SPECTRUM
Asset Management

COVID-19 and the Evolving Insurance Landscape

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The COVID-19 pandemic has reshaped the world. We firmly believe that Financials have entered this crisis from a position of strength, poised to support a socioeconomic recovery. We wish our clients and their families well.

Previously, we explained that investment exposures for insurers should be more financially impactful than COVID-related deaths. We have also shared our thoughts on insurance dividends and COVID-related business interruption claims.

Since our discussion on dividends, the European Insurance and Occupational Pension Authority (EIOPA) and the European Systemic Risk Board (ESRB) have encouraged European insurers to suspend common distributions. While these industry bodies cannot enforce a dividend ban, local regulators have taken different approaches. For example, Dutch insurers have paused common dividends while some German based insurers continue shareholder payments. In our opinion, reduced remuneration is economically prudent and can demonstrate solidarity with policyholders. We do not believe that subordinated capital payments are at risk as real-time stressed capital ratios – *e.g.,* by general account investment fallen angels/impairments, falling interest rates and market volatility – remain well in excess of regulatory requirements. US insurers continue to pay common dividends, though most have scaled back share repurchases. Companies have also raised capital amidst favorable market conditions. While this is defensive, some equity raises have been part of strategic growth plans given strengthening P&C re/insurance pricing and terms & conditions.

Like banks, insurers will face COVID earnings headwinds in 2020 and beyond. **However, industry capital should remain robust**. Ongoing COVID-related provisions will likely be larger than those booked in the first quarter of 2020, though there have also been offsets such as fewer traffic accidents as people stay home. Claims are expected to develop over the longer-term and to be pervasive across workers' compensation, credit and liability classes, for example.

We have written that profitability has been pressured by: 1) "social inflation" a trend of more frequent, severe legal payouts; 2) extreme weather activity; and 3) falling investment returns from low rates. As such, several large incumbents (*e.g.,* AIG) have reduced risk limits, and the supply of alternative re/insurance capital has fallen, supporting higher P&C prices. Moreover, COVID uncertainties, damages from ongoing social unrest in the US, and an expected active hurricane season could add to capital formation pressures. Anecdotally, insurance executives have compared the current environment to the hard P&C pricing market following 9/11. This supported underwriting profitability for leading P&C re/insurers in the years thereafter.

Spectrum is confident insurers will continue to maintain strong capital and risk management capabilities. Rising P&C prices should support profitability and help defend against emerging claims and a constant low rate environment.

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