their current level, we calculate that the global reinsurance sector might end 2020 with a decline in capital on the order of only 8%.
- Rating agencies are maintaining a cautious stance, with S&P having moved to a negative outlook on the global reinsurance sector. S&P expects the global reinsurance sector’s return on capital to undershoot its cost of capital again in 2020, having met its cost of capital only one year in the past three.

Negative impact of investment markets nearly erased¹
Since our last COVID-19 flyer on 13 May, investment markets have continued to rebound, with the S&P 500, for example, now nursing a YTD decline of only 7%. Correspondingly, our estimated impact from investment markets on reinsurers’ capital positions has also continued to ameliorate. The estimated impact now stands at only -7%, having been -30% when markets were bottoming in March.²

Estimated asset-side hit to reinsurance capital versus S&P 500²

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¹ This section is based on investment market prices as of 26 June.
² Includes National Indemnity. The originally published estimates for 23 Mar – 26 May had excluded National Indemnity.
Update on COVID-19 loss recognition – still a wide gap between bottom-up and top-down

With Q1 reporting season behind us, there have been few new COVID-19 loss announcements from individual (re)insurers. Our tally of announced losses stands at $6b. Adding on further statements from (re)insurers of losses they are expecting to book for FY 2020, the figure rises to $13b. These figures continue to be only small fractions of the top-down insured loss estimates published by industry commentators (including our own sister organization Insurance Consulting and Technology). We maintain the view that, whatever the ultimate insured loss, loss recognition, not to mention actual payments, will emerge only very slowly. We expect it will take years, not months, for the bottom-up versus top-down gap to close.

COVID-19 announced losses versus top-down industry estimates

![Diagram showing COVID-19 announced losses versus top-down industry estimates]

Capital raising is the new hot topic, with a largely supportive investor base

The most significant recent COVID-related theme has been the industry’s capital raising. YTD we add up announced capital raises (both equity and sub-debt) across the global (re)insurance sector of $20b. Not all of this will be COVID-related and we (somewhat subjectively) knock this down to $11b of capital raising amongst companies with significant commercial P&C or reinsurance operations. On top of this, trade press has reported on several incumbents who are contemplating capital raises (eg Ark). We put this contemplated capital raise at $1b. Trade press has also reported on several start-ups or vehicle re-purposing (eg Starstone), and we put this potential capital raise at $4b. Altogether, we put announced and potential COVID-related capital raising at $16b. On top of these moves, Willis Re is also seeing increased activity in capital-motivated reinsurance transactions.

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3 WTW’s USD 32-80bn estimate corresponds to its Moderate to Severe scenarios. WTW has also published Optimistic and Limited Success scenarios. These are represented by the hashed portions of the WTW bar and widen the range to USD 11-140bn.
COVID-related capital raising has reached $16b

Looking at the relative size of the already-announced moves, Fidelis leads the way, with its two equity raises totaling $800m equating to nearly 60% of its 2019 capital base (and this ignores an additional raise of senior debt).

Capital raising as a percent of 2019 capital base – companies with the largest percent increase

Putting the $4b of potential start-ups in context of the previous Bermuda capital-raising ‘classes’, 2020 already eclipses the mid-1980s and 1993 classes and is approaching the $5b raised by the Class of 2005, post-KRW. It still ranks well behind the $8b of start-up capital raised in 2001 post-WTC.

Since the KRW hurricanes in 2005, the growth of the alternative capital market has prompted much speculation that there would be no more ‘classes’ — that capital inflows would come in collateralized form via a flexible expansion of ILS managers. The current dislocation in the alternative capital market, however, has created space for another wave of traditional ‘rated paper’ entrants. Having said that, many of these will no doubt be funded by the same investors who have funded (and continue to fund) the collateralized market.
Start-up capital vs previous Bermuda capital raising

Investors, sensing improving (re)insurance market conditions, have been largely supportive of these capital raises. This is exemplified by how share prices have reacted to the most prominent raises by quoted companies. Hiscox, Beazley, Ren Re and Lancashire all saw strong relative share price performances on the day following their announcements.

Investors have been largely supportive of capital raises

Source: Dowling & Partners, Willis Re

Source: S&P Capital IQ
At present, COVID is not a capital event for the industry

The waterfall below pulls together all the above moving parts, in the context of the global reinsurance capital base. Starting with the $605bn we have calculated as the global reinsurance industry’s end-19 capital base:

- We estimate that investment losses as they currently stand have only a 6% negative impact.5
- COVID losses, if we simply take the mid-point of the roughly $30-100bn top-down consensus range and assume 50% is borne by reinsurers, would take another 4% off. In practice, we expect losses will not be fully recognized in 2020, and the 50% assumption for the reinsurers’ share could well prove too high.
- Against these negatives, reinsurers should make ‘normal’ profits elsewhere across their portfolio, and we have plugged in the 3% underlying ROE we have calculated for the industry’s 2019 performance. This implicitly allows for a ‘normal’ level of nat cats. This ROE could also be too cautious, as last year’s price increases should be beginning to earn through, and reinsurers should also participate in the reduced claim frequency many of their clients will be experiencing.
- Payouts to shareholders will no doubt be reduced versus previous years due to regulatory forbearance, but they will also not be zero.
- Finally, we plug in the reinsurance portion of the $16bn completed and prospective capital raising referred to above. We put this reinsurance portion at roughly $6bn.

All-in-all, we estimate that the global reinsurance industry’s capital level may end 2020 about 8% lower than at the start of the year. And it should be remembered that capital growth had been very strong in 2019 (we calculate +15%) due to buoyant investment markets. Our back-of-envelope 2020 calculation would leave industry capital still well above the end-2018 level. So, given the current level of investment markets, we do not see COVID-19 as a capital event for the global reinsurance sector. Clearly, the global reinsurance market is seeing price increases and a tightening of T&Cs, but we do not believe this is being driven by a shortage of supply.

Potential impact on global reinsurance capital base

[Image: Chart showing the potential impact on global reinsurance capital base]

Source: Willis Re

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4 See Willis Re’s Reinsurance Market Report
5 The estimated impact is -7% pre-tax and -6% after-tax.
Rating agencies’ caution persists
In our 13 May update on this topic we predicted further lowering in rating outlooks due to increased rating agency pessimism around future profits. This trend has indeed continued with S&P switching to a negative outlook on the global reinsurance sector on 18 May due to lower earnings expectations for 2020 as a result of COVID-19. This puts S&P in line with Fitch who also put a negative outlook on the sector in March due to COVID-19 concerns. AM Best and Moody’s remain more optimistic with both agencies citing improved pricing as an important factor for the retention of their stable sector outlooks for global reinsurance.

S&P notes that despite lower risk-free interest rates the cost of capital increased in Q1 2020 due to higher equity and credit risk premiums. It also notes that, although the cost of capital has decreased in Q2, it remains higher than the year-end 2019 level. S&P expects that, despite the partially offsetting tailwind of pricing improvement for P&C reinsurance, reinsurers will not cover their cost of capital in 2020. It calculates that ROC has exceeded the cost of capital only one year out of the past three.

Reinsurers’ ROC expected to undershoot their cost of capital again in 2020

![Graph showing return on capital and weighted average cost of capital from FY 2013 to Q1 2020.]

Source: S&P

AM Best issued a Special Report on 18 May titled Stress Testing Rated Companies for COVID-19 which provided the results of its stress testing and the methodology applied. Of the more than 700 North America property and casualty rating units subjected to these stress factors, only 11% and 2% experienced a drop of 1 and 2 levels, respectively, in BCAR assessment. The report additionally described that AM Best would continue its consideration, including qualitative liquidity assessments and consideration of impacts to operating performance, business profile and risk management.
How can we help?

Willis Re’s Strategic & Financial Analytics teams advise clients on strategic and capital management issues. To find out more, please contact your local client advocate or reach out to our experts.

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