

HOW INSURANCE RISK FUNCTIONS SHOULD RESPOND TO COVID-19



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The coronavirus (COVID-19) is affecting insurers in a unique way, as it impacts both the asset and liability sides of the balance sheet and threatens business continuity as well as future economic growth. The Organisation for Economic Co-operation and Development (OECD) considers COVID-19 as the greatest danger to the global economy since the financial crisis, and this statement is applicable to the insurance industry as well.

At the same time, risk management frameworks and crisis response have been significantly upgraded since the global financial crisis. The COVID-19 pandemic is an acid test for financial institutions', and in particular insurers', risk management capabilities in a crisis.

A pandemic is a stress most insurers have tested and scrutinized in their financial risk analysis, operational risk analysis, and business continuity planning. Insurers' Risk functions have a unique understanding of the impact of such a scenario and how to manage the risk as it becomes reality and have dealt well with the immediate priorities over the past weeks.

These include working with the business to agree and implement immediate operational measures aimed at minimizing adverse impact on the health and safety of employees and ensuring business continuity; assessing the financial impact of COVID-19 and triggering risk-mitigating management actions where sensible; and planning the work for the weeks ahead and reprioritizing other scheduled work where necessary.

We now see the following priorities for insurers' Risk teams:

PERFORM IN-DEPTH SCENARIO ANALYSIS

The impact of the coronavirus has already been significant. Nonetheless, the "instantaneous shock" to insurers' balance sheets and operations has broadly been in line with previous stress test modelling, and so far (at the time of writing), has been absorbed by existing capital buffers. But there are a range of scenarios for how the pandemic will further evolve, how long it will last and what the post-crisis world will look like.

Our [COVID-19 primer](#) analyzes three alternative scenarios: 1) serial outbreaks lasting 3-4 months, 2) 6-12 months to rein in pandemic and 3) ongoing pandemic for more than 12 months. Setting out such scenarios and their impact on mortality, the economy and capital markets is an important step. Insurance Risk functions should also understand the likely evolution of COVID-19 cases in geographies in which they have liability exposure, along with the capacity of the health system and the effectiveness of government actions taken.

The analysis of scenario impact on a company's operations and balance sheet will require continuous refinement, for instance by examining questions like: How will the COVID-19 crisis feed through to exposures where an impact is not (yet) visible? And on the asset side, how will ratings and expected loss in the private credit portfolio be affected? What is the likely range of policy responses from governments and how will these affect assets? Will evolving market conditions such as contraction of bond issuance and trading volumes restrict the range of possible responses in each scenario? Meanwhile, on the liability side, what will be the impact of the stretched healthcare system on mortality more broadly (beyond COVID-19)? How will the health, economic and social impacts of the pandemic affect lapse rates?

Finally, Risk functions should analyze financial and operational risk under each of the scenarios, including a broader economic downturn, and define triggers for remedial management actions.

ADAPT AND PREPARE

As the future economic development is uncertain, and while more and more geographies take measures to slow the spread of the virus, preparing and adapting risk management practices is key. This should include thinking through how risk management needs to evolve when employees are working remotely for a prolonged period of time, in particular for operational and cyber risk.

The CRO needs to be a core member of the crisis response team. Risk functions should test senior management's readiness for responding to future developments in the current working mode, ensuring a playbook is ready to act on in a range of scenarios.

Finally, there may be a need to review risk appetite, solvency triggers and actions and exposure limits to ensure they remain suitable for such an environment. In particular do the proposed actions still make sense? If not, there may need to be formal changes signed off at up to Board level.

COMMUNICATE WELL

There is not much chance for a speedy recovery, and the COVID-19 crisis is likely to stay for several months if not longer. It is important to develop analysis-driven communication strategies outlining actions to regulators, the market, and investors as well as internal staff. Communication should be adapted by developing a purpose-built section in Board and Executive risk report(s) that focuses on key vulnerabilities of the company relating to COVID-19.

As the pandemic unfolds Risk functions should continuously re-prioritize their work to ensure an effective response to the outbreak, limiting the undesirable outcomes for clients, employees, and the company.

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