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Insurance regulatory measures in response to Covid-19[1]

Highlights

- *Currently, insurers are more likely to experience losses from financial market volatility than from higher insurance claims arising from Covid-19. Few insurance supervisors have seen a need to strengthen or adjust prudential requirements to insulate insurers from current financial market uncertainties.*
- *So far, authorities have responded mainly by taking measures to provide operational relief to insurers from regulatory and supervisory requirements so that they can continue providing insurance services. These measures will also help insurers to enhance risk monitoring of their Covid-19 financial exposures.*
- *Some authorities have set out expectations for insurers to conserve capital through prudent exercise of dividend and variable remuneration policies. The aim is to enhance their resilience against huge uncertainties from potential Covid-19 fallout. Other capital-related measures should relieve supervisory pressures and reduce the tendency of insurers to manage their investments in a procyclical manner. These measures include: extending the supervisory intervention ladder, triggering the countercyclical lever and recalibrating capital requirements.*
- *The far-reaching impact of Covid-19 calls for sustained vigilance by both supervisors and insurers. In the post-pandemic phase, the extraordinary measures currently warranted will need to be unwound through a carefully crafted exit strategy that preserves sound risk management practices and protects policyholders' interests.*

1. Introduction

In the insurance sector, the most obvious potential impact of the Covid-19 global pandemic is an increase in insurance claims from death, hospitalisation, events cancellation and business interruption cover, among other eventualities. Yet, these have not significantly affected insurers' solvency so far. This may be due to delays in claims submission because of restrictions on movement, exclusion of pandemic events from insurance contracts, protracted loss adjustment process or diversification effects (eg higher insured death pay-outs being offset by lower annuity payments or lower claims from motor insurance). In some emerging market economies, low insurance penetration rates mean that most of the financial losses are not covered by insurers.

Volatile financial markets and the global economic downturn have had a relatively greater impact on insurers, particularly life insurers, due to large holdings of fixed income securities and, correspondingly, exposure to movements in interest rates. The ultra-low interest rate environment could depress the solvency position of insurers, particularly those with mismatched asset-liability profiles.[2] A global economic recession, which is becoming increasingly likely, might affect insurers in several ways. These include, for example, lower demand for insurance products, higher surrenders of certain life insurance

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2 Löfvendahl and Yong (2017) describe how low interest rates could adversely impact insurers, resulting in lower solvency ratios due to higher insurance liabilities from lower discount rates and higher investment guarantee value.

policies (that may give rise to liquidity pressure) and increased market and credit risk exposures from investment portfolios. Consequently, and unsurprisingly, the share prices of major insurers have fallen sharply since end-February, reaching lows in mid-March.

At a broader level, insurers play an important role in the financial sector as investors. Excessive deleveraging may amplify the financial impact of the Covid-19 crisis on capital markets. Moreover, insurers provide services that are essential for households and corporates if they are to withstand the adverse consequences of the crisis. Authorities may need to strike the right balance between ensuring the solvency of insurers while, at the same time, giving incentives for them to avoid excessive procyclical behaviour and continue providing insurance services.

This note provides a non-exhaustive summary of regulatory measures[3] that insurance authorities have taken to achieve four objectives: (i) preserve capital adequacy of insurers (Section 2); (ii) mitigate excessive procyclical investment behaviour by insurers (Section 3); (iii) provide temporary relief from non-essential regulatory and supervisory requirements (Section 4); and (iv) preserve the continuity of insurance coverage (Section 5).

2. Capital conservation measures

In general, insurers remain well capitalised with sufficient capital buffers to withstand temporary market downturns or moderate increases in unexpected insurance claims.[4] However, there are huge uncertainties as to how Covid-19 could affect insurers' assets and liabilities in the longer term. As such, it is prudent to conserve capital in case of need and so that insurance services can continue to be provided.

To these ends, insurance authorities have encouraged or instructed insurers to conserve capital by:

- delaying, reducing or cancelling dividend distributions and share buybacks (Australia, Croatia, the Czech Republic, EIOPA, Finland, France, Guernsey, India, Ireland, Italy, Mexico, North Macedonia, Norway, Poland, Portugal, Russia, Slovenia, South Africa, Spain, the United Kingdom)
- reviewing variable remuneration policy and consider postponing disbursements (Australia, EIOPA, Finland, France, Italy, Poland, South Africa, the United Kingdom)

Explicit regulatory direction in these areas could be helpful to insurers in dealing with any potential adverse reaction from shareholders and employees. The Australian Prudential Regulation Authority (2020) and the European Insurance and Occupational Pensions Authority (EIOPA (2020c)) expect insurers to take a forward-looking view in assessing the need to conserve capital. Australian insurers are strongly encouraged to delay dividend payments. Any dividend distribution should be based on robust stress-testing results and at levels lower than previously announced. EIOPA has asked that (re)insurance groups apply a prudent dividend distribution policy at the consolidated level, which covers intra-group dividend distributions.

[3] The regulatory measures covered in this paper are based on public announcements from over 50 insurance authorities globally as of 21 April 2020. This paper excludes business continuity guidance issued by insurance authorities, some of which is covered in Coelho and Prenio (2020).

[4] In the United States, over 85% of life insurers have a risk-based capital (RBC) ratio of more than 500% (the minimum RBC ratio before supervisory action is triggered is 200%). See National Association of Insurance Commissioners (2019).

3. Countercyclical capital measures

Following lessons learnt from the Great Financial Crisis, the International Association of Insurance Supervisors (IAIS), through its Insurance Core Principles (2019), advises insurance supervisors to consider putting in place measures to dampen procyclical investment behaviour when designing a risk-based regulatory capital framework. An example of such a measure is the volatility adjustment in the European Union Solvency II framework that allows insurers to raise the risk-free rates that they use to discount future cash flows when valuing insurance liabilities or technical provisions (see Box 1). European Union (2014) states that this regulatory tool is designed to "prevent procyclical investment behaviour" and "mitigate the effects of exaggerations of bond spreads".

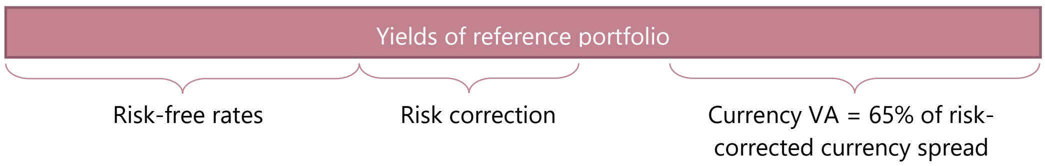
Box 1

Volatility Adjustment (VA) under Solvency II

Solvency II specifies two types of VA that are distinguished in terms of the currency and country of the reference portfolio of assets. The reference portfolios are intended to reflect the average asset composition of insurers.

The currency VA is calculated by comparing yields of a reference portfolio of assets against the risk-free rates in the same currency. The spread is risk-corrected to remove credit and other risks in the reference portfolio. As illustrated in Figure 1, the currency VA is 65% of the risk-corrected currency spread.

Figure 1: Simplified illustration of currency VA



The country VA may be triggered if the risk-corrected country spread (calculated based on a country-specific reference portfolio) is more than 100 bps and more than twice the risk-corrected currency spread. Under such conditions, the country VA is 65% of the difference between twice the risk-corrected currency spread and the risk-corrected country spread.

In March 2020, the Italian government lowered the country-specific trigger from 100 bp to 85 bp to allow a wider application of the country VA by Italian insurers. This measure is aimed at reducing the solvency impact of widening credit spreads, particularly steep increases in Italian government bond spreads and falling equity markets. Based on EIOPA (2019), the Solvency Capital Requirement (SCR) ratios of Italian insurers should improve by more than 21 percentage points with this measure.

Other countercyclical measures are built into regulatory capital adequacy requirements and do not currently require specific adjustments by insurance supervisors. Examples of such mechanisms include:

- the European Union (2014) Solvency II symmetric adjustment mechanism for equity risk charge that counteracts short-term market fluctuations
- the Solvency II matching adjustment that increases discount rates to limit the impact of spread movements from bonds or other similar assets that are held to maturity
- a temporary increase in limits on investments issued or backed by financial institutions and relaxation of accounting rules for certain fixed income and real estate investments in Peru

In applying regulatory levers to counteract adverse market movements, be they trigger-based or "automatic" procyclical-dampening measures, an appropriate balance needs to be struck with the overall prudential aim of preserving risk sensitivity of regulatory capital adequacy requirements.

From a supervisory perspective, most risk-based solvency regimes have a supervisory intervention ladder that provides for graduated supervisory intervention actions based on capital adequacy indicators. This supervisory tool can be used to provide supervisory relief to insurers to deal with short-term market fluctuations and minimise unintended procyclical investment behaviour. EIOPA (2020a) and Reserve Bank of South Africa (2020) announced greater flexibility in using the supervisory intervention ladder to prolong the recovery period of troubled insurers, thus allowing for more leeway before supervisory actions are triggered in times of market stress. The Bank of Russia has extended deadlines for insurers to respond to supervisory actions by a month.

Other capital-related measures in response to Covid-19 include:

- allowing loans or premium payment deferrals not to increase capital requirements (Canada, South Africa)
- adjustment to capital requirements for interest rate risk (Canada, Malaysia)
- favourable consideration of requests for application of transitional measures on technical provisions under Solvency II (Germany, Poland, United Kingdom)
- an extension of the period for unpaid premiums to 180 days before additional provision needs to be established by insurers (Peru)
- the lowering of capital requirement for certain risks eg credit and suretyship (Poland) or investments in exchange-traded stock market stabilisation funds (Korea)
- the Swiss Financial Market Supervisory Authority's (2020) consideration of requests from insurance companies for temporary smoothing of yield curves in order to reduce daily fluctuations of the Swiss Solvency Test

4. Regulatory and supervisory relief measures[5]

Many insurance authorities have taken action to provide operational relief to insurers. Such measures will help insurers to redeploy resources to cope with increased support needed by policyholders, maintain business continuity and intensify monitoring of financial exposure to Covid-19. These measures include:

- extending deadlines to submit regular supervisory reports[6]
- allowing submission of pro-forma unaudited financial reports (Guernsey, Jersey, Tunisia)
- postponing public consultation of new or revised regulatory/supervisory measures (Canada, Dubai, EIOPA, Malaysia, Peru, Singapore, New Zealand, the United Kingdom)
- extending the deadline for penalty payments or proceedings (British Virgin Islands, North Macedonia) or providing exemption from sanctions for minor misconduct (Korea)
- lowering of licensing fee (Dubai, Thailand)

[5] The IAIS (2020) is monitoring the impact of Covid-19 on the global insurance sector and coordinating supervisory response among insurance supervisors globally. It has adjusted the timelines of its activities to provide operational relief to its member supervisors and insurers.

[6] Australia, Belgium, Bermuda, Botswana, British Virgin Islands, Canada, Chile, Dubai, EIOPA, Gibraltar, India, Ireland, Isle of Man, Italy, Japan, Korea, Malaysia, Mauritius, Mexico, North Macedonia, Peru, Poland, Portugal, Russia, Singapore, Slovakia, South Africa, Spain, Switzerland, Thailand, the United Kingdom, various US states. The National Association of Insurance Commissioners (2020) provides compilations of measures taken by state insurance regulators.

Some regulatory requirements and supervisory practices can only be carried out with face-to-face interactions. Given the restrictions imposed in many countries, authorities have adjusted requirements such as the following:

- postponement of on-site inspection visits (Botswana, Germany, Guernsey, Italy, Jersey, Liechtenstein, North Macedonia, Poland, Portugal, Russia, Singapore)
- temporary relaxation of minimum frequency of board meetings (Bermuda) or allowing virtual board meetings (British Virgin Islands,[7] India, Nevada, New York)
- temporary extension of licensing deadlines or acceptance of incomplete licensing applications (Botswana, British Virgin Islands, Mexico, various US states)
- temporary relaxation of continuing professional development requirements, prolongation of existing licences for insurance intermediaries (Italy, Portugal, Thailand, various US states) or temporary exemption from examination requirement for insurance intermediaries (various US states)
- temporary suspension of requirements on insurers to audit healthcare providers, insurance intermediaries, employers etc (various US states)
- temporary relaxation of anti-money laundering documentation requirements (Hungary)
- acceptance of electronic regulatory filings and signatures (Germany, various US states)

5. Measures to preserve the provision of insurance services

Many insurance supervisors have facilitated adjustments that insurers may need in order to continue providing insurance services to financially distressed individuals and businesses and to overcome practical difficulties due to restrictions on movement. Regulatory approaches vary widely in implementing such measures, from providing high-level supervisory expectations to requiring insurers to undertake concrete actions. Table 1 presents a non-exhaustive list of measures that authorities have specified thus far:

Table 1

Area	Example of measures
Product design, coverage and pricing	• Review products that may be impacted by Covid-19 to ensure they continue to meet customers' needs (EIOPA). • Relax pricing requirements to improve affordability of certain insurance products (China, Thailand). • Extend coverage period of certain types of product (eg marine, aviation, transport, travel insurance) without additional charge to compensate for the movement restrictions period (China, India, Tunisia) or reduce premium rates (various US states). • Expand insurance coverage for Covid-19 risks (India, Singapore, Thailand), hard-hit business lines (eg commercial property, workers' compensation, trade credit insurance for small and medium enterprises, agriculture insurance, mortgage insurance) (China, Hungary). • Adjust insurance coverage due to movement restrictions eg accept claims arising from telemedicine services, simplify hospitalisation claims processing and expand scope of coverage such as the use of personal vehicles for commercial purposes (various US states). • Provide accident, health, pension, medical and other insurance services on favourable terms to staff on the frontline of Covid-19 prevention and control (California, China, North Dakota). • Reduce cost-sharing of medical insurance (various US states).

[7] British Virgin Islands Financial Services Commission (2020) has enacted a new legislation that outlines specific adjustments to regulatory requirements including corporate governance when an emergency is declared by the government.

Underwriting and product distribution	•	Relax requirement for insurance intermediaries to undertake face-to-face financial needs analysis (Hong Kong SAR, Korea, Thailand).
	•	Require or allow more extensive use of technology and remote authentication to replace face-to-face underwriting processes (China, Poland, Thailand, various US states).
	•	Require insurers to be flexible in providing or extending insurance coverage without complete paper documentation, for example motor insurance certification (Russia, the United Kingdom).
Policy servicing	•	Allow deferral of premium payment or revised premium payment schedule without lapsing insurance policies of financially distressed individuals and businesses (Belgium, EIOPA, Hong Kong SAR, India, Japan, Malaysia, Peru, Korea, Russia, Singapore, South Africa, Thailand, Turkey, various US states).
	•	Avoid triggering of policy cancellation, non-renewal of policies or denial of claims due to movement restrictions (the United Kingdom, various US states).
	•	Require insurers to clarify policy exclusions for pandemic events such as Covid-19 (Chile, EIOPA, India, Ireland, Portugal, the United Kingdom, various US states).
	•	Require insurers to explain clearly the implications of cancelling life insurance policies with significant investment/savings component (Portugal, the United Kingdom).
	•	Allow deferral of loan (including mortgage) repayment for financing facility taken from insurers (Belgium, China, Thailand).
	•	Extend period within which insurers need to respond to complaints or queries by policyholders (Italy, Poland, Portugal).
Claims processing	•	Adjust operational processes to accommodate virtual interaction with policyholders including simplifying or exempting requirements for paper-based claims submission (Belize, China, Hong Kong SAR, India, various US states).
	•	Expedite processing of valid insurance claims arising from Covid-19 including waiving waiting periods or providing flexibility in accepting proof of claims (India, Malaysia, Peru, Portugal, Russia, various US states).
	•	Extend claims notification period by policyholders (Peru, various US states).

Recognising increased consumer vulnerability in such uncertain times, authorities such as EIOPA (2020b) have reminded insurers to pay particular attention to the need to treat customers fairly under current circumstances. However, the principle of treating customers fairly should not violate the fundamentals of insurance business. In certain jurisdictions, authorities are considering requiring insurers to retroactively cover certain insurance claims due to Covid-19 such as business interruption costs even though insurance policies may exclude pandemic events. EIOPA (2020b) calls for careful consideration as such an approach could not only jeopardise the solvency of insurers but could also adversely affect market stability more generally.

6. Concluding remarks

The modernisation of risk-based capital regimes in many jurisdictions in recent years is now bearing fruit. Insurers are much more financially resilient and are thus better able to withstand unexpected insured and investment losses. Nevertheless, the far-reaching impact of Covid-19 calls for sustained vigilance by both supervisors and insurers in case further action is needed for the smooth functioning of the insurance sector. Moreover, there could be potential consequences from the massive economic rescue packages,[8] deteriorating fiscal positions,[9] the expected global recession and the unknown trajectory of insurance

[8] Insurers in jurisdictions that are not currently in a low interest rate environment could face difficulties if interest rates are cut as part of economic stimulus packages. See Löfvendahl and Yong (2017).

[9] Schrimpf et al (2020) highlighted that "Given the importance of the government bond market as a benchmark financial market price, any dysfunction has far-reaching detrimental effects that ripple through the rest of the financial system and the real economy."

claims. Well managed insurers would carefully consider the wide range of possibilities and capital conservation measures such as prudent dividend distribution and remuneration practices.

The extraordinary regulatory measures to provide operational relief to insurers and preserve the continuity of insurance services should be reviewed constantly. A well designed solvency framework should stand the test of time, and should not require frequent ad hoc adjustments that may go against the intended policy objective of withstanding extreme events. Care should be taken to avoid morally hazardous behaviour among insurers that could encourage them to expect regulatory relief when the next crisis arrives.

As we look towards the post-pandemic phase, the extraordinary measures currently warranted will need to be unwound. Current actions by supervisors and insurers may have long-lasting implications for the industry. Crucially, the potential effect on the industry's reputation and trustworthiness should be carefully considered. An exit strategy for insurers and supervisors that balances sound risk management practices with the need to treat customers fairly will become necessary.

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