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CEO Brief

COVID-19 impact on the insurance industry and possible implications

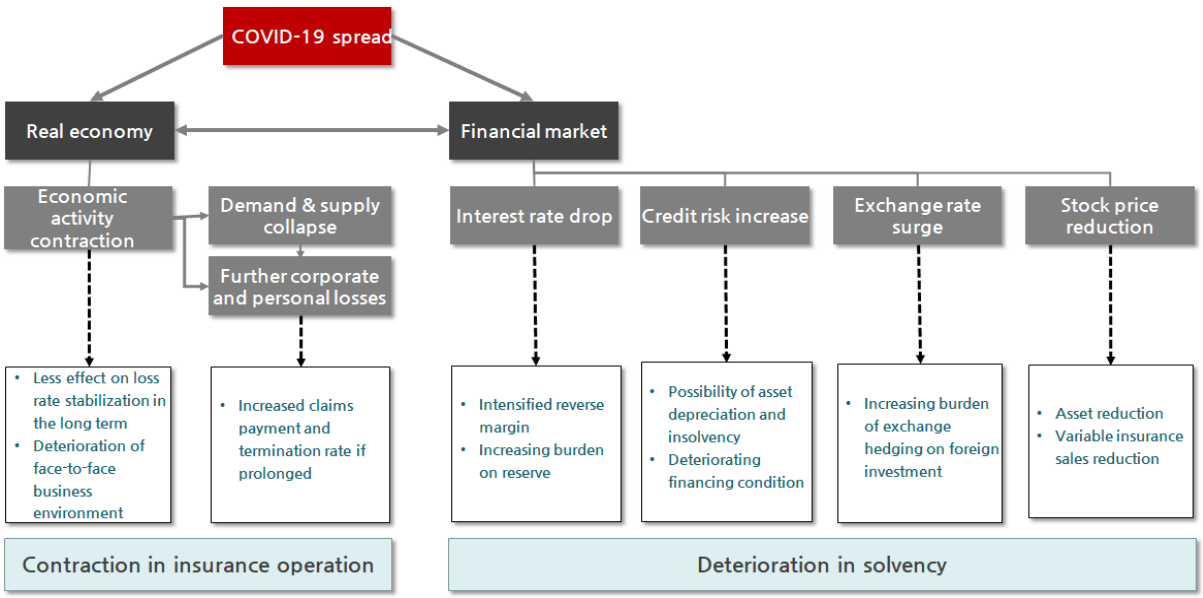
ABSTRACT

Financial impact of the COVID-19 outbreak upon insurers reaches to not only under writing business but also investment portfolio and solvency margin. Even if the spread of COVID-19 would taper off within the first half, the negative impact on business environment would persist for a considerable period, and increasing uncertainty in the financial market may worsen the insurers' soundness and profitability. Insurers should enhance risk management and develop capital management plans by conducting stress analysis and sensitivity analysis with newly reviewed assumptions. Based on the result of the analyses, insurers must ensure close communications with financial authorities.

1. Key fact

The outbreak of COVID-19 has a direct impact on insurers' premium income and claims payment. Meanwhile, with increasing volatilities of stock prices, credit spreads and exchange rates as well as subsequent interest rate cuts, insurer's assets and liabilities also take a negative impact (see 〈Figure 1〉).

〈Figure 1〉 Impact of Covid-19 on Insurance Industry



In the past, new infectious diseases such as SARS and MERS did not have a significant effect due to relatively short duration of spread. However, if the COVID-19 continues to spread, it may lead to a sharp rise in claims payment, reinsurer's loss ratio and lapse rate.

Claims payment increases as mortality and morbidity rates of health insurance rise. The soundness of reinsurance assets of original insurers is likely to be damaged when the loss ratios of reinsurers surge resulting in downgrade of credit ratings. In addition, the lapse rate for insurance contracts may increase.

Performance of new contracts in the first half of 2020 is expected to further deteriorate and even if the spread of COVID-19 would taper off within the first half, the negative impact on the business environment would persist for a considerable period. The face-to-face channel typically undergoing 1-2 months of customer discovery period is expected to suffer as COVID-19 is spreading nationwide at the end of February. However, the less affected non-face-to-face channels are not likely to replace face-to-face channels due to small portion of new contracts and limited product diversity.

Increasing financial market uncertainty reduces insurer's net asset values and returns on new investment, which could consequently exacerbate their soundness and profitability. In particular, the soundness of insurers is likely to deteriorate significantly as long-term interest rates fall.

2. Implications

Insurers should enhance risk management in line with the prolonged low-interest environment and increasing volatility in financial markets caused by the COVID-19 pandemic. In preparation for falling interest rates, insurers are required asset-liability management tailored to economic actuality through additional reserves and diversified means to capital management. Insurers also need to strengthen the monitoring on risky assets such as foreign investment and alternative investment and reset the investment caps and hedging strategies by the asset as financial market volatility increases.

Insurers first need to review the consistency of major assumptions, such as risk rates, lapse rates and discount rates used in assessing products and liabilities for better risk management. Afterwards, capital management plans should be made through stress test and sensitivity analysis by the scenarios such as interest rates, exchange rates and stock prices.

Based on the results of the analyses, insurers must ensure close communications with financial authorities. In Solvency II, regulators' intervention for a non-compliance with capital regulations can be deferred in the event of a sudden financial market downturn, a persistence of a low interest environment and a catastrophic situation with a great impact.

Financial authorities need to provide regulatory improvement to help insurers respond to financial market volatility.

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