

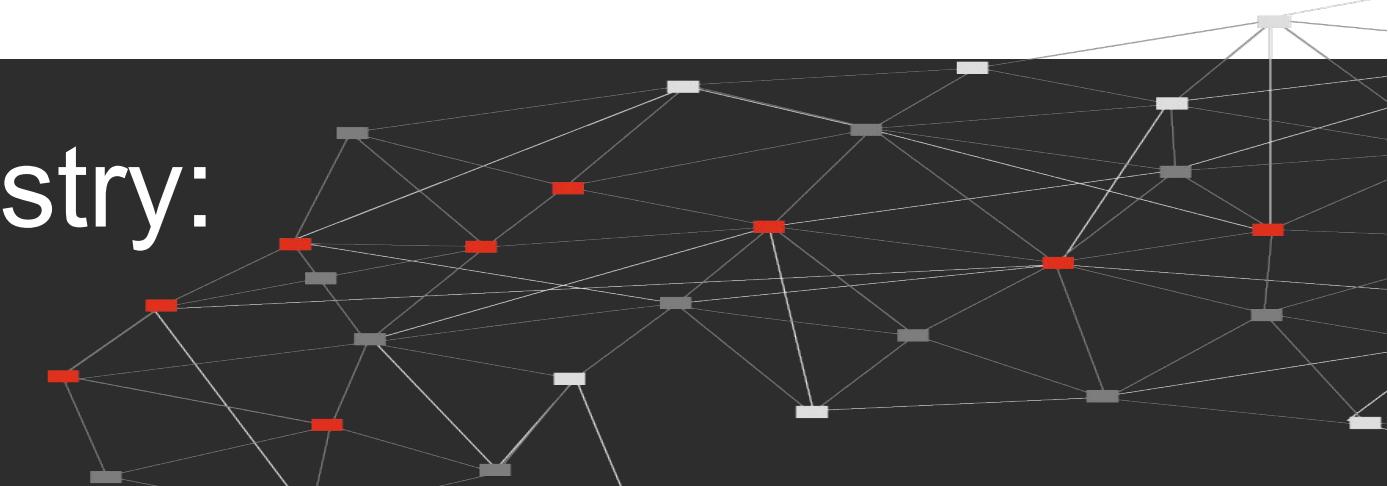
COVID-19 and the Insurance Industry: Issues and actions to consider



The World Health Organization declared the coronavirus (COVID-19) to be a global pandemic on March 11, 2020, escalating from a declaration of a public health emergency on January 30, 2020. The virus has had unexpected human and economic consequences across many countries and has resulted in significant market and interest rate volatility.

Along with its health impacts, the coronavirus is rapidly disrupting business and consumer activity in affected areas and beyond.

We have prepared some general guidance on [COVID-19: What US business leaders should know](#), which addresses six key areas of focus, consisting of crisis management and response; workforce; operations and supply chain; finance and liquidity; tax and trade; and strategy and brand.



Here is our take on some additional issues that insurance companies, in particular, might face. We also offer some thoughts on what you can do now to manage effectively through the uncertainty.

Business issues

Volatile markets and credit spreads resulting in increased risks to access to capital, operations and profitability; Anxious customers and impact on demand/consumer behavior; and increased reputational risk. How can you respond appropriately and stay resilient in this uncharted territory?

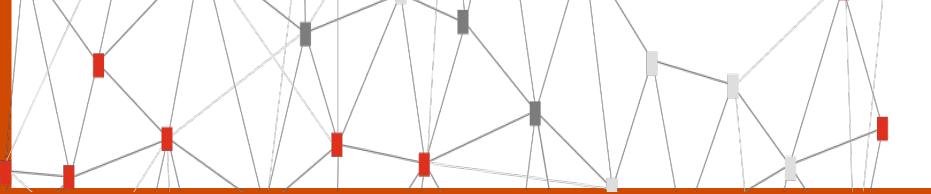
Operations & Technology issues

Staff and working practices; Ability to work remotely and satisfy ongoing data and operating requirements; untested recovery and continuity scenarios add to the pressure. How can you support your organization to keep the business running as smoothly as possible?

Accounting & Finance issues

Insurance losses, capital adequacy, liquidity, impaired assets, hedging breakage and financial instrument valuation issues and need for increased disclosures. What can you do to monitor, mitigate and report on the risks and uncertainties that lie ahead?

Business Issues



Your firm may face these issues:

You may want to consider these potential effects:

These steps may help you prepare:

Product related and customer risks

Increase in health related, death, event and business interruption claims

- You may experience a surge in health, travel, event cancellation, business interruption and supply chain claims; conversely, there may be a decrease in claims from standard coverages due to extended period of more limited activity.
- There may be second order effects to both workers compensation indemnity and medical claims, as influenced by state/ jurisdictional assessments, as well as decline in auto claims due to less activity.

- Assess impact on reserving, as well as coverages and potential increased litigation.
- Consider quantifying temporary impacts on claims to remove from assumption updates and claims development if appropriate.

Declining sales/distribution in impacted regions

- You may sell fewer insurance products where your workforce / distribution partners (e.g., TPAs, advisors, wholesalers) are unavailable.
- Policyholders may be more hesitant to invest in or have decreased demand for insurance products.
- Wholesalers may not be granted access to certain firms, further limiting distribution capabilities.

- Consider varying stress test scenarios to assess revenue and related effects.
- Inquire about distribution partner contingency plans and how they may affect business as usual activities.
- Develop client messaging regarding market activities and support wholesaler efforts to conduct alternative distribution plans.

Product and pricing strategies

- Impact on product strategy, including universal life, variable annuity, deferred annuities, fixed indexed annuities, payout annuities or other "spread" products
- Evaluating impact to bottom line and profit margins vs expected social responsibilities and customer loyalty/empathy.

- Assess effects of suspending sales of certain products, or changing the timeline for introduction of new products.
- Assess repricing current products and/or adjusting guaranteed crediting rates.
- Assess the need to change commissions schedules.
- Consider modeling various "what if" scenarios to assess sales volumes.

Customer experience/service

- Potential for increased claim experience, particularly for Life, Long-Term Care and Disability Insurance products.
- Many firms could see record web and phone traffic in response to market volatility spikes. Some firms could face digital disruptions or operational constraints.

- Develop action plans to address significant claim requests, if they should occur. In some cases, this could mean preparing plans and processes for gates, 'side pockets', or other efforts to handle increased activity.
- Assess how to limit technology issues in the coming weeks for separate account transactions, policy loan requests, customer service and other volume-sensitive activity.
- Review action plans so you can respond quickly to system and control issues.
- Assess whether the customer service team (in-house or outsourced) has the ability to operate remotely and whether business continuity plans are in place to minimize disruption to customer service.

Capital and macro-business factors

Downturn preparation

- Consider potential adverse implications to the US and global economic outlooks and the implications of further low-interest rate environments.

- Perform updated stress tests on financial projections and capital needs.
- Address discretionary spending and non-essential projects (including near to intermediate liquidity plans).

Market volatility, limited access to capital markets and shareholder expectations on ongoing buyback programs

- Capital markets and lending capacities could become less accessible and it could be more expensive or impractical for you to access markets due to less demand, or continue buy back programs and dividend levels.
- Your hedging strategies may have been affected by increased market volatility.
- Your market volatility responsive fund strategies may not have operated effectively.

- Consider effects of ongoing market losses and high volatility.
- Assess potential changes to hedging targets/programs.
- Assess effectiveness of volatility responsive fund strategies.
- Assess stockholder communications regarding expectations on buybacks/ dividends.

Deals/ Strategic projects

- Some executed M&A and/or reinsurance agreements may be voided or modified, or closing delayed.
- Some of your key expansion opportunities/ strategic priorities could be delayed (IT and infrastructure expansion).
- Acquisition or disposition valuation declines could result in suspension or adverse pricing renegotiation.

- Review any significant business transactions to model various "what if" scenarios.
- Assess availability of consultancy support for key strategic priorities/projects.

Other risks

Reputational risk (and opportunity)

- You may face reputational risks or even potential litigation risks if your firm is perceived as being dismissive of employee concerns or not prioritizing employee safety, or not properly addressing policyholder concerns.
- Conversely, there may be an opportunity to demonstrate your company's higher purpose and value to society through rapid response, coverage, waiving certain deductibles and bringing technical expertise to bear.

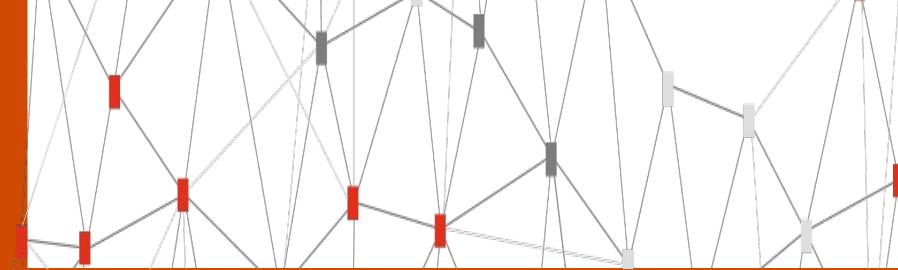
- Consider risks and exposures and then how to close gaps for employees working remotely, addressing applicable working practices and documentation procedures.
- Assess cybersecurity risk related to increased remote access (bad actors may try to capitalize on current environment).
- Update and communicate any changes promptly to all affected employees.
- Assess network capacity and resiliency (e.g. VPN, need for additional equipments) and review contingency plans.

Data and network access exposures

- Your data and networks may be exposed as more employees work from remote locations or use their own devices to access firm resources.

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Operations and Technology Issues



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Business continuity considerations

General continuity matters

- You could face an extended and uncertain period and may need to invoke contingency measures (varying by operating unit, geographic location, or team demographic).

- All businesses should be prepared to operate under a formal business continuity plan (BCP)—including a pandemic response plan.

- You should be sure that your BCP is current and comprehensive, and that it addresses key personnel and business process risk.

- Test your emergency communication plan regularly, including reach to employees, insureds and all other stakeholders.

Data backup and recovery

- Your firm's backup servers may be located in areas that could be affected by COVID-19. This could make restoration more challenging in the event of any business disruption, including non-medical scenarios such as natural disaster or equipment failure.

- Assess inventory of backup servers locations and implications of where located in proximity to outbreak areas.

- Review the strength of your data backup and recovery procedures.

Supplier risks (3rd parties and sub-service organizations)

- IT and other support services may deteriorate due to internal or vendor issues.
- Some of those suppliers may have extensive operational footprints in territories that have been hit particularly hard by COVID-19.
- Your teams may have limited visibility into these suppliers' ability to execute. For example, you may have difficulty observing data centers and other supplier resources that affect financial reporting, especially if travel restrictions continue.
- Depending on the extent of business interruption, if any, your suppliers and their suppliers could affect your own ability to produce timely financial statements.

- Look closely at your firm's supplier network (outsourced customer contracts, premiums or claims processors (third party administrators), information technology, payroll, fund accounting, custodians, third party distributors, etc.) to understand if they have operations concentrated in areas affected by COVID-19 or are otherwise adversely impacted.

- Review the service level agreements (SLAs) and key performance indicators in place with these suppliers and sub-suppliers, and understand vendor capabilities or vulnerabilities.

- Make sure that whoever is responsible for third party and vendor oversight understands how to assess potential impacts and compensating controls in the event of any issues.

Distributed operations and employee matters

Subsidiaries in areas with significant COVID-19 outbreaks

- You could see declines in productivity or impaired ability to engage in business activities from these subsidiaries for an extended period of time.

- Continue to monitor subsidiaries and affiliates in these areas closely. Where appropriate and possible, consider shifting some activity to areas that haven't been affected.
- Communicate and address potential service delivery matters with global customers.

Working offsite

- Some of your work locations may be inaccessible for some period of time, including as a result of public guidance or mandates. You may not be prepared to implement change at scale, even for work functions where remote work is achievable.

- Review your work from home policy to be sure it is up to date. Make sure employees have the right equipment/ internet access/ application access needed.
- You should leverage existing or procure new videoconferencing and other collaboration tools, to maintain an "in-person" experience with clients, employees and stakeholders.

Employee stress

- Depending on how long and/or severe the event may be, many of your employees may struggle to adapt.
- For some teams, this could involve both physical and emotional stress, as some may face income disruption, quarantines or illness among family and neighbors, etc.
- Some workers may be unable to perform work responsibilities or become less engaged. This could lead to loss of productivity, negative customer experience, more errors and control failures.

- How your company responds to a stressful event can shape employee and public attitudes far into the future; it can be a defining moment for your corporate culture.
- The first step is to understand the effects and monitor these risks closely, which should include efforts to measure the "pulse" or morale of your workforce.
- Assess higher rates of employee absenteeism and associated plans.
- Consider temporary simplification of processes or establishment of additional compensating controls in key areas.

Travel restrictions

- The COVID-19 outbreak has curtailed some participation in non-essential public gatherings such as conferences, training, networking events and site visits to subsidiaries and service providers. If travel restrictions continue (or expand), this could affect even more business activity.

- Consider how your company, unit, and department leadership can supervise remote teams and employees.
- Some teams may already be able to collaborate while working independently. Others could need updated tools and protocols in place if your staff will need to work remotely for an extended period.

Accounting and Finance Issues

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Finance and risk matters

Capital assessment and risk management

- In extreme cases, a crisis can place severe pressure on availability of capital, liquidity and increased risk due to increased market volatility, disorderly markets and decreasing financial investment valuations.
- Capital may be impacted by collateral requirements (impacted by declining investment valuations) or restrictions on your subsidiaries' ability to pay dividends (see below).

Dividends / capital contributions

- Due to capital limitations, dividend capacity from regulated subsidiaries may be reduced due to regulatory requirements or other emerging restrictions.
- Subsidiaries and captive insurance companies may need capital infusions.

Regulatory oversight / communications

- Companies are likely to be subject to increasing regulatory requirements, including readiness assessments and solvency tests beyond ORSA assessments (e.g., the March 11, 2020 NYDFS circular letter focusing on plans to address (1) the disruption to operations and (2) the financial risk stemming from the virus, as well as the March 20, 2020 planned NAIC public meeting).
- Actuarial opinions require regulatory asset adequacy testing which include descriptions of the scenarios tested and the sensitivity testing performed including consideration of stress testing pandemic events and associated solvency impacts.

Disclosures in financial statements or registration statements

- You will be required to make disclosures about the effect of COVID-19 on your business within financial statements or other SEC filings, based on relevant GAAP and SEC disclosure standards. Examples of affected disclosures could include risk factors, impairment, debt, liquidity, and Management Discussion and Analysis (MD&A) when discussing operating results and changes in key asset or liabilities balances.
- Stakeholders, including regulators, will expect disclosures as to the effects and risks of subsequent events in various financial statements.

- Review your contingent capital plans/facilities and liquidity profile based on new market based scenarios and market environment. Assess the need to revise trading limits and reconsider the need to modify "stress scenarios" reflecting current market (or projected worsening) conditions.
- Reassess reliability of valuation or risk management processes, models and controls to operate in low interest environment or stressed environment.
- Reassess hedging strategies and related documentation.
- Revisit limits, regulatory buffers and adequacy of stress scenarios, as well as approval levels for large transactions.
- Gather data required to determine if dividend capacity will be impacted.
- Allow for sufficient (increased) time to obtain regulatory approval for dividends.
- Consider additional information that may be required by the regulator in their approval process.
- Address ability to effectively respond to regulatory requests for information.
- Determine if the process in place for monitoring and actioning changes to regulatory requirements is sufficient.
- Consider comments required of the appointed actuary in the regulatory asset adequacy opinion including subsequent events and interim results.
- Address regulatory questions about risks and proactively address relevant impacts to your capital and solvency from pandemic level mortality leveraging ORSA assumptions as augmented by current information.

- Define extent of required disclosure and put in place process to update regularly.
- Disclosures may be required outside of the financial statements and notes. These could include disclosures about the business, risk factors, and management's discussion and analysis of results, liquidity, and capital resources (including consideration of trends and uncertainties).
- Need to assess ability to frequently update disclosures/ investor materials on an ongoing basis in a volatile environment.
- Subsequent events should be evaluated for recognition and disclosure up to the date of issuance of the audited financial statements (including assessing any SEC, NAIC or regulatory COVID-19 specific disclosures that have or may be mandated).

Accounting considerations

Valuation of investments and insurance liabilities

- Due to increased market volatility and potentially decreased liquidity for certain products valuation will present challenges (including impacts on investments, hedging arrangements, or insurance liabilities).
- Companies that apply hedge accounting should be mindful of their compliance with the hedge accounting requirements when considering the impact of 1) the current macroeconomic environment and 2) altering their existing hedging strategies. Additionally, the volatility in markets may cause a company's existing hedge(s) to no longer be effective.
- Companies will need to focus on: ensuring the determination of fair value considers observable market information, determining whether specific markets are active or inactive, and whether transactions in inactive markets are deemed to be disorderly (i.e. forced or distressed). Distressed or forced liquidation sales are "disorderly" transactions and therefore should not be used to determine fair value.

- Reassess valuation policies and controls to reflect new environment and increased valuation risk or reduced price discovery, approaches and model performance in light of new risks and decreased liquidity, and impact on instrument leveling and available valuations
- Consider whether disclosures appropriately describe hedging programs and differences between GAAP and hedge targets, and whether changes in hedging strategy and hedge targets are warranted
- Management's determination whether a given transaction is disorderly or distressed itself requires considerable judgment.

Asset impairment: Investments, Goodwill, Intangible Assets and Deferred Acquisition Costs

- Credit quality may deteriorate for specific companies, sectors or sub-sectors impacted by weakened demand or supply chain issues (international, oil, travel, airline companies, entertainment).
- Consumer credit may be weakened and anticipation of credit loss may increase (mortgage loan or consumer loan investment products).
- Reinsurers could experience higher losses, which create heightened credit risks on recoverables.
- Assess goodwill/ intangible assets triggering events requiring an impairment due to revised outlooks.
- There could be need for more robust "off cycle" loss recognition testing and premium deficiency/ impairment of deferred acquisition costs.

- Assess impact on loss measurement using the new Current Expected Credit Loss (CECL) accounting standard, as well as key assumptions, level and methodologies of qualitative reserves, and projected credit losses. Determining a reasonable and supportable forecast (forward-looking projections) as required by the credit losses standard may be challenging given the volatility and lack of clarity on the overall macroeconomic impact caused by COVID-19.
- Consider significant assumptions used in asset impairment testing and whether updating them for current market conditions will drive a triggering event.
- Consider how credit deterioration impacts impairment conclusions for bonds on a statutory basis.
- Prepare loss recognition testing models with updated market data and best estimate assumptions.
- Consider downstream impacts to valuation models if loss recognition event occurs.

Assumptions in long duration products

- While off-cycle assumption updates are typically not required for long-term assumptions, given market conditions, an assessment of whether the long-term assumption still represents the current best estimate should be performed.
- Reasonableness of mean reversion assumptions, especially where the reversion period is relatively short, long-term interest rate assumptions, including grading period, and mortality/morbidity assumptions and IBNR balances.
- For fair value measures, assess whether correlation assumptions are appropriate, and whether volatility assumptions are sufficiently responsive to current market movements.

- Consider which long-term assumptions could potentially require an off-cycle update.
- Determine whether, given the methodology and inputs used, the outcome of your assumption represents a reasonable best estimate.
- Consider if recent market movements have changed fund correlation.
- Assess grading from current volatility to long term volatility given increased business volatility index measures.
- Review that algorithmic funds (volatility controlled funds, etc.) have been tested and that performance has been assessed.