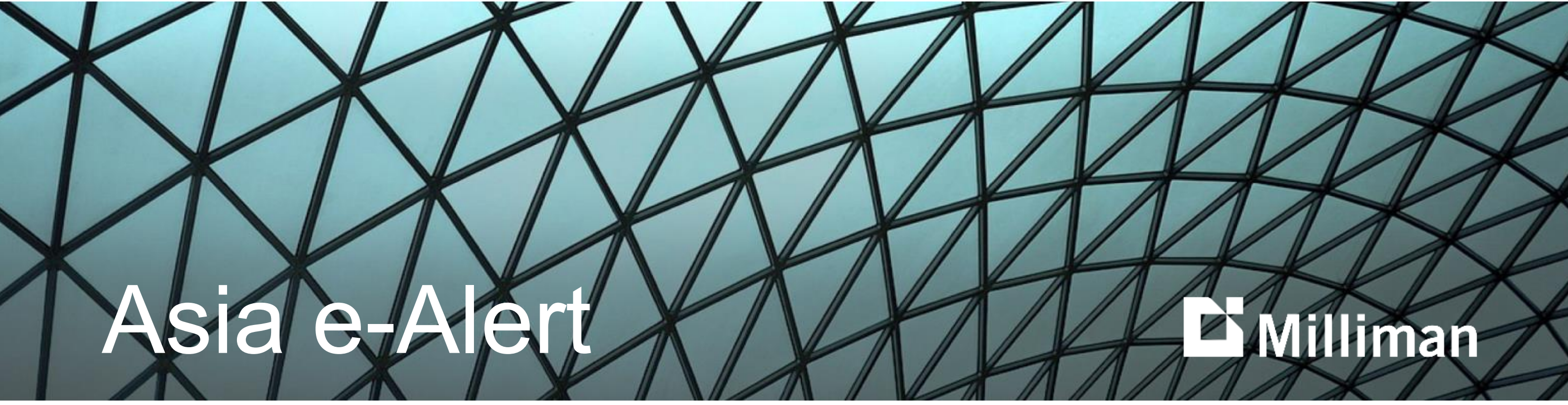
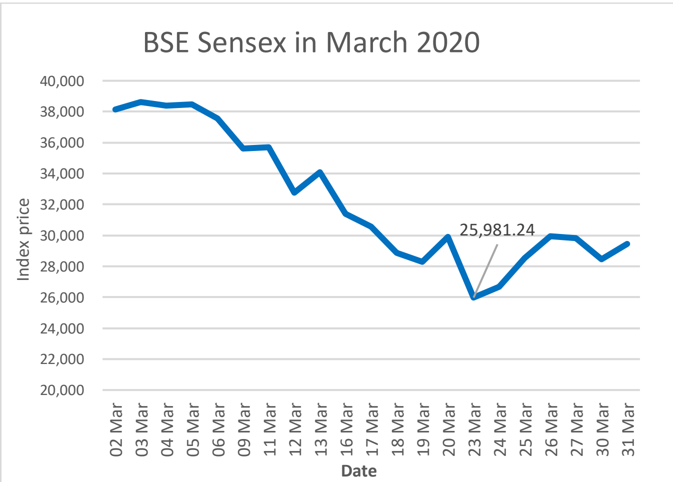



# COVID-19: Consequences for Indian life insurers

The onset of COVID-19 and the impact on capital markets pose several challenges for Indian life insurers. This note discusses some of those issues and how we anticipate insurers will be looking at them over the coming months.

## EQUITY EXPOSURES

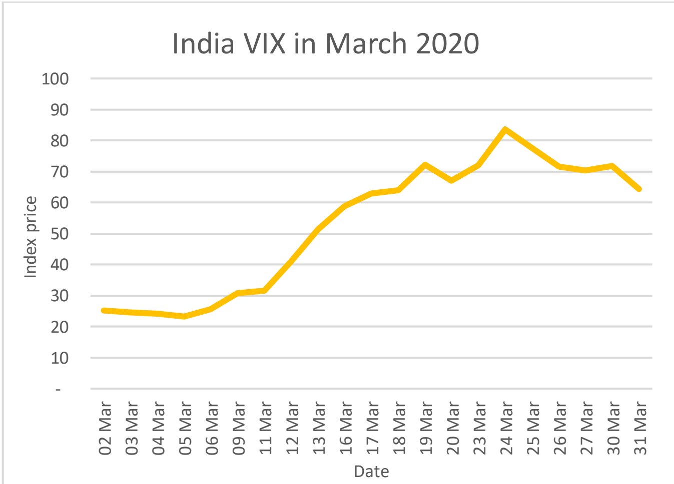
In line with many stock markets globally, Indian equities suffered sharp declines during March 2020. The BSE Sensex opened the month at 38,144, falling to its lowest point of 25,981 on 23 March, before closing at 29,468, a 23% decline.




Source: www.bseindia.com

Equities are held at market value on insurers' balance sheets, so these falls can directly affect the available asset base and reduce solvency ratios, especially where there is no corresponding fall in liabilities (e.g., non-participating business where policyholder benefits are fixed and fully guaranteed at outset).

Furthermore, we have seen a sharp rise in equity implied volatilities, with the NIFTY 30-day volatility index (VIX) opening the month at 25, touching a high of 84 and closing at 64. By way of context, during the 10 years ending 29 February 2020, the VIX averaged 17.8, ranging between 8.7 and 39.3.




Source: www1.nseindia.com

This implies that market participants believe there is continued volatility ahead, so insurers may need to recalibrate their internal stress tests. For those insurers that have written policies with options or guarantees (typically participating policies or some unit-linked contracts), there may also be a need to monitor the cost of these on an ongoing basis.

Mitigations will naturally depend on the results of stress testing as well as the risk appetite of the insurer, but avenues may be limited given that a paring back of equity exposures at this point would crystalise losses, affecting both shareholders and often policyholders where policy benefits are linked to the insurer's investment performance.

## INTEREST-RATE RISK

Against the backdrop of an already sluggish economy, the onset of COVID-19 has seen the Government of India and the Reserve Bank of India (RBI) taking further steps to stimulate the economy by announcing a financial package for the poor and vulnerable sections of society and by cutting the reverse repo rate to 4.15% from 4.90% at the start of 2020. This reduction in the reverse repo rate is an extension of an ongoing exercise with the rate declining from 7.00% at the start of 2015. The 10-year bond yield (semi-annual) also ended March 2020 at 6.14% having touched a low of 5.99% on 9 March.

While this would likely affect all insurers, those with material non-participating savings books with no/minimal hedging may be most adversely affected. This should bring asset-liability management, and analysis of the optimum derivative exposure, to the very front of insurers' minds.

## CREDIT-RISK

With corporate India coming under stress, insurers may wish to re-examine their current credit exposures. Corporate-bond spreads have widened considerably for debt issued by certain corporates, and there is increasing concern that in the future, there will be further widening of credit spreads together with the possibility of further defaults. Insurers will need to assess the level of credit risk in their investment portfolios and make appropriate allowance in liability valuations if the default expectations have increased.

## PRODUCT MIX

Besides managing assets, it is equally important to manage the nature of liabilities. In particular, for regular premium non-participating savings products (where new business margins are very sensitive to the level of interest rates), a slowdown in sales or a re-price may be required. In the case of participating products, insurers may wish to move to structures that result in lower implied guarantees to help mitigate the risk from further economic downturns or reflect a sustained low interest-rate environment if the current situation is expected to persist.

## MORTALITY EXPOSURES

The onset of COVID-19 has focused insurers' minds on their mortality exposures. The global case fatality ratio (CFR) based on confirmed cases stood at 5.54% (74,564 fatalities from 1,345,048 confirmed cases) as at 6 April[1]. The CFR for India stood at 2.8% (140 fatalities from 4,917 confirmed cases) as at 7 April, 1703Hrs Indian Standard Time (1133 UTC).[2]

While the CFR is the most prevalent measure currently in use, it is potentially inaccurate as mild cases that ultimately recover may not all have been identified (therefore not entering the denominator of the calculation) and there may be deaths caused by COVID-19 which are not reported as such (therefore not entering the numerator of the calculation). Furthermore, it is very difficult to meaningfully compare CFRs across countries given, amongst other things, differences in the level of testing performed, differences in the quality of healthcare and the different stages of the curve that different countries have. While the development of COVID-19 in India is extremely uncertain, global data suggests that fatality rates increase sharply with age. We show data for China as at 11 February published in The Lancet on 30 March.

| Age group | CFR |
|---|---|
| 0-9 | 0.0% |
| 10-19 | 0.2% |
| 20-29 | 0.2% |
| 30-39 | 0.2% |
| 40-49 | 0.4% |
| 50-59 | 1.3% |
| 60-69 | 3.6% |
| 70-79 | 8.0% |
| 80-89 | 14.8% |
| **Total** | **2.3%** |

Source: https://www.thelancet.com/action/showPdf?pii=S1473-3099%2820%2930243-7

Insurers may wish to carry out an assessment of their COVID-19 exposure and carefully examine the provisions of their existing catastrophic reinsurance treaties.

## POLICYHOLDER BEHAVIOUR

The behaviour of existing policyholders, in terms of lapse/surrender/paid-up decisions also needs to be monitored closely. While low interest rates may make high IRR non-participating savings products already held more attractive, resulting in higher persistency the effects of a long-term recession may result in a greater level of surrenders.

For protection products, increased awareness created by the COVID-19 situation, coupled with the hardening of term insurance rates, may make term insurance policyholders value their existing cover more and improve persistency. Depending on the margins for prudence taken by insurers in their reserving bases, a change in policyholder persistency may further stress balance sheets.

## NEW BUSINESS

The complete lock-down imposed across India due to COVID-19 has clearly had an adverse impact on new business volumes, especially in March 2020, when insurers typically write the highest monthly volumes as consumers reach the taxation year-end.

This would have resulted in many insurers missing their business plan volume targets, which can have implications on expense overruns. As insurers recognise the impact of starting from a lower volume base coupled with an uncertain outlook for volume recovery, they may need to re-examine their business plans for the current financial year in order to keep financial metrics in check.

[1] SCOR. The Art & Science of Risk. COVID-19: Total Number of Cases. Development between March 08 and April 06, 2020. Retrieved on 7 April 2020, from http://domino.scor.com/u/mpascariu/COVID-19-Production/app)

[2] India COVID-19 Tracker. Retrieved on 7 April 2020, from Source: https://www.covid19india.org/

Aside from a recasting of new business volumes, the current environment may give insurers an opportunity to sell more protection business, thereby shifting product mix to a historically more profitable segment. It remains to be seen whether margins can sustain in the face of a global pandemic or whether rates will need to further harden for insurers to maintain profit margins.

## CONCLUSION

As has occurred in bseveral other countries, COVID-19 has affected the Indian capital markets, with the equity markets falling, equity volatilities and credit spreads rising and bond yields declining.

We expect some insurers to see solvency ratios fall, as well as a reduction in new business volumes in the short to medium term, given the ongoing nationwide lockdown. This may create a requirement for some insurers to consider raising capital, a tough prospect given that promoters' funds may be scarce with the downturn affecting businesses across sectors.

We further note that the recent ban by IRDAI on fresh capital gearing treaties for non-life insurance companies may signal a hardening of regulatory attitudes in relation to financial reinsurance for life insurers. If so, this avenue to raise capital may also not materialise.

In these uncertain and challenging times, insurers will need to bring risk management to the very top of their agendas and take steps such as:

- Re-calibrating solvency stress tests
- Assessing solvency levels more frequently
- Monitoring guarantee exposures
- Re-examining interest-rate hedging programs
- Re-examining credit exposures
- Assessing COVID-19 mortality exposure and existing catastrophe reinsurance arrangements
- Monitoring new business profitability for lines that are sensitive to the level of interest rates and/or lapse rates (e.g., regular premium non-participating savings business)
- Revisiting business plan targets (both volumes and mix) for FY20-21 and beyond

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