Top Risks For The Global Insurance Industry

Could COVID-19’s second wave shake up the sector?
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Key Takeaways

- The impact of COVID-19 on global insurance markets is largely felt through asset risks, notably capital markets volatility, and weaker premium growth prospects.

- We expect most COVID-19-related losses (business interruption, event cancellation, etc.) to be picked up by reinsurers, so primary insurers' technical performance is unlikely to deteriorate materially.

- Strict lockdown measures helped maintain satisfactory performance, as motor and medical claims had a positive impact on loss ratios.

- Developed markets, particularly life ones, are likely to shrink in real terms as a result of the economic slowdown.

- Developing markets, through their riskier asset allocation, will likely experience more declines in return on equity than developed markets.

- Ultralow interest rates mean that the most significant source of risk to insurers is the performance of investments, especially life insurers with guaranteed back books.
Insurance | Relative Resilience, Risks Remain

2020 Insurance Rating Actions In Context: For Insurance Capital, Quantity And Quality Matter

- Insurance downgrades this year have been almost exclusively linked to sovereign rating changes.
- Outlook changes occurred for issuers with thinner capital buffers and those most impacted by financial market volatility.
- We expect insurance ratings to continue to show resilience, but risks remain from: investment portfolio exposure, business lines most acutely affected by the pandemic, wider pressures on investment returns, low interest rate, and lower economic growth.
- Since second-quarter 2020, the following sectors have carried negative sector outlooks: U.S., Canada, Australian mortgage insurance, global reinsurance, APAC life, and Latin America.

C&G--Corporates & Governments. EMEA--Europe, the Middle East, and Africa. Source: S&P Global Ratings.
## Top Risks For The Global Insurance Sectors

<table>
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<tr>
<th>Risk Category</th>
<th>Description</th>
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<tr>
<td>Investment performance risk</td>
<td>Capturing financial markets risks, including interest rates, mark to market, and asset quality.</td>
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<tr>
<td>Exposure to high-risk assets</td>
<td>High-risk assets typically include equities (listed and unlisted), real estate, fixed-income investments or deposits in institutions that are rated 'BB+' or lower, and unrated bonds and loans.</td>
</tr>
<tr>
<td>Country risk</td>
<td>Risk factor taking into account considerations such as macroeconomic risk, sovereign rating limitations, geopolitical, and rule of law risks.</td>
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<tr>
<td>Intense competitive environment</td>
<td>Whether the market is concentrated with a few players or contains a high number of smaller ones, an intense competitive environment could lead to price wars and hurt profitability.</td>
</tr>
<tr>
<td>Muted market growth prospects</td>
<td>The lack of potential for premium growth in a market, either because it is mature or due to adverse macroeconomic conditions, with high inflation resulting in near-zero (or negative) real growth.</td>
</tr>
<tr>
<td>Weak technical results</td>
<td>An industry where technical performance, typically measured by combined ratios (non-life) and return on assets (life) is loss-making.</td>
</tr>
<tr>
<td>Exposure to natural catastrophes</td>
<td>Markets with material exposure to climate risk, notably, earthquakes, hurricanes, and other natural disasters.</td>
</tr>
<tr>
<td>Litigious legal system</td>
<td>A sector where litigation often leads to lengthy court cases, increasing the tail of an insurer's liabilities, and consequently, resulting in unpredictable claims settlements.</td>
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<tr>
<td>Government and regulatory policy risks</td>
<td>Markets exposed to changes in government or regulatory policies, often resulting in material impacts on insurers' business models and/or profitability.</td>
</tr>
<tr>
<td>Foreign exchange impact</td>
<td>Reflects the impact foreign exchange risks could have on profitability.</td>
</tr>
<tr>
<td>Other</td>
<td>Risk classification that does not fit any of the 10 categories described above.</td>
</tr>
</tbody>
</table>
Key Risks
Developed EMEA Property/Casualty Insurance

Source: S&P Global Ratings.

German-speaking
- Austria
- Germany
- Switzerland

Nordic
- Denmark
- Finland
- Norway
- Sweden

Northern Europe
- Belgium
- France
- Ireland
- Netherlands
- U.K.

Southern Europe
- Italy
- Portugal
- Spain
To a lesser extent than life insurers, the low interest rate environment will likely impact investment yields for P/C insurers, and consequently ROE.

Insurers (particularly Nordics) have increased investment leverage to enhance returns through higher-risk assets, mainly equities.

The intense competitive environment translates into weaker technical earnings, particularly on motor and medical lines in the U.K. and Ireland.

Changes in government and regulatory policies historically resulted in profit volatility, notably in the U.K. and Ireland (for example, the discount rate in the U.K. used in settling bodily injury claims). The countries’ litigious legal system has also increased product risk, and consequently unpredictable claims settlements.

Exposure to natural catastrophes is mainly limited to flooding and weather events such as hailstorms, windstorms, and torrential rain. Their impact has generally been manageable.

Source: S&P Global Ratings.
Developed EMEA P/C | Performance Metrics

Relatively Stable Combined Ratios

Capital Markets Volatility To Impact Nordic ROE, The Result of Insurers' Risky Asset Mix

South Europe's Economic Performance Going Into COVID-19 Gives It Solid Push For GWP Growth

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Developed EMEA Life

Source: S&P Global Ratings.

German-speaking
- Austria
- Germany
- Switzerland

Nordic
- Denmark
- Finland
- Norway
- Sweden

Northern Europe
- Belgium
- France
- Netherlands
- U.K.

Southern Europe
- Italy
- Portugal
- Spain
Developed EMEA Life | Low Interest Rate Risk Is Pronounced

We assess investment performance risk as a key driver of industry risks.

The ultra low interest rate environment will continue to weigh on life insurers' profitability (ROA and ROE), particularly those with guaranteed products. This is especially relevant for insurers in the German-speaking and Nordic regions.

In search of higher investment yields, some markets are exposed to the volatile equity and real estate classes. These high-risk assets result in ROE volatility.

The subdued macroeconomic environment weighs on growth prospects, where we expect real premium growth to remain flat at best in 2020-2021.

Despite competitive market dynamics, most markets are dominated by a few large players that share the market's premiums and profits.

Source: S&P Global Ratings.
Developed EMEA Life | Performance Metrics

Conservative Investment Portfolio Limits ROA Volatility Outside The Nordic Region

Capital Markets Volatility To Impact Nordic ROE In 2020

Real Premium Growth To Remain Flat At Best

Developing EMEA Property/Casualty

Group 1
- Bahrain
- Jordan
- Kuwait
- Qatar
- Saudi Arabia
- United Arab Emirates

Group 2
- Czech Republic
- Israel
- Poland
- Slovenia

Group 3
- Azerbaijan
- Kazakhstan
- Russia
- South Africa
- Turkey

Group 4
- Angola
- Kenya
- Morocco

Source: S&P Global Ratings.
Developing EMEA P/C | Macroeconomic And Geopolitical Risks Prevalent

- **Country risk**, particularly sovereign rating caps and geopolitical risk, is pronounced for many of EMEA’s developing sectors, notably in the Middle East and North Africa.

- **Foreign exchange risk** results currency devaluation in non-pegged regimes, which **increases the cost of claims** for the dominant motor and medical lines. This is particularly the case in Turkey, South Africa, and Angola.

- **Low market growth prospects** in the absence of new mandatory covers increases **competitive pressures**, which often results in **poor technical performance**.

- **Exposure to high-risk assets** (equities and real estate) results in earnings volatility.

*Source: S&P Global Ratings.*
Developing EMEA P/C | Performance Metrics

**Combined Ratios Feel Little Impact From COVID-19 As Russia/CIS Drives Deterioration In Group 3**

- Group 1: 102% (2018), 98% (2019), 96% (2020f), 94% (2021f)
- Group 2: 106% (2018), 102% (2019), 98% (2020f), 96% (2021f)
- Group 3: 104% (2018), 100% (2019), 96% (2020f), 94% (2021f)
- Group 4: 108% (2018), 104% (2019), 100% (2020f), 98% (2021f)

**ROE Likely To Take A Hit From Equity Volatility, Lower Interest Rates, And Lower Oil Prices**

- Group 1: 30% (2018), 25% (2019), 20% (2020f), 15% (2021f)
- Group 2: 28% (2018), 23% (2019), 18% (2020f), 13% (2021f)
- Group 3: 26% (2018), 21% (2019), 16% (2020f), 11% (2021f)
- Group 4: 24% (2018), 19% (2019), 14% (2020f), 9% (2021f)

**Real GWP Growth Materially Impacted in CEE By The Economic Downturn, But Will Rebound**

- Group 1: 0% (2018), 4% (2019), 8% (2020f), 12% (2021f)
- Group 2: 2% (2018), 6% (2019), 10% (2020f), 14% (2021f)
- Group 3: 4% (2018), 8% (2019), 12% (2020f), 16% (2021f)
- Group 4: 6% (2018), 10% (2019), 14% (2020f), 18% (2021f)

**Currency Devaluation Increases Claims Costs**

- USD per AOA: (8%) (2018), (4%) (2019), 0% (2020f), 4% (2021f)
- USD per TRY: 0% (2018), 4% (2019), 8% (2020f), 12% (2021f)
- USD per ZAR: 4% (2018), 8% (2019), 12% (2020f), 16% (2021f)
- USD per RUB: 8% (2018), 12% (2019), 16% (2020f), 20% (2021f)

**Source:** S&P Global Ratings
Developing EMEA Life

Source: S&P Global Ratings.
Developing EMEA Life | Weak Macroeconomic Conditions Impede Growth Potential

- In EMEA's developing markets, insurance sectors have little in common, but country risks and government and regulatory risks are more prevalent than in developed markets.
- Prolonged periods of weak economic conditions, muted growth prospects, together with low levels of wealth, have led to increased lapse rates, particularly as policyholders find themselves with less disposable income.
- The low interest rate environment and volatility in capital markets are factors weighing on profitability.
- Litigation risk on certain unit-linked policies in Czech Republic and Poland.

Source: S&P Global Ratings.
2020 ROA Supported By Bounce In Israel After A One-Off Reserve Strengthening in 2019

Real Premium Growth Remains Albeit Below Historic Levels

ROE To Remain Relatively Unaffected

APAC Property/Casualty

Source: S&P Global Ratings.

Developed
- Australia
- Hong Kong
- Japan
- Korea
- New Zealand
- Singapore

Developing
- China
- Malaysia
- Taiwan
- Thailand
- **Mature and saturated markets**, with some segments producing reasonable returns, resulting in increased competition.
- **Exposure to natural catastrophes**, notably tsunamis, earthquakes (Japan and New Zealand), and flooding (Taiwan and Thailand). We also note an *increase in frequency* of cat events, such as in Australia and New Zealand.
- **Excessive risk-taking** in the investment portfolio, mainly through domestic and foreign equity investments. This leads to *earnings volatility*.
- **Rising compliance costs and government policy changes** (Hong Kong and Malaysia) make the operating environment uncertain.

*Source: S&P Global Ratings.*
Combined Ratios To Remain Relatively Stable

Deterioration In ROE, Particularly In Developing Markets Unlikely To Bounce Back Materially

No Material Impact On Real Premium Growth In Developing Markets As A Result Of The Pandemic

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The low interest rate environment and volatility in financial markets mean that investment returns are unlikely to be a major offsetting factor to improve ROA and ROE.

Legacy high-yield guaranteed policies and structural duration mismatch cause material ALM risk, which leads to weak technical results.

Life insurance technical results have been dampened by weaker-than-expected experience across disability lines.

The economic slowdown caused by COVID-19 means that premium growth will be subdued in 2020, with developed markets likely to shrink materially in real terms.

Increased regulatory scrutiny in relation to sales and distribution, notably in Australia and New Zealand.

Source: S&P Global Ratings.
Developing Markets' ROA Unlikely To Recover To Pre-Pandemic Levels in 2021

Developing Markets' Riskier Assets to Generate Higher ROE Than Developed Markets

Developed Markets To Shrink While China Continues To Drive Growth in Developing APAC

North America Property/Casualty

Very low risk
Low risk
Intermediate risk
Moderately high risk
High risk
Very high risk

Source: S&P Global Ratings.
The weaker investment environment, namely due to low interest rates and volatile equity markets, will continue to suppress investment performance.

Macroeconomic pressures will continue to weigh on the market’s growth prospects.

The U.S.’s legal system is generally litigious, resulting in unpredictable claims settlements and related reserve volatility arising from unanticipated spikes in claims severity or frequency trends than in most other markets.

Material exposure to natural perils, especially hurricanes, tornados, and wildfires, the latter becoming more prevalent in recent years. These losses tend to be borne by insurers as exposures are within retention levels.

Source: S&P Global Ratings.
North America P/C | Performance Metrics

Net Combined Ratios Not Materially Impacted By COVID-19

Drop In Real Premium Growth, Particularly The U.S., Before A Rebound In 2021

Some Dip In ROE From Financial Market Volatility


Source: S&P Global Ratings. f—Forecast. Copyright © 2020 by Standard & Poor’s Financial Services LLC. All rights reserved.
North America Life

Source: S&P Global Ratings.
North America Life | Weak Macroeconomic Conditions Amid Rising Counterparty Credit Risk

- **Ultralow interest rates**, which we expect will remain for longer, coupled with **guaranteed policies**, give rise to **weak technical performance**.
- Macroeconomic risk, namely **weak economic growth and higher unemployment** in the developed U.S. and Canadian markets, make for a difficult operating environment.
- Financial market risk arising from **increased credit risk** in corporate bonds, together with significant **losses in equity markets**.

*Source: S&P Global Ratings.*
Low Interest Rates Coupled With High Guarantees To Impact ROA

Equity Market Losses To Depress ROE In 2020 Before A Considerable Rebound In 2021

Sharp Decline In Real Premium Growth In 2020 To Recover In 2021

Latin America Property/Casualty

Source: S&P Global Ratings.
Latin America P/C | Macroeconomic And Political Instability Hinder Growth Prospects

- **Weak technical results** due to a high cost base and aggressive competition, with insurers relying on investment returns to produce overall net profits.
- **Exposure to currency devaluation**, particularly on the largest lines of business (motor and medical).
- The **economic downturn** caused by COVID-19 will have an **adverse effect on potential premium growth** for the sectors.
- A **history of sovereign defaults**, notably in Argentina, exposes insurers' credit quality. **Unstable political environments** also pose a drag on insurance sectors.

Source: S&P Global Ratings.
Latin America P/C | Performance Metrics

Some Deterioration In Combined Ratios, Partly Reflecting Foreign Exchange Movements

Adverse Currency Movements And Lockdown Measures To Impact ROE

Markets To Shrink In Real Terms In 2020 Before A Strong Rebound In 2021

Currency Devaluation Increases Claims Costs

Latin America Life

Source: S&P Global Ratings.
Latin America Life | Weak Growth Potential Amid A Difficult Macroeconomic Environment

- Difficult management of **asset-liability mismatches** for insurers carrying **long-tail businesses** such as workers' compensation and annuities in Colombia.
- Unfavorable country risk, characterized by **unstable political environments** and an **economic slowdown** attributed to COVID-19, and relatively high **inflation**.
- Lower disposable income for consumers means that life insurance sectors will likely remain immature and underpenetrated.

Source: S&P Global Ratings.
Latin America Life | Performance Metrics

ROA To Feel Impact Of Lower Investment Returns And Higher Lapse Rates

Interest Rates To Keep High, But Reduced ROE Levels In A High Inflationary Environment

Lockdown Measures To Have A Sizable Impact On Real Premium Growth In 2020

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