Casualty Actuarial Society Spring Meeting – COVID-19 Coverage Issues

Tancred Schiavoni
Zoheb Noorani

May 10-13, 2020 - Chicago

Issues Addressed

1. Impact on Premium and Claim Volume
2. Impact on Types of Coverage
   a. First Party Property
   b. General Liability
   c. Site Impairment Liability
   d. Maritime
   e. Directors and Officers Liability
3. Class Actions / MDL Proceedings
4. Legislative Initiatives

Impact on Premium and Claim Volume

Type of Coverage	Expected Premium Volume	Expected Claim Volume	
First Party Property (Business Interruption)	↑	↑	Business impact may be significant due to pandemic issues
First Party Property (Civil Authority)	↑	↑	Claims may allege shelter-in-place-orders prohibit access to premises
Bodily Injury	→	?	Unclear—may increase when businesses re-open; talk of immunity before re-opening
General Liability	→	?	Unclear—may increase when businesses re-open
Site Impairment Liability	→	↑	Hotels may seek coverage for remediation and third-party liability
Maritime	↑	↑	Cruise lines may seek coverage
Directors and Officers Liability	↑	↑	Potential allegations of unpreparedness and misrepresentations

First Party Property Coverage

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First Party Property Coverage

Is the policy a “named perils” policy or an “all risk” policy?

- “Named perils” policies only cover enumerated risks
- “All risk” policies cover risks not excluded

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First Party Property Coverage

If it is an “all risk” policy, does it have a virus exclusion?

- <u>Sample “Virus, Bacteria, Microorganism” Exclusion</u>: “We will not pay for loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease.”

First Party Property Coverage

Is there physical loss or property damage?

- Sample Policy Language:

> We will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration". The "suspension" must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit Of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss. With respect to loss of or damage to

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Is there physical loss or property damage?

Coverage	No Coverage
Ammonia discharge that rendered building uninhabitable. *Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am.*, 2014 U.S. Dist. LEXIS 165232 (D.N.J 2014).	Mold that was present only on surface of the building's siding and could be removed without causing harm to the wood. *Mastellone v. Lightning Rod Mut. Ins. Co*., 175 Ohio App. 3d 23 (2008).
E-coli contamination of a well (issue of fact). *Motorists Mut. Ins. Co. v. Hardinger*, 131 Fed. Appx. 823 (3d Cir 2005).	Dust and debris that could be removed simply by cleaning. *Mama Jo's, Inc. v. Sparta Ins. Co*., 2018 U.S. Dist. LEXIS 201852 (S.D. Fla. 2018).
Gasoline that infiltrated and saturated church, rendering it uninhabitable. *W. Fire Ins. Co. v. First Presbyterian Church*, 165 Colo. 34 (1968).	Odors and presence of mold and bacteria in HVAC system. *Univ. Image Prods. v. Chubb Group*, 703 F. Supp. 2d 705 (E.D. Mich. 2010).
Strong odor of cat urine that forced condo owners to vacate. *Mellin v. N. Sec. Ins. Co.*, 115 A.2d 799 (N.H. 2015).	Asbestos contamination, as building remained unchanged. *Great N. Ins. Co. v. Benjamin Franklin Fed. Sav. & Loan*, 793 F. Supp. 259 (D. Or. 1990), *aff'd*, 953 F.2d 1387 (9th Cir. 1992).

First Party Property Coverage

How to prove presence of the virus?

- Confirmed case at the location?
- Statistical probability?
- Presumption/burden shifting?

First Party Property Coverage

How will damages be measured?

- Lost income that would have been earned absent the pandemic?
- Amount that would have been earned had the business stayed open during the pandemic?

First Party Property Coverage

Civil Authority Coverage:

- Sample Policy Language: "We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from any Covered Cause of Loss."

First Party Property Coverage

Civil Authority Coverage:

- Did a covered cause of loss cause damage to property other than at the described premises?
- Do the shelter-in-place orders prohibit access to the premises?

General Liability Coverage

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General Liability Coverage

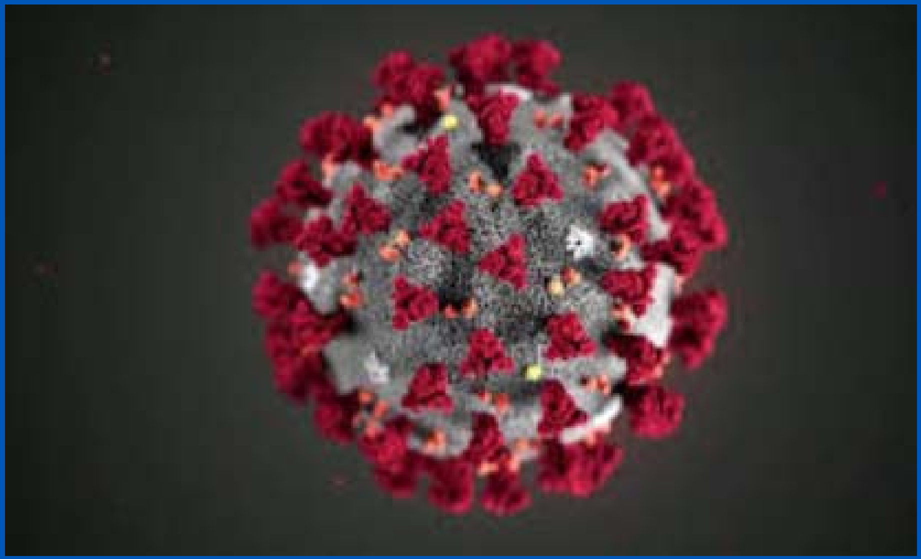
- Businesses may be at risk of being held liable for any outbreaks that occur on their premises on grounds of alleged negligence

- In such situations, commercial general liability policies may be triggered

General Liability Coverage

- Primary targets of claims:
  - Hotels
  - Cruise ship operators
  - Nursing homes
  - Venues of public gathering

Site Impairment Liability Coverage



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Site Impairment Liability Coverage

- Some policies provide coverage for remediation and third-party liability based on the presence of biological agents on scheduled sites, such as hotels

Maritime Coverage

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Maritime Coverage

- Certain maritime polices provide coverage in case there is an outbreak of disease on the vessel

- Since cruise ship operators have been severely impacted, they may search for all coverage, which may be inadvertently available where it is least expected

Directors and Officers Liability Coverage

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Directors and Officers Liability Coverage

- There may be suits against Directors and Officers alleging:
  - Misrepresentation about risks of COVID-19
  - Mishandling of the COVID-19 crisis to the financial and reputational detriment of the company

Directors and Officers Liability Coverage

- Two key issues:
  - D&O policies may only provide coverage to individual directors and officers, not the corporate entity
  - D&O policies typically exclude coverage for bodily injury and property damage claims

Directors and Officers Liability Coverage

- Some D&O bodily injury and property damage exclusions are limited to claims ***for*** bodily injury or property damage
  - This version of the exclusion requires that the claim be brought by or on behalf of the person that allegedly sustained injury
- Other D&O bodily injury and property damage exclusions apply to claims ***based upon or arising from*** bodily injury or property damage
  - This version of the exclusion could apply to claims that are based upon or arise from COVID-19 injury or damage to physical property

Directors and Officers Liability Coverage

- The same issues may apply to pollution exclusions
- D&O policies rarely define “pollutant” or “pollution,” however, and COVID-19 may not qualify

Class Actions / MDL Proceedings

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Class Actions / MDL Proceedings

- Several class actions have been filed against insurers seeking coverage for losses related to COVID-19

- Plaintiffs have filed petitions to consolidate several of these actions in MDL number 2942

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Class Actions / MDL Proceedings

- The petitions claim that transfer and consolidation is appropriate based on the similarity and importance of the issues:

5. While the Related Actions are geographically dispersed and involve industries across the entire spectrum of the economy, the core issue in each of the Related Actions – whether the Governmental Orders trigger insurance coverage for losses caused by business interruption and whether any exclusions apply – is identical and is one of national importance and great significance to the ultimate survival of many businesses.

6. As explained in more detail in the accompanying brief, this central issue is too important to the survival of the insured businesses and indeed, to the recovery of the economy as a whole, to leave to various courts across the country that could reach divergent and conflicting results. Addressing it in a uniform manner helps to serve one of the main purposes of Section 1407. Utilizing such transfer and consolidation or coordination on an issue of such national significance is prudent.

Class Actions / MDL Proceedings

Considerations for Opposing the MDL:

- Common issues of fact?
  - "When civil actions involving one or more common questions of fact are pending in different districts, such actions may be transferred to any district for coordinated or consolidated pretrial proceedings." 28 U.S.C. § 1407.
- Convenience of the parties and witnesses?
  - "Such transfers shall be made by the judicial panel on multidistrict litigation authorized by this section upon its determination that transfers for such proceedings will be for the convenience of parties and witnesses and will promote the just and efficient conduct of such actions." 28 U.S.C. § 1407.

Class Actions / MDL Proceedings

Considerations for Opposing Class Certification:

- What is the class definition?
- Which venue is proper?
- Common issues may not predominate.
- The named plaintiff’s claims may not be typical of the class.
- Class actions may not be superior to individual actions.

Legislative Initiatives

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Legislative Initiatives

- Two insurance bills related to COVID-19 have been proposed in Congress:
  - Pandemic Risk Insurance Act
  - Business Interruption Insurance Coverage Act of 2020

Legislative Initiatives

- Pandemic Risk Insurance Act ("PRIA"):

  - The model PRIA draft bill currently circulating through Congress closely mirrors the Terrorism Risk Insurance Act ("TRIA") that was passed in the wake of the September 11 attacks

  - It would require participating insurers to "make available" insurance coverage for a "covered public health emergency," which includes "any outbreak of infectious disease or pandemic" on terms that do not materially differ from the terms applicable to losses arising from other events

  - It would apply to any insurance company licensed in any U.S. state, territory, or possession, as well as any insurance company eligible to write insurance in the U.S. on a surplus lines basis

  - Participating insurers would be subject to individual and industry deductibles, and would then share with the Treasury in losses up to certain thresholds

Legislative Initiatives

- PRIA versus TRIA:
  - Unlike TRIA, which is a mandatory program, the current PRIA draft is a voluntary program whereby participating insurers would be required to pay reinsurance premiums to the Treasury for participation
  - TRIA requires that each insurer "make available, in all of its property and casualty insurance policies, coverage for insured losses . . ." In contrast, the current PRIA draft requires that each insurer "make available, in all of its business interruption insurance policies, coverage for insured losses . . ."
  - Thus, on its face, PRIA is significantly narrower than TRIA

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Legislative Initiatives

- Business Interruption Insurance Coverage Act of 2020:
  - The current draft would require all insurers that offer business interruption insurance to offer coverage for a viral pandemic
  - The current draft provides that "[a]ny exclusion in a contract for business interruption insurance that is in force on the date of the enactment of [the] act shall be void to the extent it excludes" viral pandemics
- A number of states also have bills in their legislative chambers that would augment current in-force business interruption insurance policies to compel coverage for COVID-19

Legislative Initiatives

- On March 16, 2020, legislation was introduced in New Jersey's assembly to compel insurers to cover business interruption losses resulting from COVID-19, overriding applicable exclusions
  - The bill would apply to businesses with less than 100 eligible employees in the State of New Jersey
  - The bill purports to reimburse carriers for the coverage paid to insureds, but does not explain how the State will cover such costs; it appears the reimbursements to insurers will be paid out of taxes levied on the insurance industry

Legislative Initiatives

- Separately, several Congressional representatives have reached out to insurance trade groups requesting that insurers provide coverage for COVID-19 losses despite any exclusions

- In view of the size of the anticipated losses, other governmental and legislative initiatives can be expected as aid legislation is considered

Tancred Schiavoni

Partner
Insurance Practice
New York
D: +1-212-326-2267
tschiavoni@omm.com

Education

Georgetown University, J.D., 1988: Member, Georgetown Journal of Legal Ethics

Georgetown University, B.S., 1984

Tancred Schiavoni, Chair of the Firm's Insurance Practice, represents insurance and reinsurance companies in a variety of disputes, including bad faith claims and environmental coverage litigation. Tanc has represented carriers in cases in a number of states, including New Jersey, New York, and New Hampshire. He has also conducted and assisted in mediations and provided coverage advice to clients to assist them in avoiding disputes without the need for litigation. Tanc participated at trial in the defense of a major environmental coverage action involving multiple parties and claims for coverage exceeding US$500 million. Tanc also was involved in the trial of another major multiparty coverage dispute involving coverage claims in a dozen states and Canada.

Chambers USA notes that Tanc is “known as a go-to lawyer on high-stakes mass tort and insurance bad faith litigation.”

Apart from his work for insurance companies, Tanc has been active in a broad range of complex commercial litigation and appeals in both federal and state court, involving such issues as accountants liability, fraudulent conveyance, securities, and employment litigation. Tanc has represented lenders and borrowers in actions involving securities transactions and loans. He has also been involved in a variety of adversary proceedings in bankruptcy court.

Professional Activities

Member

New York City Bar Association

Speaker

“Responding to Extreme Losses in the New Normal,” ARIAS US Spring Conference (May 2018)

“Recent Trends and Developments in Allocation Issues – Which Policies Apply and in What Order,” Perrin Conferences: Insurance Coverage and Allocation Issues Conference (April 2018)

“Changing Politics of Asbestos Bankruptcies,” HB Asbestos Bankruptcy Current Trends & Future Outlook (October 2010)

Author

"No Harm, No Foul: Jury Rejects Reinsurer’s Late-Notice Defense," *Arias US Quarterly* (August 2018 co-authored with Vincent Weisband)

Zoheb Noorani

Counsel
Insurance Practice
Los Angeles
D: +1-213-430-6377
znoorani@omm.com

Education

University of Southern California, J.D., Order of the Coif
University of Southern California, B.A., Film Studies

A *Legal 500* Next Generation Insurance lawyer, **Zoheb Noorani** has been involved in the firm's most challenging insurance matters. He has defended insurance companies in all stages of coverage actions—from pre-litigation counseling to appeals. Along with the day-to-day management of cases, he has been the principal drafter of several case-winning summary judgment motions.

In addition to his insurance coverage work, Zoheb also has experience defending pharmaceutical companies in product liability cases.

Experience

Assisted in obtaining a complete reversal of a multimillion-dollar coverage judgment against an insurance company in the US Court of Appeals, Ninth Circuit.

After an adverse Phase One coverage ruling, substituted-in for prior counsel, and obtained complete victory by winning summary judgment based on rescission of the insurance policy.

Obtained summary adjudication in favor of an insurance company based on the No Voluntary Payments Clause for a Consent Decree entered into by the policyholder without notice.

Despite a prior finding of a breach of the duty to defend, stepped in as substitute counsel and prevailed on summary judgment on the duty to indemnify by demonstrating no actual coverage for the claims at issue.

Counseled a ceding insurer in connection with a multi-million dollar reinsurance dispute which ultimately resulted in a favorable settlement for the client.

Defending an insurance company in litigation based on environmental contamination emanating from a former DDT plant.

Honors & Awards

Named to *Legal 500*'s “Next Generation Lawyer” list in the “Insurance: advice to insurers” category (2018-2019)

Languages

COVID-19 Briefing

Capital Model Impact and Solutions

May 11, 2020

SPEAKERS

SHERMAN POWER, CFA
Senior Managing Director
Reinsurance Solutions
Aon

DUSTIN LOEFFLER, FCAS
Managing Director
Reinsurance Solutions
Aon

INTRODUCTION AND AGENDA

Impact of Pandemic on P&C Insurance Industry is Wide-ranging and Still Emerging – What We See From Our Vantage Point in Reinsurance

Aon's Capital Advisory Perspective

Topics

- P&C Industry impact, what's apparent so far
- Individual Company Responses & Lessons
- How can our industry can help …

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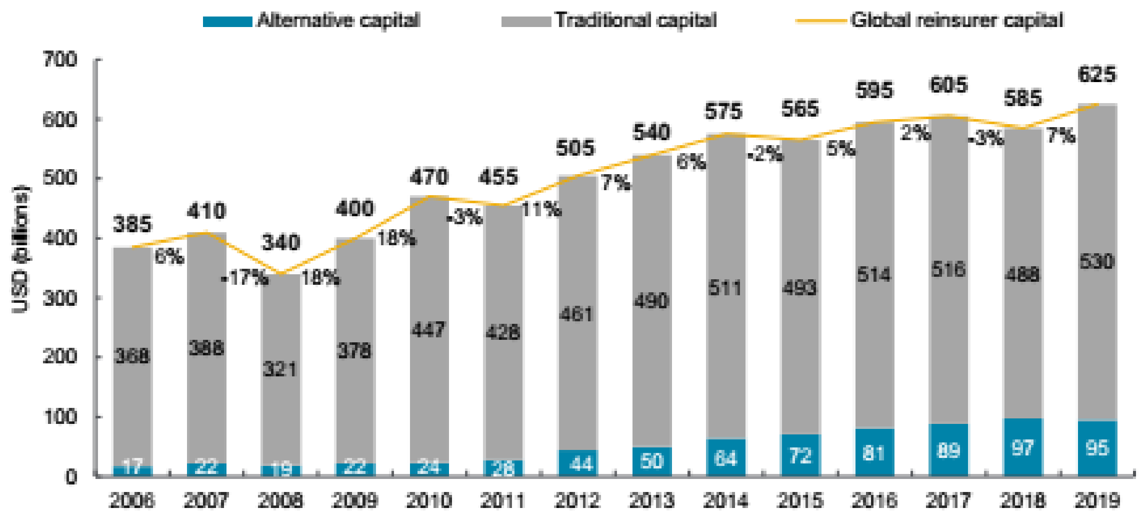
P&C Industry Market Update

Position of Reinsurer Capital Going In



Source: Aon / company reports

- Aon estimates that global reinsurer capital rose by 7%, or USD40 billion, to USD625 billion over the year to December 31, 2019
- This calculation is a broad measure of the capital available for insurers to trade risk with and includes both traditional and alternative forms of reinsurer capital
- Industry players have looked to estimate impact of pandemic on P&C industry – what will this look like in 2020?

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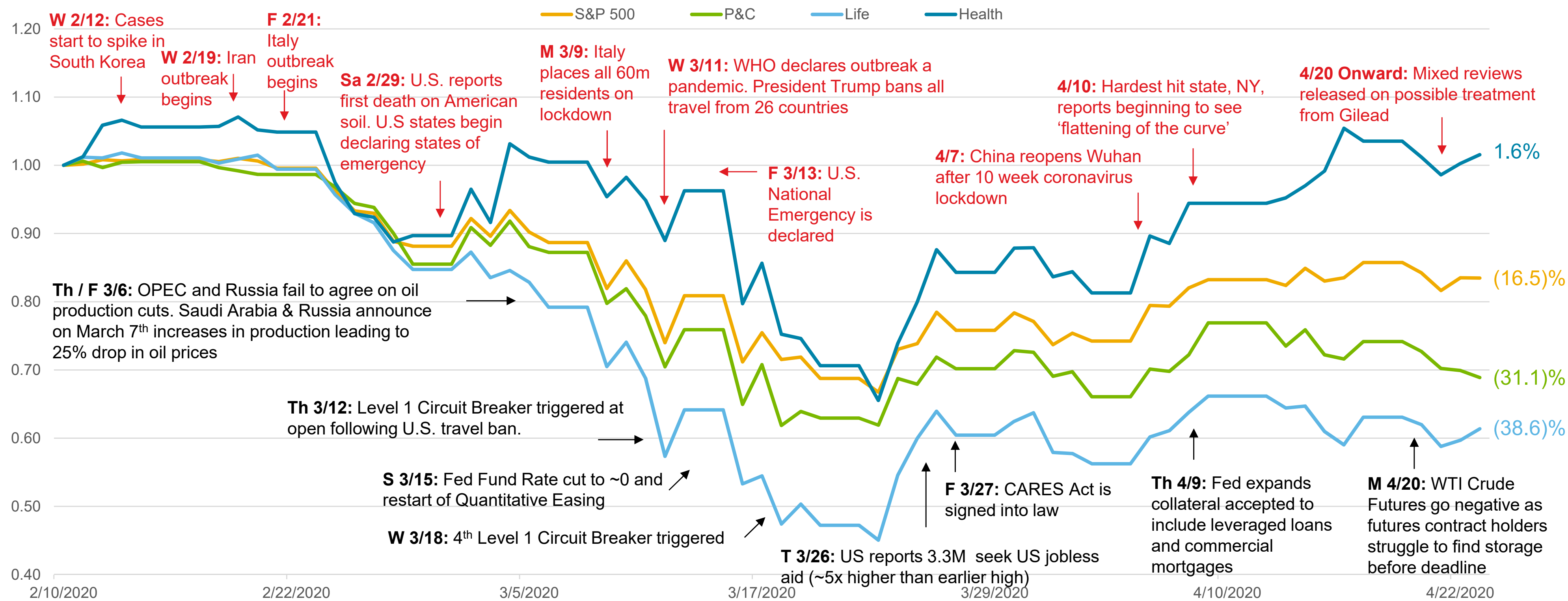
There has Been a Push-Pull on Valuations in the Insurance Industry following COVID-19 News and Macro Response

Equities Markets Globally React to COVID-19 Developments, indexed to 2/10/2020



Sources: S&P Global, Business Insurance, New York Times, Financial Times, SeekingAlpha, Yahoo! Finance, Johns Hopkins, World Health Organization
P&C: AIG, CB, HIG, TRV, CINF, CNA, ORI, THG, ALL, DGICA, EFH, ERIE, HMN, IFC-TSX, KMPR, KINS, MCY, NGHC, PGR, SAFT, STFC, ACGL, AFG, AIZ, ARGO, MKL, PRA, RLI, SIG, WRB, AXS, ESGR, GLRE, MHLD, RE, RNR, TPRE, Y
Life: AEL, AFL, ANAT, ATH, BHF, CNO, FFG, GWO-TSX, IAG-TSX, LNC, MET, MFC-TSX, NWLI, PFG, PRI, PRU, RGA, SLF-TSX, GL, UNM
Health: ANTM, CI, CNC, HUM, MCH, UNH

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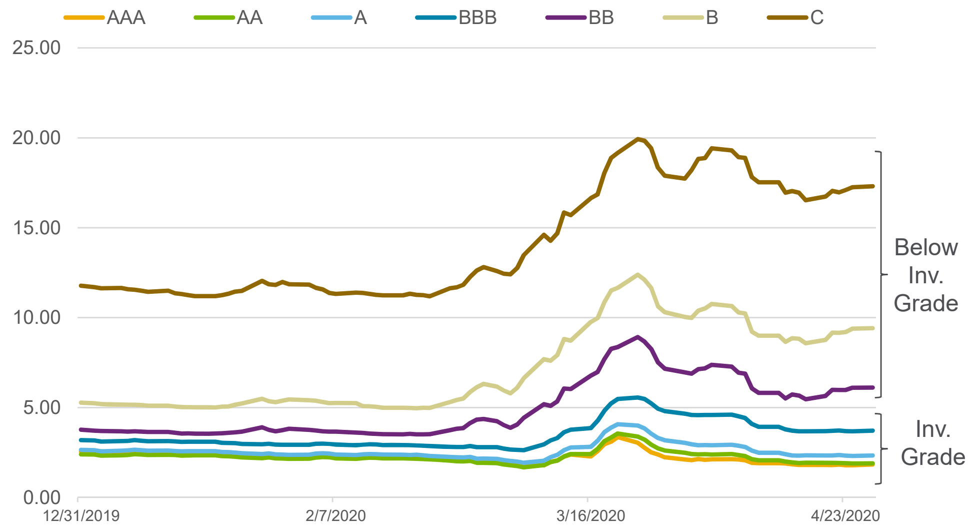
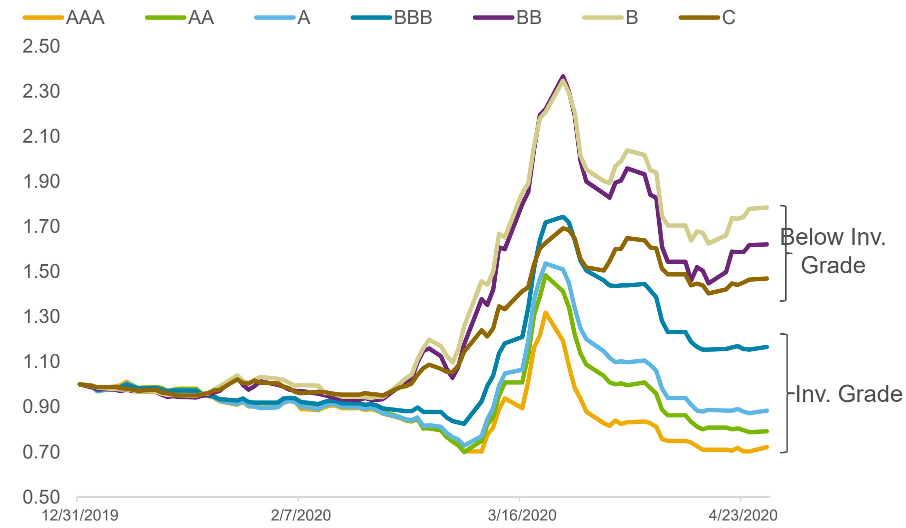
Corporate Credit Spreads Continue to be Materially Impacted Despite Aggressive Fed Actions

Corporate Index Effective Yield by Rating



Corporate Index Effective Yield by Rating, Indexed to 12/31/2019



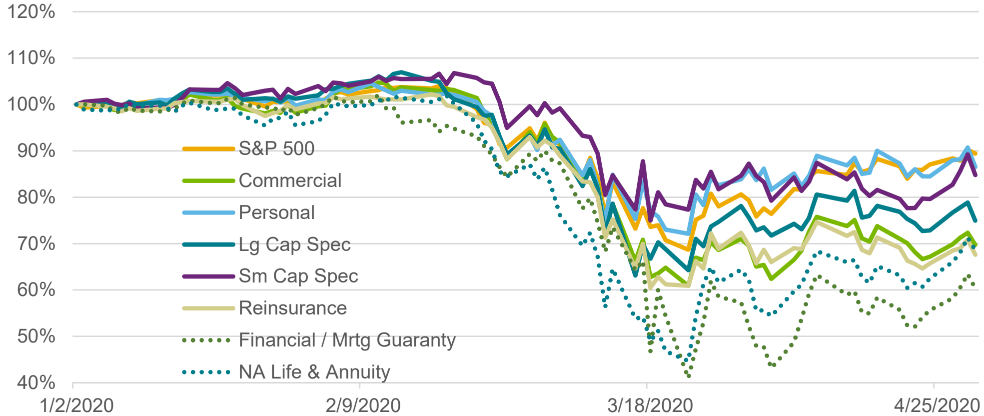
- The left chart shows actual yield spreads based on BofA's index of fixed income corporates at various credit ratings, and the right shows the change in the spread (i.e. velocity and acceleration)
- A, AA and AAA bonds are below year-end levels following Fed action and 'flight to safety'
- BBB and below investment grade are still elevated
- The high cost of debt for companies with poorer credit ratings will likely lead to evaluating alternative forms of capital and / or delay in certain investments that could require debt (e.g. cash acquisitions)

Sources: Bloomberg, Federal Reserve of St. Louis, Bank of America Corporate Yield Index ("ICE")

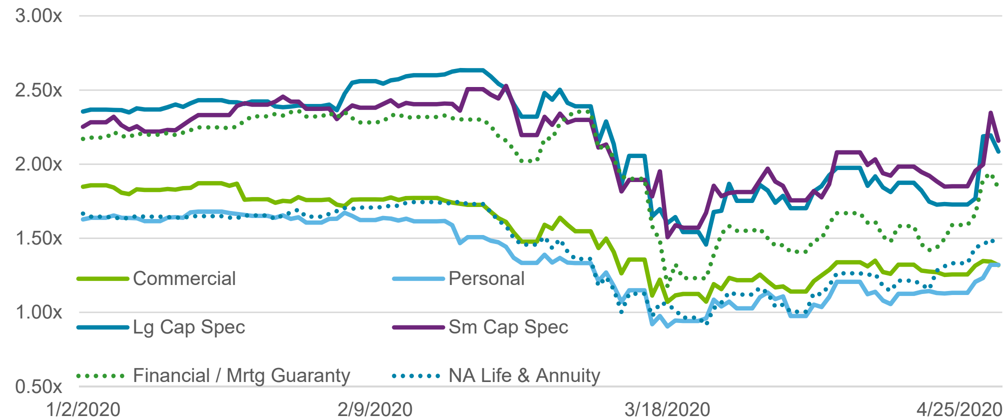
Update for a public market view of COVID 19 impact (at April 30)

Insurance Valuation Reaction:

Insurance Equities Indexed to 2019 Year-End through 4/30/2020



Q1 2020 Reported Median P/TBV* by segment[1], indexed to 2019 Year-End



Potential Implications:

- Market view of COVID 19 impact on sector suggests more pain to come, in terms of revenues and underwriting profit – not just an asset value reaction
- M&A could potentially slow if financial buyers' have less access to efficient debt; Total deal value is likely to be smaller in times of elevated volatility
- M&A activity has historically recovered to pre-crisis levels 6 to 12 months post-crisis resolution

Source: S&P Global Market Intelligence, Bloomberg, BMO Capital Markets. Data as of 04/30/2020
*P/TBV – Price to tangible book value.
1 Reported companies included in the P/TBV segments: Commercial: CB, CINF, HIG, ORI, THG, TRV, Personal: DGICA, NGHC, PGR Lg Cap Spec: MKL, RLI, WRB Sm Cap Spec: AMSF, EIG, JRVR Financial / Mrtg Guaranty: FAF, FNF, STC NA Life & Annuity: AFL, GL, PFG, PRI

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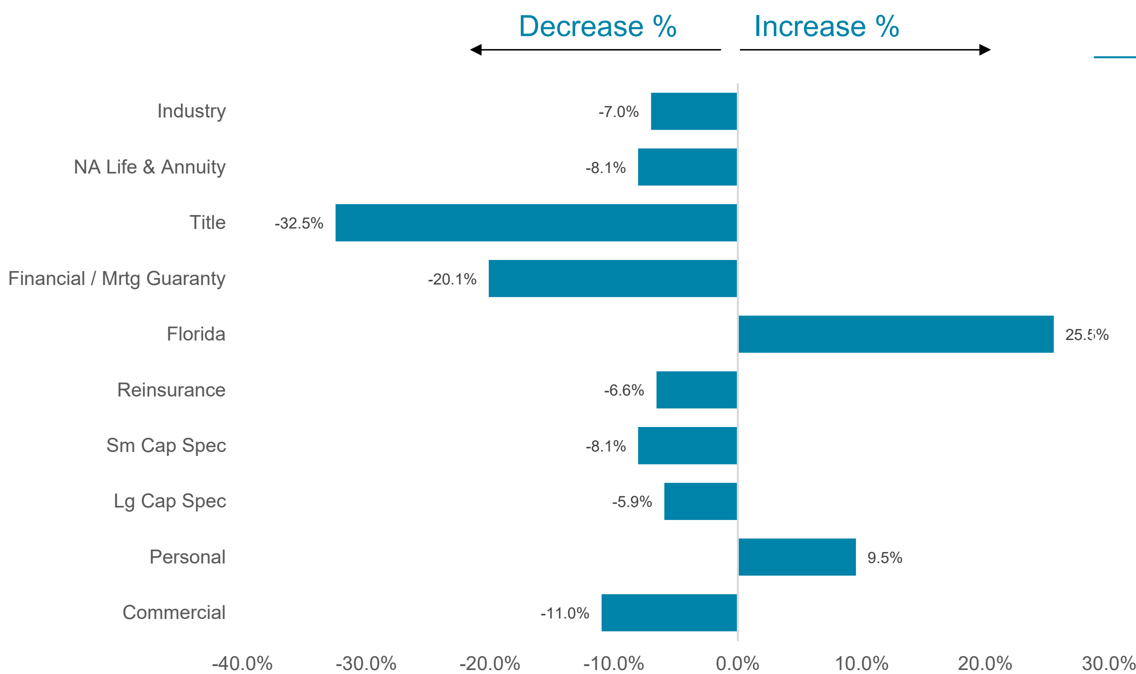
2020E EPS Consensus Estimates down ~7% for Industry (~$31 per share)

Change in 2020E EPS Consensus for Public Carriers, 2/12/2020 to 4/22/2020



Median 2020E EPS Δ	Total 2020E EPS Δ
-0.35	-30.96
-0.35	-10.52
-1.06	-4.00
-0.66	-3.76
0.81	2.97
-0.68	-3.18
-0.11	-3.36
-0.20	-2.98
0.35	2.83
-0.58	-8.95

Sources: SNL Financial
Industry = all publicly traded Life and P&C insurers with EPS estimates reflected in the following sectors
NA Life & Annuity: AFL, AEL, ATH, EQH, BHF, CNO, FFG, GL, LNC, MFC-TSX, MET, PRI, PFG, PRU, RGA, SLF-TSX, UNM, VOYA
Title: FAF, FNF, STC; **Financial / Mrtg Guaranty:** AGO, ESNT, MBI, NMIH, RDN; **Florida:** FNHC, HCI, HRTG, UIHC
Reinsurance: Y, AXS, RE, RNR; **Sm Cap Specialty:** AMSF, EIG, HALL, JRVR, KNSL, PLMR, PROS, UFCS
Lg Cap Specialty: AFG, ACGL, ARGO, AIZ, MKL, PRA, RLI, SIGI, WRB
Personal: ALL, HMN, IFC-TSX, KMPR, MCY, NGHC, PGR, STFC
Commercial: AIG, CB, CINF, CNA, FFH-TSX, THG, ORI, TRV

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Carrier Responses and Lessons Learned

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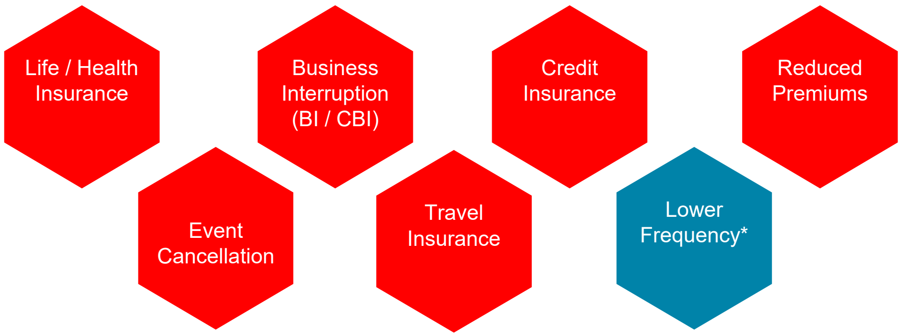
How does the current COVID-19 crisis affect (re)insurers' solvency?



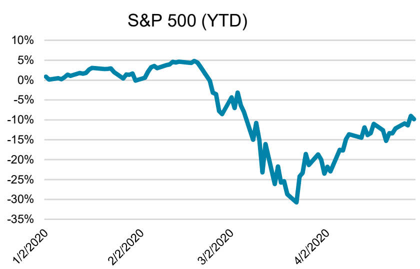
Underwriting Performance
Mostly manageable, but negative impact on certain LOB

Underwriting Losses:

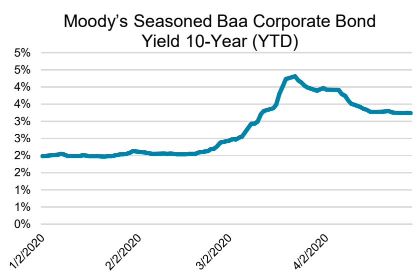
- Certain lines of business (LOB) will be more impacted, and some companies may report outsized concentration
- BI & Contingent BI are an area to watch as they may have significant impact for some insurers depending on how reinsurance recovery will work
- Recession may have a negative impact through reduced premium (budgeting and higher combined ratios) and a positive one for some lines through lower claims frequency* (e.g. less driving)

*Note: certain LOB such as workers' comp, other liability, etc. may experience increase in claims

Equity Markets Down ~10% Year-to-date (YTD)



Credit Spread Increase ~126 basis points (bps)



Unrealized losses dependent on company portfolio composition

Investment Losses and Fixed-Income Downgrades:

- Equity markets dropped 10% YTD with high volatility
- Corporate bonds lost value due to +126bps spread increase over government bonds reflecting credit risk
- Severity of losses largely dependent on these two elements and company portfolio composition

→ companies who invested heavily in Equities or Corporate Bonds to enhance investment return will be most affected

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Reported Earnings or Pre-Release Estimates Related to COVID-19 and Q1 2020 Investments Through April 30, 2020

Reported COVID-19 underwriting and Q1 'paper' losses

Company	UW Losses ($M)		Unrealized Inv. Losses		Inv Losses as % 2019YE GAAP Equity
American Financial Group, Inc.	NA		438.1	a.t.	7.0%
Arch	135.0	p.t.	NA		NA
ARGO Group	26.0	p.t.	162.0	p.t.	7.2%
AXIS	235.0		336.0		4.8%
beazley	170.0		55.0	p.t.	2.7%
CHUBB	13.0	p.t.	2,200.0	a.t.	4.0%
Cincinnati	NA		1,300.0	p.t.	10.4%
Everest	150.0	p.t.	NA		NA
FAIRFAX	NA		1,500.0	a.t.	8.4%
GREENLIGHT RE	NA		43.0	a.t.	9.0%
The Hartford	50.0	p.t.	1,009.0	a.t.	6.2%
HISCOX	150.0		NA		NA
The Hanover Insurance Group	NA		161.6	p.t.	4.4%
Markel	325.0	p.t.	1.7	p.t.	0.0%
Old Republic	NA		944.1	p.t.	12.4%
RLI Different Works	5.0		130.4	p.t.	10.3%
TRAVELERS	86.0		1,785.0	a.t.	6.9%
Berkley	67.0	p.t.	110.0	a.t.	1.8%
Median	**110.5**				**6.9%**

Underwriting Losses for COVID-19 (~$2B[1] public so far)

- Limited estimates to date
- Many characterize COVID-19 like a catastrophe event (e.g. Chubb, Liberty Mutual, WRB)
- Some have created IBNR estimates (e.g. WRB, Everest Re)
- Types of losses so far: event cancellations, policies with specific pandemic covers, and bad debt write-downs for billing relief
- Some companies do not have explicit viral exclusions (e.g. Cincinnati) or have communicable disease sub-limits (e.g. FM Global)

Unrealized Investment Losses (~$10+B public so far)

- Decreases revenue…decreases net income**…decreases equity**

Outlook

- Companies expect to see more losses (underwriting, credit), decreased future premium and fee revenue and thereby rising expense ratio, lower net investment income with smaller investments pool

Sources: SNL Financial, Earnings Releases, Company Filings. Note: p.t. = pre-tax and a.t. = after-tax; [1] includes Swiss Re and Lancashire estimates

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COVID-19 Stresses by Company Examples

S&P and Reinsurers

- S&P has Berkshire Hathaway current confidence level is AA and even with the stress for COVID-19, S&P still expects their capital position at the AA level to be 0-5% redundant at the year-end 2019 capital level and the projected year-end 2020 and 2021 capital levels
- In regard to its pandemic stress test and a cohort of rated reinsurers, S&P expects six reinsurers to maintain capital redundancy, four to become deficient by 0% to 10%, and three to become deficient by more than 10% after implementation of the COVID-19 asset stresses
- Most reinsurers are projected to maintain or build capital back up to their current redundancy assessment level by 2021, with only TWO reinsurers projected to still be deficient by year-end 2021

Company Comments

- FM Global is lowering communicable disease business interruption (BI) sub-limits provided in its standard property policies from $1,000,000 to just $10,000 in the COVID-19 fallout ahead of an expected tightening of terms from reinsurers at its upcoming treaty renewal
- Arch: "Estimated pre-tax net losses of $85 million to $95 million across property casualty insurance and reinsurance segments, for exposure to COVID-19 claims as of March 31, 2020. Estimated pre-tax net losses of $40 million to $50 million in the mortgage segment, as a result of financial stress due to COVID-19. These incurred losses are largely a result of our loss reserving selections being set at the higher end of our range of indications across the mortgage segment as of March 31, 2020."
- Hannover Re: "According to preliminary estimates, the solvency ratio at the end of the first quarter - and hence allowing for considerable volatility in interest rates and credit spreads - remains comfortably above the limit and threshold of 180% and 200% respectively. At year-end 2019 the solvency ratio amounted to 251%."
- Hiscox: "…believes its business interruption exposure to COVID-19 is limited in Europe and it has negligible exposure in its US retail business. Hiscox Retail has substantial reinsurance cover in place. Hiscox publishes a realistic disaster scenario which estimates a net loss of $175 million for losses emanating primarily from event cancellation, entertainment and travel in a global pandemic scenario. Hiscox is proactively paying claims for these lines of business and the claims are progressing in line with its expectations."

38 Industry Sector Outlooks Have Been Changed to Negative
(19 Americas)

A.M. BEST

- Revised Stable outlook to **Negative on 17** sectors including the following US segments:
  - Annuity
  - Commercial Lines
  - Excess &Surplus Lines
  - Life
  - Professional Liability
  - Workers Comp
- Confirmed **Stable** Outlook on seven US sectors including:
  - Personal lines
  - Health
  - Homeowners
  - Personal Auto

No rating downgrades or outlook changes specific to COVID-19

FitchRatings

- Revised Stable outlook to **Negative on 15** sectors including:
  - Global Reinsurance
  - APAC Non-Life & life
  - US Health
  - US Life
  - US P&C

3 companies have been downgraded
Outlook lowered from positive to stable for 15 companies
Outlook lowered from stable to negative for 14 companies

MOODY'S

- Revised Stable outlook to **Negative on five** sectors including:
  - US Life
  - Japan Life
  - Korean Life
  - Italian Life
  - UK Life
- Confirmed **Stable** outlook on US Health Sector

No downgrades were made that were specific to COVID-19
Outlook lowered from stable to negative for 4 companies

S&P Global Ratings

- Revised Stable outlook of APAC Life sector to **Negative**
- Confirmed Stable outlook of Life & Health including US and North America Health, North America Life, EMEA life
- Confirmed **Stable** outlook on:
  - Global Reinsurance
  - US Health
  - US Life
  - US P&C

5 companies were downgraded
Outlook lowered from positive to stable for 12 companies
Outlook lowered from stable to negative for 8 companies

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Addressing Pandemic Industry Impact

Reinsurance Market Update

Markets are messaging robust platforms

- COVID-19 “event” discussed as a “typical” Cat in terms of underwriting loss
- “open for business” – we see business as usual on current deals in the market
- “Extensions” viewed warily, renewals had been viewed as a chance to address casualty “trends”

Aon is hearing from a few clients that capital relief solutions could be needed.

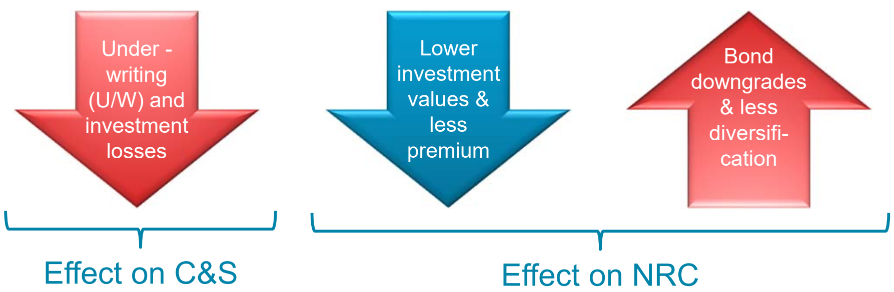
Markets still anticipate emerging pandemic related capital or cash flow needs by H2; markets expecting some demand for capital relief reinsurance.

Reinsurance capital relief providers generally anticipate deploying underwriting capital in the second half for impacted companies

How does the current COVID-19 crisis affect (re)insurers solvency?

<u>Rating Agency and Regulatory Capital Models</u>

- AM Best BCAR
- S&P
- Fitch Prism
- NAIC RBC



Underwriting and Investment Effect on Rating Agency and Regulatory Capital Models:

- Rating agencies and the NAIC require insurers to hold a certain level of capital against various risks (e.g. net required capital / NRC)
- Decrease in value of investment portfolio reduces available capital and surplus (C&S)
  - Potential fixed-income downgrades and less diversification benefit could also increase NRC
  - Partially offset by corresponding reduction in NRC from lower stock / bond values, less premium

Conclusion:

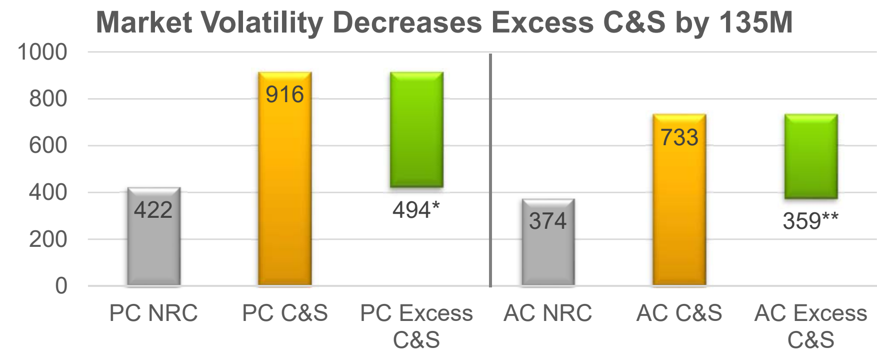
For most companies, C&S still within / at bottom of acceptable range, but they will need to recreate a buffer

- Profit and loss (P&L) and balance sheet impact from underwriting & asset risk not critical, **BUT makes them more vulnerable with lower capacity to absorb future shocks or execute on their growth plans**
- Prepare “Contingent Management Actions”: ability to have capital levers ready to use if and when needed
- Equity & Sub Debt issuance are not much of an option currently, which points to **reinsurance solutions**

→ For a minority: significant losses leading to immediate rating and / or solvency issues

- In the example to follow, restore the initial BCAR / S&P Capital / RBC Ratio compensating for the 20% drop in C&S

What is the impact on Rating Agency Capital (BCAR Example)?



BCAR Ratio Calculation: 1 – NRC / C&S. PC – Pre-crisis. AC – After / post-crisis.
*Results in BCAR ratio of 54%. **Results in BCAR ratio of 49%.

BCAR Example:

- Given a pre-crisis BCAR ratio of 54% (1 – 422 / 916) at the VaR 99.6 confidence interval, a 20% reduction in C&S (order of magnitude Aon expects to see for many companies) leads to a net reduction* of 135M of excess C&S and a new BCAR ratio of 49% (1 – 374 / 733)

*C&S reduced 183M, with partial offset from reduction in NRC of 48M = 135M; tax-effect excluded for purposes of simplicity

Quick Detour → Partial Reduction in NRC Explained

- Decrease in amount of equities leads to decrease in balance that is charged
- If equities are largest risk component of company's required capital, more benefit from covariance adjustment as equities decrease, leading to lower NRC
- A.M. Best may manually adjust equity risk charges based on historical performance, but current market conditions and portfolio performance will not be factored in until year-end 2020 model

	Statement Value $ Millions		Asset Risk Factors VaR 99.6		Adjusted Required Capital VaR 99.6
PC Common Stock Charges	446	x	44.0	=	196
AC Common Stock Charges	299	x	44.0	=	131
PC Covariance Benefit					406
AC Covariance Benefit					389
Change in NRC	(Δ Common Stock Charges less Δ Covariance Benefit)				**48**

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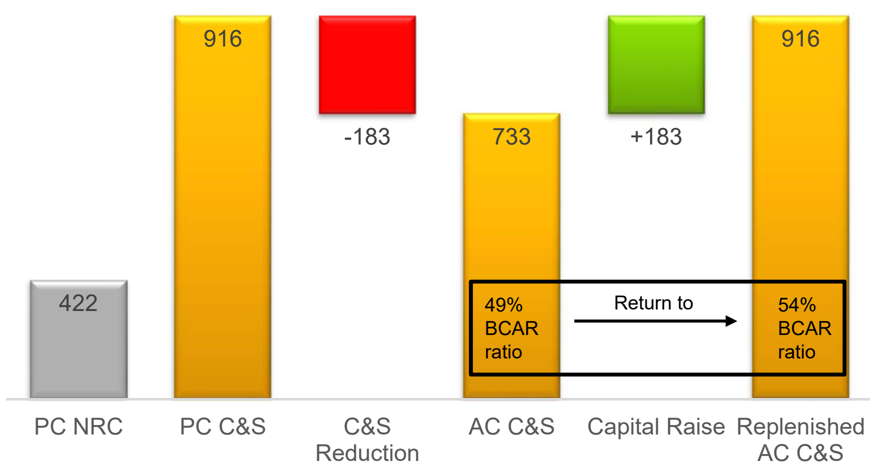
How can I get my BCAR Score Back to its Pre-Crisis Level?

Coming back to our previous BCAR example of a company with a 54% pre-crisis score which dropped to 49%, resulting in a net reduction in excess C&S of 135M

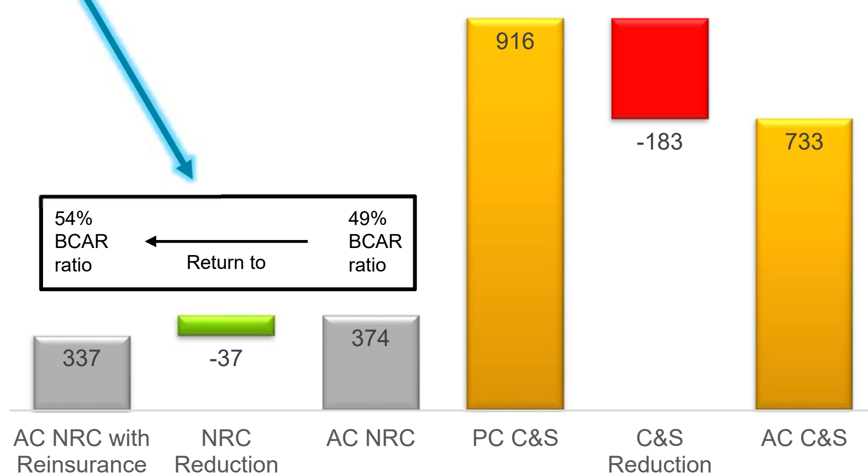
- On the left, one solution would be to **raise the 183M, i.e. increase Capital and Surplus (C&S)** back to its original level. May be difficult given capital market situation but provides a reference on amount and cost of capital
- On the right, **reinsurance is used to reduce Required Capital (i.e. NRC after diversification). 37M reduction is enough** to restore the 54% BCAR ratio, **this is only 20% of the capital lost**. And the higher the BCAR ratio, the more efficient reinsurance is

183M Capital Raise through Equity/Debt



Note: Assumes funds from Capital Raise added back to same investments pre-crisis; NRC same pre-/post-crisis.

37M NRC Reduction through Reinsurance



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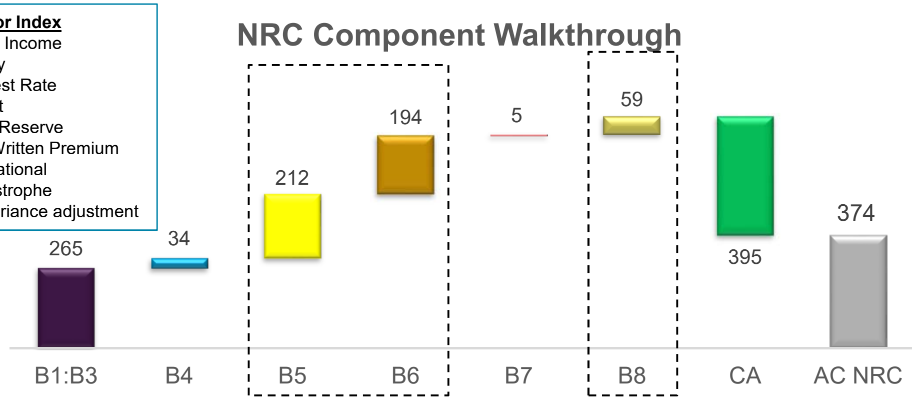
What Reinsurance Structures will Provide Most Capital Benefit?

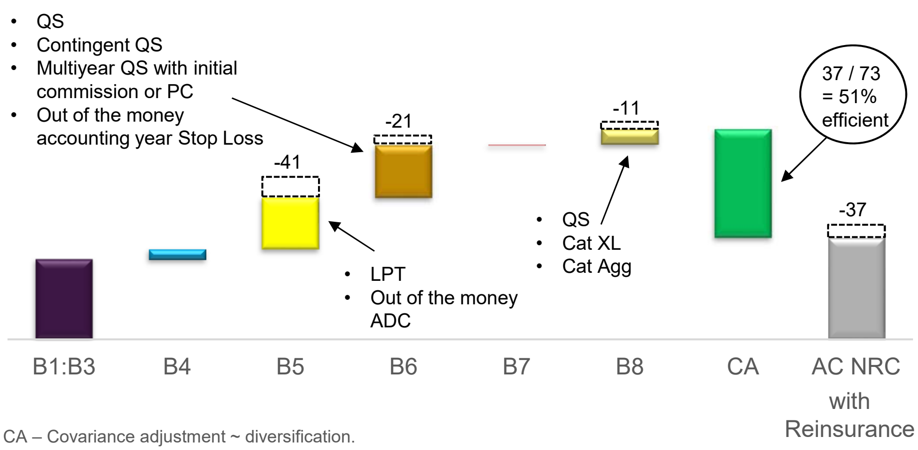
Risk Factor Index
B1 – Fixed Income
B2 – Equity
B3 – Interest Rate
B4 – Credit
B5 – Loss Reserve
B6 – Net Written Premium
B7 – Operational
B8 – Catastrophe
CA – Covariance adjustment



CA – Covariance adjustment ~ diversification.

- NRC is the sum of asset risk components (B1:B3), credit risk (B4), U/W risk components (B5, B6, B8) and operational risk (B7), with covariance / diversification
- **Reinsurance can address three components of UW risk:** Premium Risk (B6, loss ratio variability), Cat Risk (B8) and Reserve Risk (B5, insufficiency of reserves)
- Depending on the company, we will deal with Premium risk, Cat risk and Reserve risk or a combination of the three to get to the target 37M NRC reduction

Reinsurance Acronyms
QS – Quota Share
XL – Excess of loss
Agg / ASL – Aggregate / Aggregate stop loss
LPT – Loss portfolio transfer
ADC – Adverse development cover



CA – Covariance adjustment ~ diversification.
Note: For simplicity, does not take into account slight expected increase in B4 – Credit Risk.

What reinsurance structure?

- Premium Risk: various forms of QS, and for companies with internal models, out of the money stop loss
- Cat risk: classic solutions, QS, Cat XL or Agg cover
- Reserve risk: cession of a portion of the reserves (LPT), or out of the money Adverse Development Cover (ADC) for companies with internal model

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Contact Information

Sherman Power, CFA
Senior Managing Director
+1.312.381.5572
sherman.power@aon.com

Dustin Loeffler, FCAS
Managing Director
+1.312.381.5223
dustin.loeffler@aon.com