SPECTRUM
Asset Management

Bank and Insurance Dividend Policies

March 25, 2020

We do not expect severe credit deterioration in the high-quality financials in which we invest. ***This is not 2008.*** *COVID-19 has NOT elevated systemic risk, which is what occurred during the Great Financial Crisis (GFC). Banks were a cause of the crisis. Today, they are part of the solution, not the problem.*

Banks

Some have suggested that banks should reduce or eliminate their common stock dividends for a period of time in order to: 1) demonstrate solidarity with those who are stressed by the effects of the COVID-19 related economic contraction – especially given that central banks and governments are providing such broad and deep support to banks, and 2) provide enhanced capital resources to meet customers' liquidity and funding needs. Already, many banks (such as large US banks) have said they will stop share buybacks, and we would expect more banks to follow. Cutting or eliminating all common stock dividends by European banks through the end of 2020 would certainly boost their capital resources, but only in the mid-single digit range as far as risk-weighted asset growth capacity is concerned. *Notably, a common stock dividend reduction strategy is not game-changing.* In addition, eliminating a dividend can create investor issues, whereby some investors are precluded, for example, from holding non dividend-paying stocks. We believe that a change in banks' dividend policies is likely to be a reduction rather than a full stoppage. From a credit perspective, reduced dividends raise capital levels and cash on hand, a positive for financial and non-financial companies. In our opinion, while cutting or eliminating common stock dividends is usually construed as a weakness, such is not the case here — banks are well-positioned as "white knights" to provide capital to fund business growth, and thus boost the economy. We note that there has been no serious discussion of junior subordinated capital security coupons or dividends being passed**. Bank fundamentals are in the best shape ever.**

Insurance

While the situation remains fluid, we do not foresee broad based risk of common dividend stoppage by insurance companies. For one, insurers tend to be less politically sensitive than banks, and more regionally regulated in certain jurisdictions such as the US. Thus far, some insurers have prudently suspended or postponed additional shareholder returns such as share repurchases. Though not without unique challenges, the insurance industry enters the COVID-19 health crisis from a position of balance sheet strength, relative to the GFC. And, in that period, while some companies reduced their common dividends, few household names stopped paying them altogether (ex-AIG, though it continued to pay distributions on preferred securities). Both life and property & casualty (P&C) insurers are supported by robust capitalization. P&C insurers are particularly defensive to macro risks as they are less leveraged to credit and low rates than life insurers. Nonetheless, life insurers are long-term buy and hold investors funded by "sticky" policyholder liabilities. Their liability-driven investment strategy helped them to look to underlying fundamentals and ride out market moves during the GFC. Today, life insurers hold mostly investment-grade fixed income investments with low default probabilities, though downgrades of existing bonds to below investment grade remain a risk as this would result in higher regulatory capital requirements to maintain currently strong capital ratios. In addition, today insurance holding company liquidity is typically greater than one year's interest and dividend payments, whereas this was not the case heading into the GFC, when some companies also faced debt refinancing issues due to challenging market conditions. Today, debt maturities are better laddered to reduce such funding risks. **We are confident that the insurance industry will remain adequately capitalized, even in a severe economic scenario.**

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