SLAUGHTER AND MAY

COVID-19: INSURANCE NEWSLETTER

April 2020

COVID-19 and the insurance sector

The impact of the COVID-19 pandemic has been felt across all business sectors. Some particular issues apply to regulated firms and in particular those in the insurance sector. Regulatory responses have mainly been aimed at reminding firms of existing obligations rather than introducing new ones, although firms should read between the lines of the expectations being communicated. We discuss below some of the key messages from EIOPA and UK regulators and associated developments.

Dividends and other distributions of profits

The PRA sent a Dear CEO letter to insurers on 31 March urging them, when considering payment of dividends and decisions on variable remuneration, to "*pay close attention to the need to protect policyholders and maintain safety and soundness and in doing so to ensure that their firm can play its full part in supporting the real economy throughout the economic disruption arising from Covid-19*". This fell short of requiring insurers to suspend payments, in contrast to the PRA's position regarding major UK banks.

In a statement issued on 2 April, EIOPA went further and urged (re)insurers to temporarily suspend all discretionary dividend distributions and share buy backs aimed at remunerating shareholders. In response to this, the PRA reiterated its previously stated position but regulators in a number of other European jurisdictions have requested insurers to suspend dividend payments.

On 8 April, a number of major UK insurers with significant non-life operations announced that they will not proceed with planned final dividends. The PRA made a statement in response welcoming "the prudent decision from some insurance companies today to pause dividends given the uncertainties associated with Covid-19". We expect that more insurers may follow suit, although well capitalised groups with little direct exposure to COVID-19 related risks may choose to go ahead with dividend payments.

All insurance groups will need to take particular care in considering their capital positions in a range of possible future scenarios before making distributions.

Reporting

Delays to reporting deadlines

In recognition of the strain placed on all businesses by the current crisis, EIOPA has recommended (in a statement published on 20 March) that national supervisors relax the timetables for both supervisory and public reporting. In the UK, the PRA has issued a statement of the delays which it will accept, which are in some cases more generous than EIOPA's suggestions.

Key points from the PRA statement are:

- A delay of up to 8 weeks is permitted for the SFCR with no exceptions (EIOPA had recommended some templates to be published with only a 2 week delay)
- The RSR is not required for year end 2019 (EIOPA had recommended an 8 week delay)
- A delay of up to 8 weeks is permitted for annual quantitative reporting templates, subject to some exceptions where a delay of only 2 weeks is permitted
- A delay of up to 4 weeks is permitted for Q1 2020 quarterly reporting (EIOPA had recommended a 1 week delay only for most aspects of the reporting)
- A delay of up to 8 weeks is permitted for the ORSA (not mentioned by EIOPA).
- For non-harmonised reporting, the PRA will accept the following delays:
  - Up to 8 weeks for national specific templates
  - Up to 8 weeks for internal model outputs
  - Up to 8 weeks for standard formula reporting for firms with an approved internal model
  - Up to 4 weeks for market risk sensitivities.

Reporting COVID-19 as a "major development"

In its 20 March statement EIOPA states that undertakings should consider the current situation to be a "major development" for the purposes of Article 54(1) of the Solvency II Directive and that they should therefore publish, alongside their year-end information, any appropriate information on the effect of COVID-19 on the published information.

SFCRs published in March by European insurers reflect a range of responses to EIOPA's request, varying from general statements regarding the impact of COVID-19 on the economic outlook to more specific reporting of incurred claims under travel insurance policies and changes in market value of assets as a result of market reaction to COVID-19.

Conduct issues

Both EIOPA and the FCA have emphasized the need to treat customers fairly in the context of both existing policies and policy renewals.

In a statement issued on 1 April, EIOPA warned that:

> "*the scale and depth of the disruption caused by the Coronavirus/ COVID-19 outbreak could undermine trust in the sector if the fair treatment of consumers does not remain at the heart of the sector's response*".

EIOPA suggested that insurers and intermediaries should exercise flexibility in how consumers are treated, where reasonable and practicable. EIOPA does, however, recognise that there are limits to how flexible insurers can be, commenting that as a general principle "*imposing retroactive coverage of claims not envisaged within contracts could create material solvency risks and ultimately threaten policyholder protection and market stability, aggravating the financial and economic impacts of the current health crisis*".

Similarly, the FCA's webpage on its expectations of insurance firms in the light of the pandemic states that "*We expect firms to consider very carefully the needs of their customers and show flexibility in their treatment of them*". On a micro level, this includes points such as cover under home insurance where the policy is written on the basis that the home is not someone's principal place of business but COVID-19 has required the insured to work from home. The ABI has subsequently confirmed that this type of change in circumstance will not prejudice cover. The FCA is also concerned that changes to policy terms and exclusions are clearly communicated to policyholders at renewal, and that the needs of the customer are taken into account when such changes are made.

Business interruption

Business interruption (BI) insurance has been under the spotlight as businesses around the world are forced into temporary closure by various lockdowns.

The ABI has so far been robust in its response to issues raised by, amongst others, the UK government and the House of Commons Treasury Committee regarding BI cover. It published an initial response on 17 March and elaborated on its position in a letter to the Committee published on 27 March. In that letter, the ABI made the following key points:

- no insurance market in the world provides widespread insurance coverage for pandemics and the UK is no exception
- for such cover to be available at affordable prices for businesses would require a very significant subsidy from the State given the scale of business disruption seen with the COVID-19 pandemic
- only a very small minority of businesses will have chosen to buy any form of cover that includes local closure due to an infectious disease and an even smaller number will have cover enabling them to potentially claim on their insurance for the presence or impact of the Coronavirus pandemic
- instead, business insurance typically protects against day to day risks such as damage to premises, motor accidents, supplier failure and employee harm.

Although there has been no official suggestion to date that government or the regulators will attempt to create retroactive coverage under business interruption policies, the Financial Ombudsman Service has published guidance relating to business interruption insurance which is potentially unhelpful to insurers who have written cover to "small businesses". Whilst recognising that the starting point for any claim is the cover provided by the policy, the FOS has also commented that "*insurers should not only consider a strict interpretation of the policy terms but what's fair and reasonable in the particular circumstances – taking into account in particular the unprecedented situation that the response to the coronavirus has created*".

What should insurers be thinking about?

Key considerations in the light of the COVID-19 pandemic will vary enormously between firms. We set out below some of the key prudential, governance and conduct issues which insurers may need to consider.

Prudential and governance considerations
Capacity to raise additional capital and/or liquidity if required
Possible impact of asset impairments
For matching adjustment portfolios - risks of significant downgrades; management and hedging of trigger levels
Dividend policy including review of risk appetite and consideration of public perception
Review of financial resilience including exposure limits, solvency triggers and recovery plans
Risk of higher levels of default on both private and public issuances
Potential acceleration of plans to clean-up/optimise back books
Monitoring of position of reinsurers and the need for early warning of credit problems/rating downgrades
Ability to assemble the board at short notice, and availability/health of senior management; if necessary, appointment of appropriate board committees to handle urgent matters
For UK insurers that are part of non-UK headquartered groups, ensuring that the UK board has adequate information about the condition of the group as a whole; competing/conflicting requirements of different national regulators

Conduct considerations
FCA requirements to treat customers fairly in the context of the COVID-19 pandemic – what exactly does this mean/ what are the expectations?
Monitoring of potential coverage disputes (e.g. business interruption; supply chain interruption; event cancellation; travel insurance losses, etc.)
Capacity to originate new business (e.g. current difficulties carrying out medical checks for life assurance; other pre-contract checks that are currently more difficult than usual)
Changes to products - attitudes to new exclusions; relationship with intermediaries; opportunities and challenges of a hardening market
Capacity of claims handling processes and customer call centres (especially where customer enquiries increase significantly and if staff numbers are depleted by illness)

Second-order effects, e.g. rising cyber/GDPR risks with increased remote working
Material outsourcing and service agreements - risk of frustration; related PRA/FCA expectations concerning exercise of remedies/information and audit rights

If you would like further information about the impact of COVID-19 on your business, please speak to your usual Slaughter and May contact.

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