Actuaries Institute

LIWMPC Risk Margins Task Force

COVID-19 survey

May 2020

Introduction

- COVID-19 was declared a global pandemic by the World Health Organisation on 11 March 2020.
- Since this time, there has been increased market volatility and it is expected there will be deterioration in morbidity and mortality claims experience for life insurers.
- This presentation summarises the results of the Actuaries Institute's COVID-19 survey of life insurance entities. The survey was performed in April 2020 with 20 companies participating.
- The survey questions related to the implications of COVID-19 on Best Estimate Assumptions, Insurance Risk Margins and asset valuations.

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Survey Participants

- AIA
- Allianz Life
- AMP Life
- Challenger
- Clearview
- CommInsure
- Gen Re
- Hallmark
- Hannover Re
- HCF Life
- Integrity
- Metlife
- MLC
- Munich Re
- NobleOak
- Pacific Life Re
- QInsure
- RGA
- Westpac Life
- Zurich - OnePath

Survey Highlights

- The majority of respondents will treat the impacts of COIVD-19 as an experience item (which reduces Target Capital coverage) and have increased monitoring of claims experience.
- The majority of respondents are not intending to change Best Estimate Assumptions or Insurance Risk Margins at the current time as the impact of COVID-19 is viewed to be highly uncertain. Of the 20 respondents:
  - 7 respondents are changing Best Estimate Assumptions in response to COVID-19. Each of these respondents will strengthen their Disability Income (DI) / Group Salary Continuance (GSC) termination rates.
  - 6 respondents are changing Insurance Risk Margins in response to COVID-19. Half of these respondents will review their 'random stress' assumptions.
- The potential adverse impact to DI / GSC claims experience has been highlighted as a key concern by many – likely due to the expected contraction of the Australian economy.
- Respondents considered socio-economic factors as most relevant when considering the potential impacts of COVID-19.
- The majority of respondents agreed there should be an allowance for an illiquidity premium when determining the Disabled Lives Reserves (DLR) and/or Group Life Incurred But Not Reported (IBNR) reserves.
- The majority of respondents indicated that they did not experience any asset valuation issues during the recent COVID-19 market volatility.

Survey Questionnaire and Summarised Responses

Question 1: Assumptions

Q1A (i) Are you planning to change any Best Estimate Assumptions for Policy Liabilities given knowledge of COVID-19 to date?

20 respondents

7 out of 20 respondents are planning to change Best Estimate Assumptions in light of COVID-19.

Most other respondents indicated that they were not planning to change Best Estimate Assumptions at the current time, but are monitoring emerging experience closely.

Q1A (ii) If you are planning to change Best Estimate Assumptions, which assumptions are you intending to change?

7 respondents

	Respondent 1	Respondent 2	Respondent 3	Respondent 4	Respondent 5	Respondent 6	Respondent 7
GSC/IP Termination	✓	✓	✓	✓	✓	✓	✓
GSC/IP Incidence	×	✓	✓	✓	✓	✓	✓
Mortality	×	✓	×	✓	×	✓	✓
TPD	×	×	✓	×	✓	✓	✓
Lapses	×	×	×	✓	×	✓	×

Of the 7 respondents planning to change Best Estimate Assumptions, all respondents intend to change their GSC / DI termination rates at a minimum. In addition, most of these respondents intend to change their GSC and / or DI incidence rates. These changes are likely driven by the expected contraction of the economy leading to reduced opportunities to facilitate return to work (RTW) and an expected increase in stress and mental health related claims.

Question 1: Assumptions

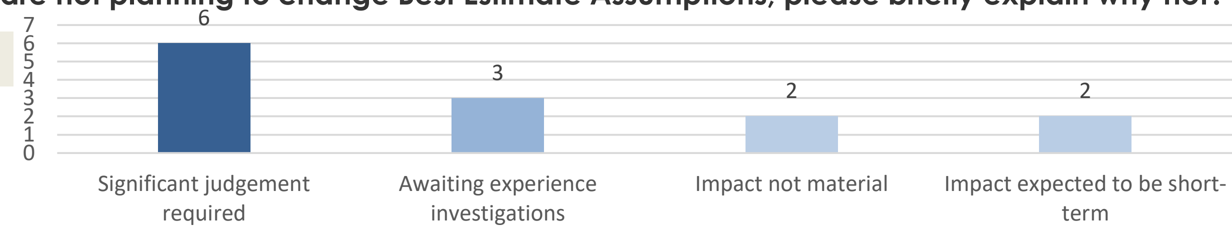
Q1A (iii) If you are planning to change Best Estimate Assumptions, are you considering a change that applies for a short period or a long term change?

7 respondents

Of the respondents planning to change their Best Estimate Assumptions, 5 respondents will apply a short-term overlay to Best Estimate Assumption, while 2 respondents will apply a long-term change for GSC and/or DI terminations and short-term changes for all other assumptions.

Q1A (iv) If you are not planning to change Best Estimate Assumptions, please briefly explain why not?

13 respondents



Of the 13 respondents who are not changing assumptions, most respondents were of the view that the expected impact of COVID-19 on experience remains highly uncertain and a significant amount of judgement would be required to change assumptions. These respondents have increased monitoring and have a preference to review assumptions as COVID-19 experience emerges.

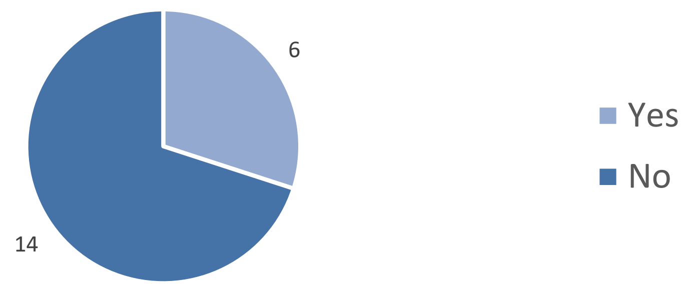
Q1A (v) If you are not planning to change Best Estimate Assumptions at the current time, please explain what (if any) additional monitoring of experience you intend to perform?

The respondents who are not planning to change Best Estimate Assumptions indicated they have increased monitoring of claims experience. For entities that are part of a group, this included monitoring of claims experience for other entities within the group.

Question 2: Insurance Risk margins

Q2A (i) Are you considering changing any Insurance Risk Margins in your PCA calculation in light of COVID-19?

20 respondents



70% of respondents indicated that they are not currently considering a change to the Prescribed Capital Amount (PCA) Insurance Risk Margins. Most respondents indicated they intend to wait until COVID-19 experience emerges and then review the Insurance Risk Margins alongside the Best Estimate Assumptions.

Q2A (ii) If you are planning to change Insurance Risk Margins, which Insurance Risk Margins are you proposing to change?

6 respondents

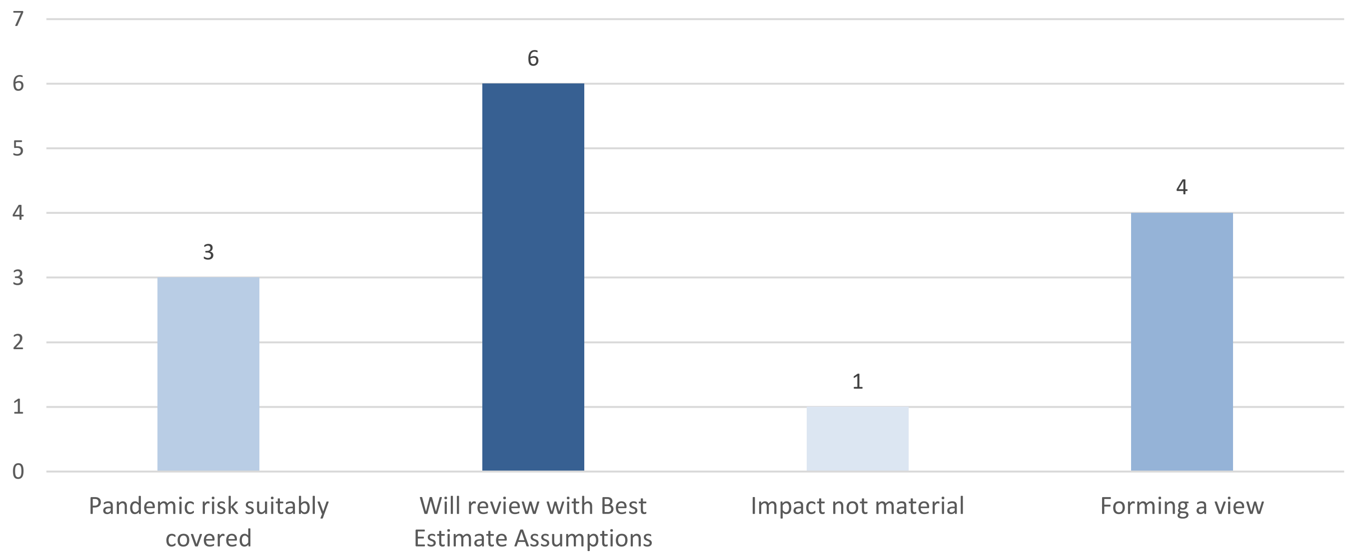
	Respondent 1	Respondent 2	Respondent 3	Respondent 4	Respondent 5	Respondent 6
Event	✗	✓	✗	Under review	✗	✗
Future	✓	✓	✗	Under review	✗	✗
Random	✗	✗	✓	Under review	✓	✓

Of the 6 respondents who are planning to change Insurance Risk Margins, there was a broad range of responses relating to the specific margins that will be updated. Half of these respondents are intending to update the Random Risk Margin given an expected adverse fluctuations in claims experience over the next 12 months. One respondent is reviewing the appropriateness of the APRA prescribed event stress in light of COVID-19.

Question 2: Insurance Risk margins

Q2A (iii) If you are not planning to change Insurance Risk Margins, please briefly explain why not?

14 respondents

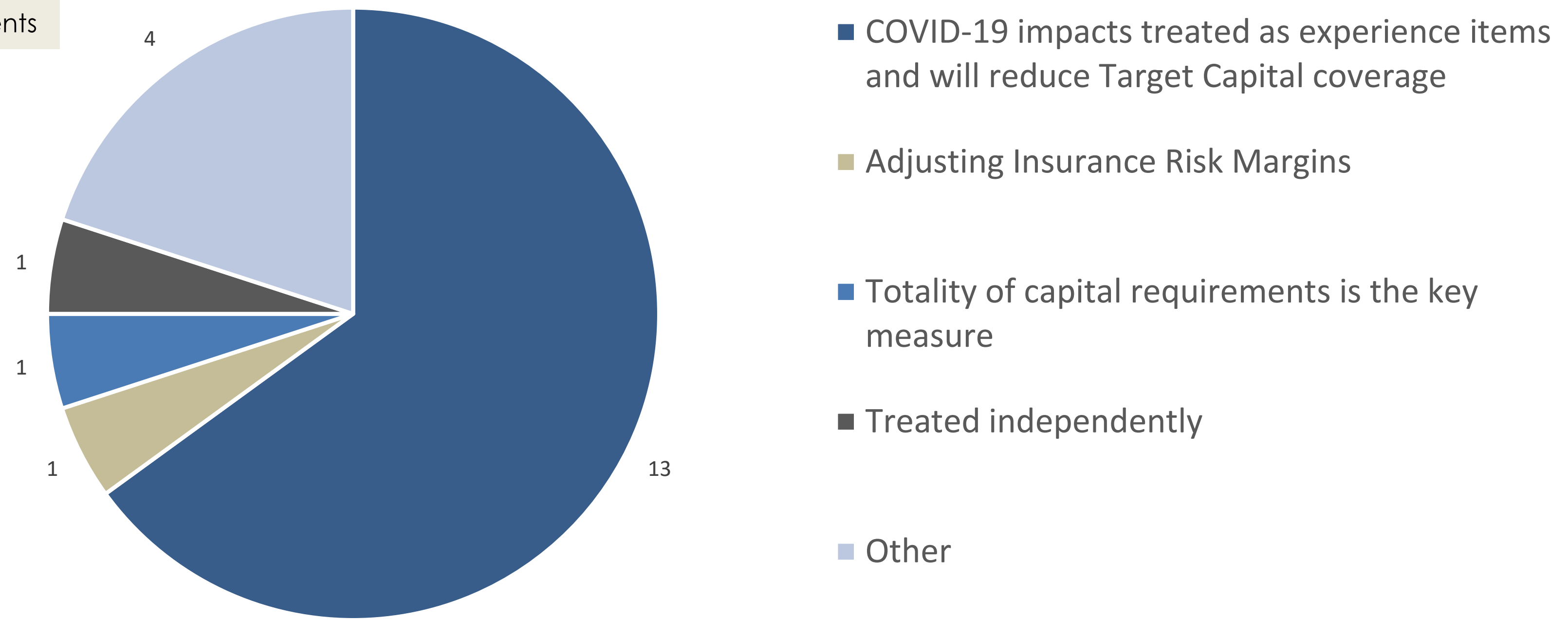


- 43% respondents indicated they will consider changes to the Insurance Risk Margins at a later time together with any changes to Best Estimate Assumptions.
- 29% of respondents indicated they are in the process of forming a view. They intended to continue to monitor COVID-19 experience and will consider the appropriateness of the Insurance Risk Margins at a later time.
- 21% indicated that they believed the APRA Life Prudential Standard 115 'Event stress' appropriately captured the risks associated with the COVID-19 pandemic.

Question 2: Insurance Risk margins

Q2B (i) How are you considering the relationship between your Best Estimate Assumptions / Policy Liability reserves and Insurance Risk Margins / Target Capital?

20 respondents

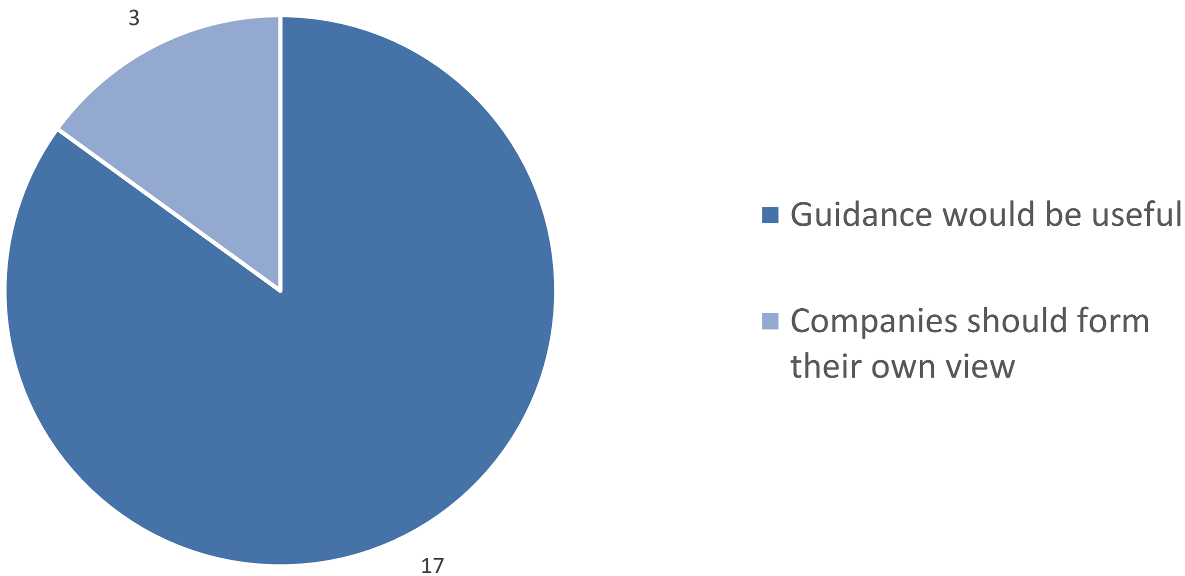


Most respondents indicated they are anticipating treating COVID-19 and its associated insurance impacts as an experience item which will reduce Target Capital coverage ratios. For small life insurance entities where the $10 million minimum capital requirement applies, COVID-19 will not have an impact on the capital requirement. However, adverse experience will reduce capital coverage ratios.

Question 3: Additional guidance

Q3A (i) Would additional guidance from the Actuaries Institute on setting Risk Margins be useful in the current COVID-19 environment or should companies be left to form their own views?

20 respondents



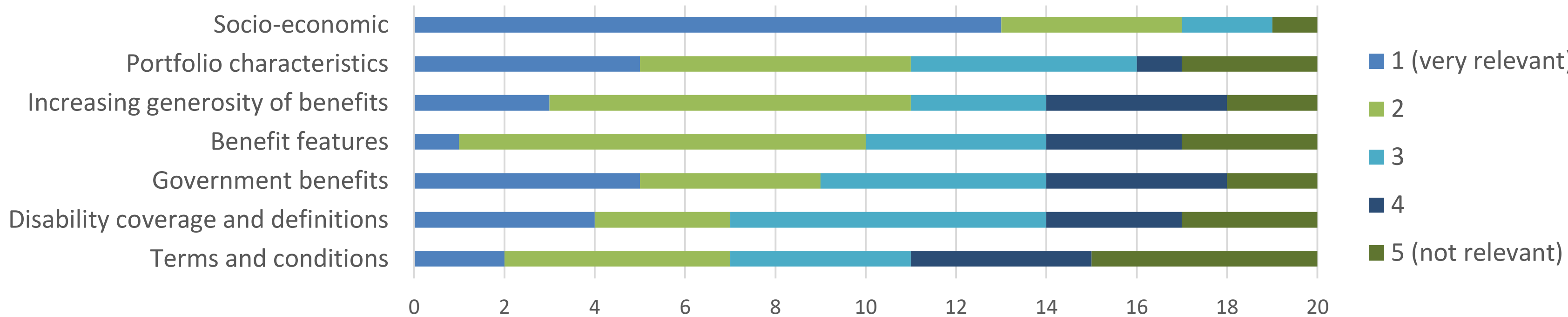
Most respondents indicated that guidance from the Actuaries Institute on setting Insurance Risk Margins in the current COVID-19 environment would be useful. Some key areas in which guidance was requested were:

- Key considerations when reviewing and setting Risk Margins in the current COVID-19 environment.
- The treatment and interaction of Insurance Risk Margins with Best Estimate Assumptions.

Question 4: Relevant factors

Q4A (i) What factors do you consider most relevant in determining the impact of COVID-19?

20 respondents



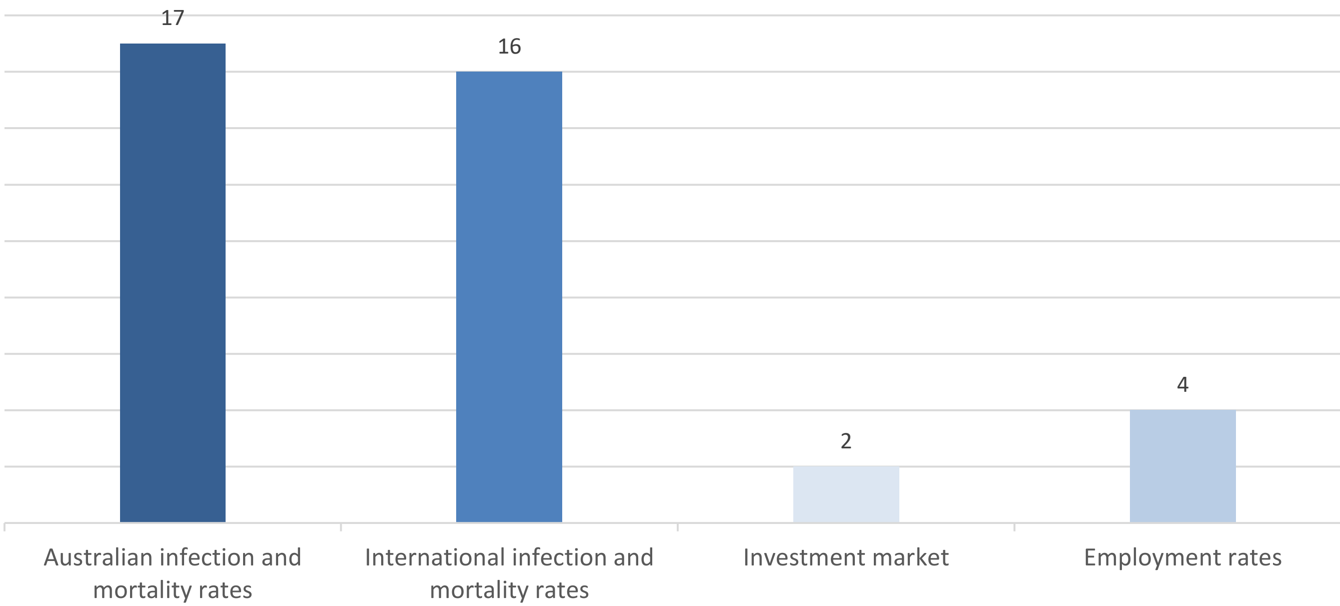
From the information provided by respondents:

- **Socio-economic impacts on the portfolio:** Respondents indicated this factor is most relevant when determining how DI / GSC termination and incidence rates will be impacted. Respondents who rated this factor as low importance have little to no exposure to DI and / or GSC claims.
- **Portfolio characteristics:** Respondents indicated this factor was less relevant than socio-economic impacts as their portfolios are less exposed to older policyholders (who have higher fatality rates).
- **Generosity of benefits:** Some respondents noted the impact of reduced incomes on the generosity of replacement ratios and benefits during COVID-19. The relatively higher replacement ratio may represent an incentive to claim or a disincentive to return to work.
- **Benefit features:** Respondents noted policies with longer waiting periods will experience less adverse claims experience as customers are more likely to recover during the waiting period. In addition, some respondents noted the need to review how government support packages will be factored into the assessment of income.
- **Ability to offset government benefits:** Most respondents indicated they intend to offset payments to claimants with the Job Keeper benefit, as not doing so would lead to high replacement ratios and represent a disincentive to RTW. One respondent stated that they will not include offsets for government benefits so as to give the best outcome for customers.
- **Disability definitions and coverage definitions:** Respondents considered this less relevant than the items above. However, a number of respondents noted the impact of changed working conditions on the ability to claim (e.g. working fewer hours or working in different roles). Respondents raised some concern over the expected increase in mental health related claims reported post COVID-19.
- **Terms and conditions:** While respondents consider this factor less relevant, they noted terms and conditions may impact the ability to reduce benefits or accept claims. Some respondents noted existing pandemic exclusions may be difficult to enforce. Some respondents noted it may be difficult to achieve optimal member outcomes given the implications of unpaid leave on the ability to claim for GSC benefits.
- **Other relevant factors:** One respondent highlighted a relevant factor was the of loss of membership due to the provisions for early drawdown of superannuation balances of up to $20k, particularly in light of the Putting Members Interests First legislation. Another respondent noted the duration of COVID-19 as a relevant factor.

Question 5: Data

Q5A (i) What are the key pieces of data (including local and overseas population metrics) you are collecting to assess the impacts of COVID-19?

20 respondents



Most respondents are collecting data on the COVID-19 in Australia and overseas. This includes information on infection rates, hospitalisation rates, mortality rates and recovery rates. Most respondents are using Australian Government sources for Australian statistics and World-o-meters and Johns Hopkins for international infection and mortality rates.

Employment rates from the ABS are also being monitored by several participants.

A small proportion of participants also indicated they were tracking information on the investment market, including bond yields, credit spreads and the economic outlook. The respondents were using Treasury, RBA and Bloomberg to source this information.

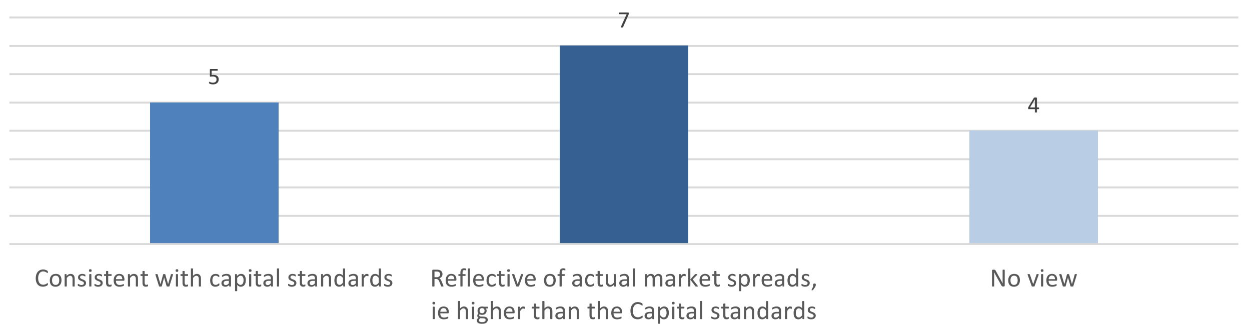
Question 6: Illiquidity premium

Q6A (i) In your view, should the allowance for illiquidity premium in the calculation of the PCA be expanded to cover additional liabilities such as Disabled Lives Reserves (DLR) and/or Group Life Incurred But Not Reported (IBNR) reserves?

20 respondents

Q6A (ii) If so, what is your view on how large this illiquidity premium should be?

16 respondents



Most respondents indicated there should be an allowance for the illiquidity premium in the calculation of the DLR and IBNR reserves.

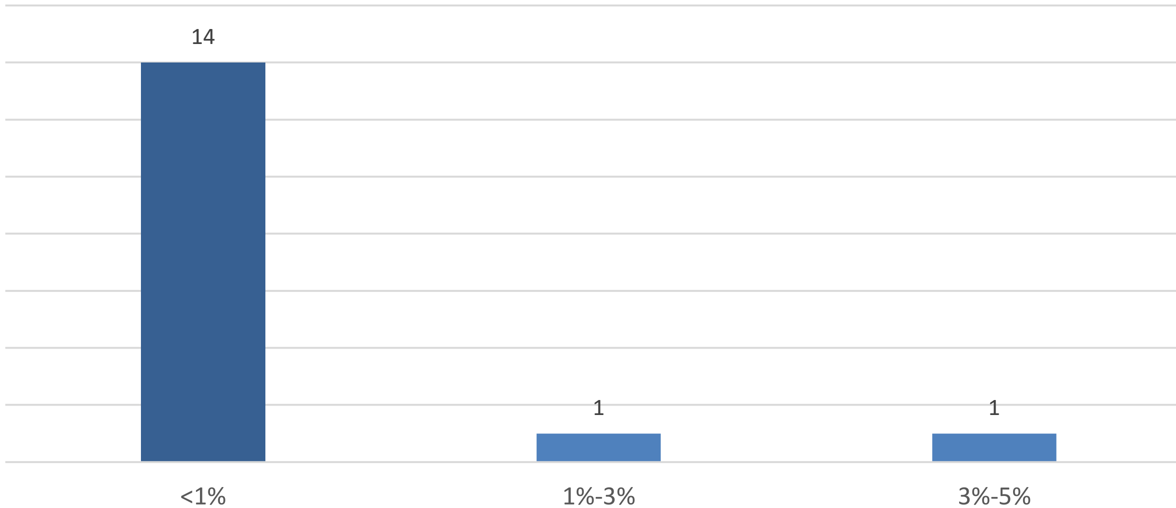
5 participants indicated that the illiquidity premium should be consistent with APRA's capital standards (i.e. 33% of the A 3 year spread up to duration 10 or 20 basis points from duration 10 onwards in line with Life Prudential Standard 112 (LPS 112)). As at 31 December 2019 the prescribed illiquidity premium was 25 basis points up to duration 10.

7 participants indicated that the illiquidity premium should be reflective of actual market spreads or reflective of the yield of the underlying assets backing the liabilities.

Question 7: Impact of DLR reduction

Q7A (ii) How much would your company's DLR reduce by if an illiquidity premium of 10 basis points was introduced (based on your latest available figures or a reasonable estimate)?

16 respondents

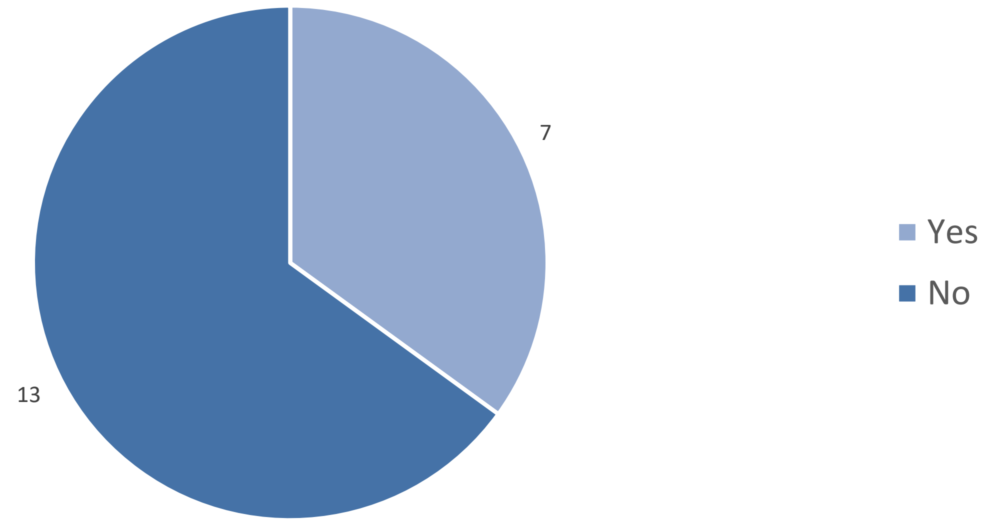


Most respondents estimated that the inclusion of a 10 basis point illiquidity premium would reduce their Disabled Lives Reserve (DLR) by less than 1%. In aggregate, across the 16 respondents, this would represent a $70.7m reduction to the total DLR of $8,837m net of reinsurance. This represents a 0.80% reduction overall.

Question 8: Asset Valuation issues

Q8A (i) Is your company experiencing any asset valuation issues in light of the current market volatility?

20 respondents



Most respondents indicated that they did not experience any asset valuation issues during the recent COVID-19 market volatility. For these respondents, many indicated they were monitoring their assets, particularly corporate bond portfolios closely.

Some respondents noted difficulties with the valuation of assets, in particular the revaluation of illiquid issues. Other respondents noted capital management challenges driven by a devaluation of equities and fluctuations in bond yields.

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