

Resilient For Now:

A second wave could eat into insurers' capital

Dennis Sugrue

Senior Director, Sector Lead
Insurance Ratings

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S&P Global
Ratings

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Key Takeaways

- Global insurance ratings have proven resilient during the first wave of the COVID-19 pandemic as **capital strength** helped stave off widespread downgrades.
- Capital buffers will be eroded through the second half of the year as **financial market losses and insurance claims pile up**, particularly for industrial lines re/insurers.
- **Asset risk** outweighs insurance risk, particularly for life insurers and those with thin capital buffers.
- While not our base case, a **prolonged economic recovery** resulting in a more severe or prolonged **financial market dislocation** would put a strain on capital and earnings, increasing the risk of downgrades.

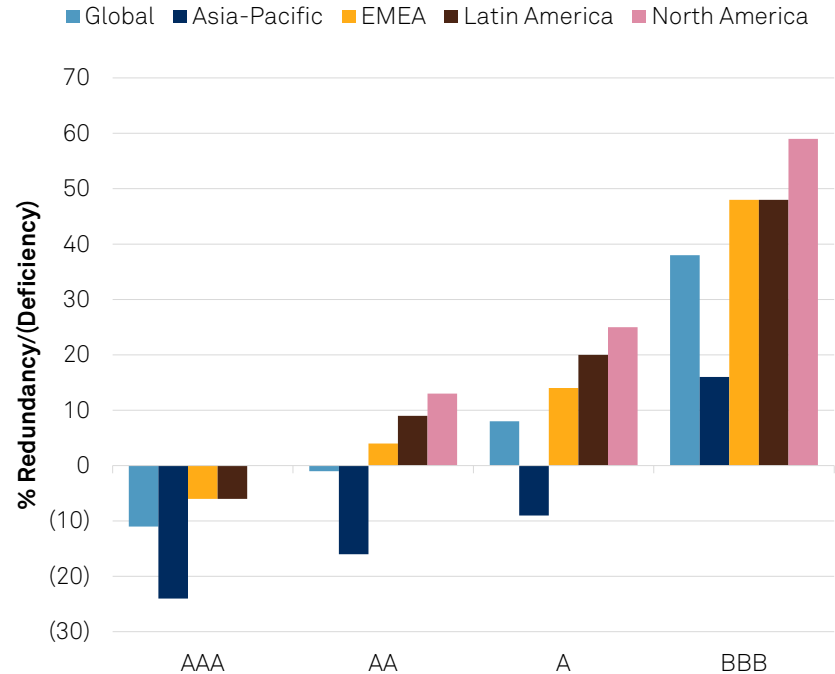
Rating Factors

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Ratings

Capital Adequacy | A Key Rating Strength

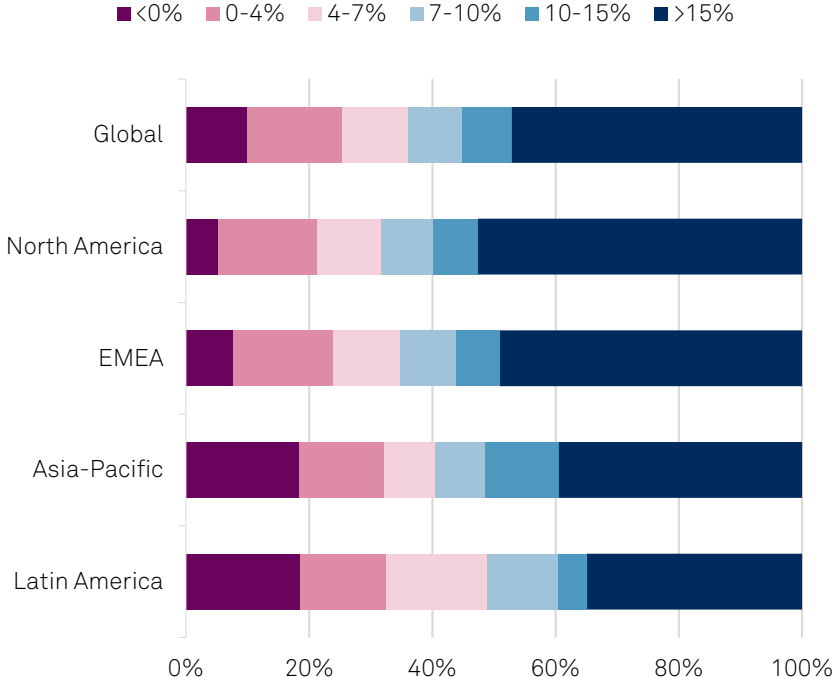
Capital buffers at most insurers are healthy enough to support ratings, but those in North America and EMEA are larger.

Strong Capital Position In Most Regions



Note: Aggregate Redundancy/(Deficiency) relative to confidence levels in S&P Risk Based Capital Model. Source: S&P Global Ratings.

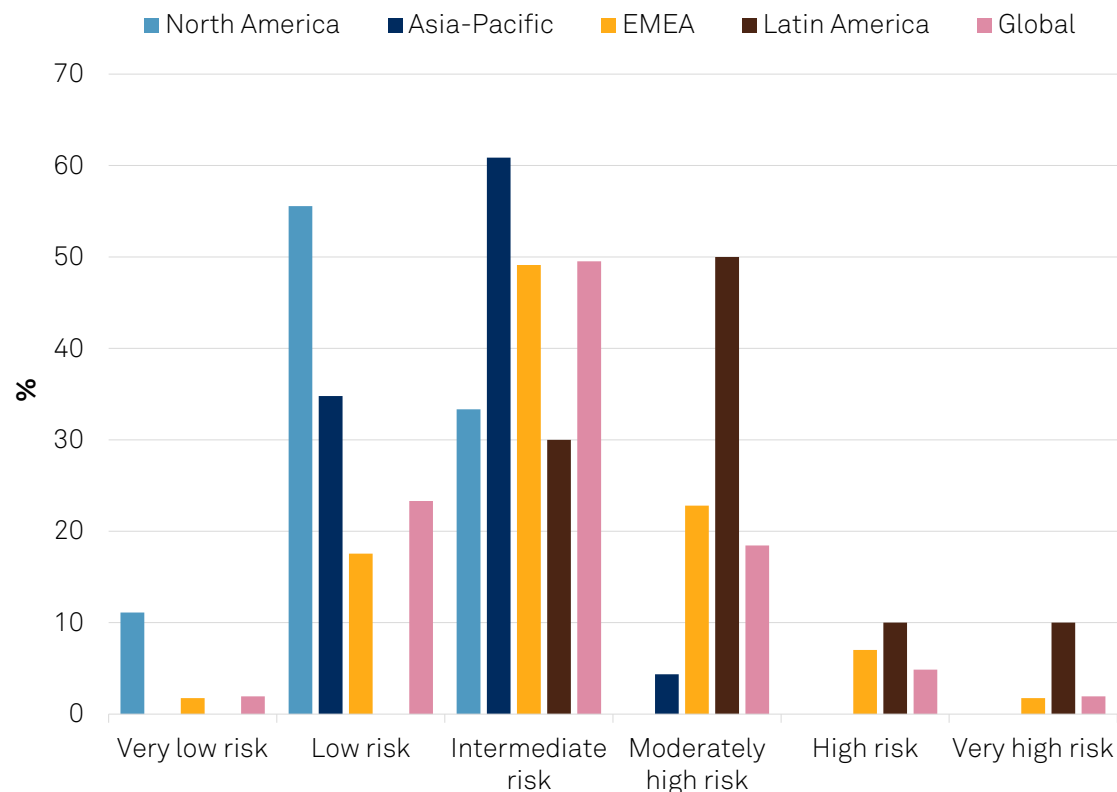
Nearly Two-Thirds Of Insurers Have A Capital Buffer >7%



Note: Buffers are relative to capital score. Source: S&P Global Ratings.

Industry And Country Risk | Stable, Despite Recent Turmoil

S&P Global Ratings Insurance Industry And Country Risk Assessment (IICRA) Distribution



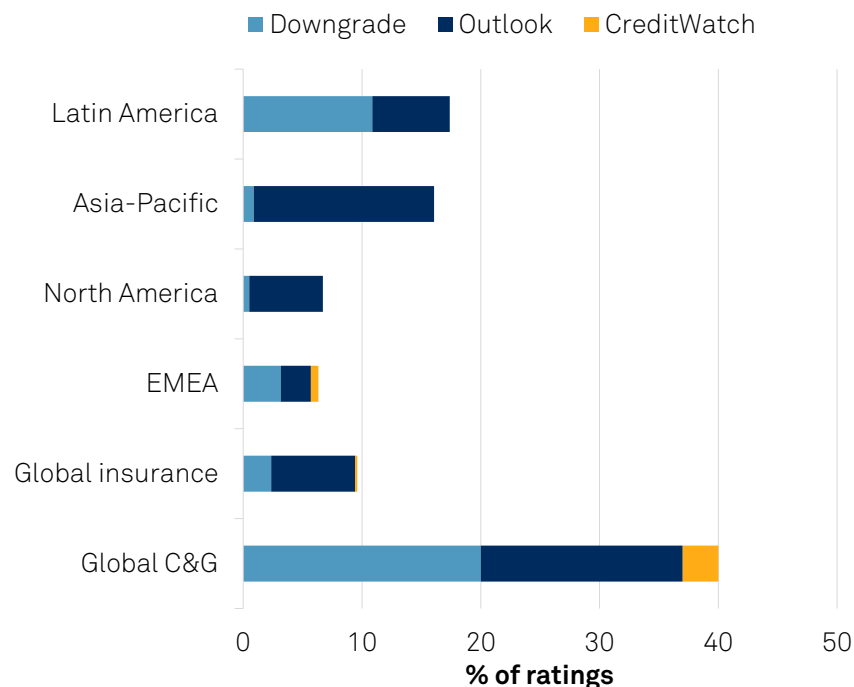
- Growth expectations for 2020 have diminished in line with both consumers' disposable income and insured values.
- Lower investment returns, mark-to-market losses, and heightened claims will erode earnings in 2020.
- For many sectors, we expect top lines and earnings to recover during 2021-2022.
- So far in 2020, we have revised downward two IICRAs. About 75% of sectors carry an IICRA of intermediate risk or better.

The latest details of our IICRAs can be found in "[Insurance Industry And Country Risk Assessment Update: May 2020](#)," published May 7, 2020.

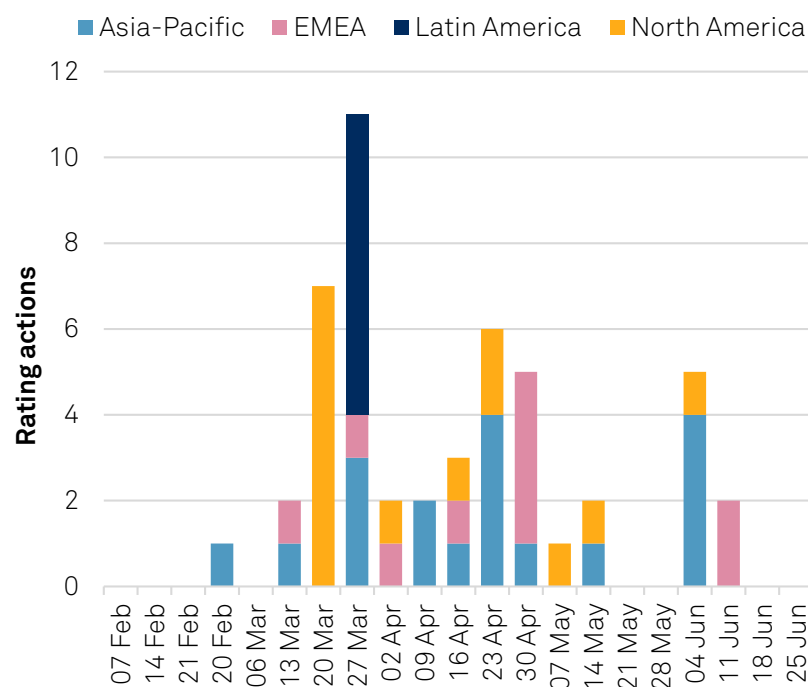
COVID-19 And Oil Price-Related Global Insurance Rating Actions

- Rating actions taken on 9% of global insurers, compared with 40% across all sectors.
- Pace of rating activity has slowed, but potential for further activity as Q2 and Q3 results are reported.

Regional variation in rating impact



Rating activity peaked in March



Note: Data as of June 30, 2020. Only includes rating actions on the issuer credit ratings on the main operating entity within a group. C&G--Corporates and governments. Source: S&P Global Ratings.

COVID-19 And Oil Price-Related Global Insurance Rating Actions



Rating actions on **sovereigns**, either as a result of **weaker economic outlooks** amid the COVID-19 pandemic, or **lower oil prices** squeezing government finances, have driven **38% of total insurance rating actions**, and **83% of insurance downgrades**.



Underperformance/weaker profitability, coupled with **volatility in financial markets**, results in **weaker capital (38%)**.



Potential increase in **mortgage delinquencies** will result in **higher credit losses** for mortgage insurers in North America and Australia **(15%)**.



Pressure on competitive position and premium volumes amid contraction in new business resulting from COVID-19 **(7%)**.



Termination of acquisition deal eliminates rating upside **(2%)**.

Note: Data as of June 30, 2020. Rating actions include downgrades, outlook changes and CreditWatch placements.

Key Risks

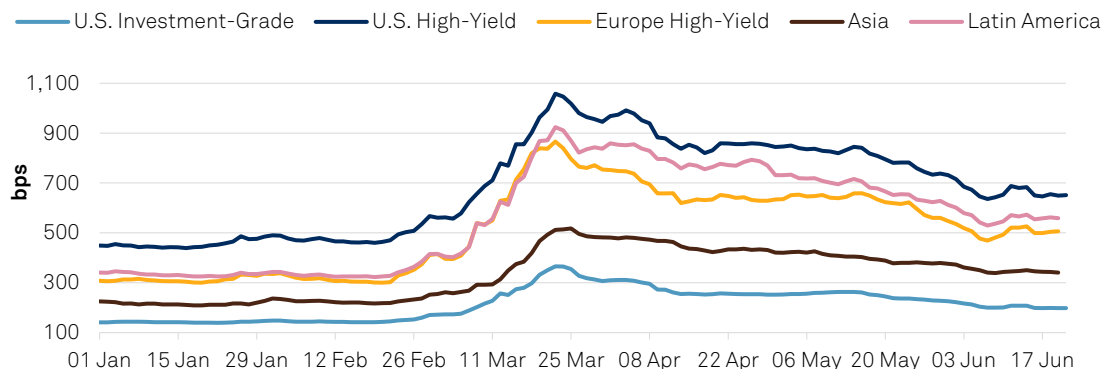
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Key Risks | Asset Risk Still Top, But Claims Rising

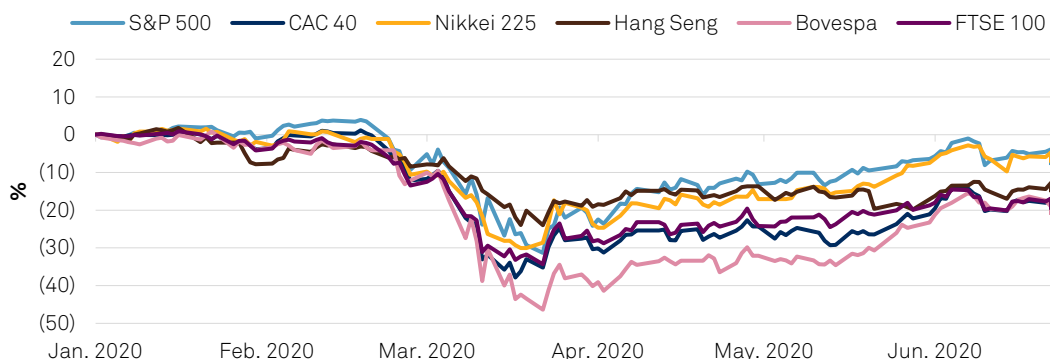
Risk Factor	Descriptor	Risk Trend	What could change?	Asia-Pacific	EMEA	North America	Latin America
Asset risk	Loss of value of insurers' invested assets as a result of financial market volatility, including equity market moves and spread movements, or rating migrations.	Unchanged	New outbreaks that prolong measures such as lockdown, or an ineffective policy response, could increase market volatility and trigger more downgrades in the corporate, bank, and sovereign sectors.	Elevated	Elevated	Elevated	Elevated
Insurance claims	Insured losses associated with the pandemic and economic disruption. Business interruption (BI), event cancellation, travel, credit & surety, and mortgage lines are most exposed. Excess mortality is the key risk for life insurers.	Slightly increasing	Although BI losses could rise if insurers face legal action, we see retroactive legislative or regulatory changes as unlikely. The pandemic could also increase D&O or professional liability claims. Excess mortality due to COVID-19 and other preventable deaths could erode life insurers' capital positions.	Moderate	Moderate	Moderate	Moderate
Insurance top line	Lockdowns will hit the top line in 2020. Recession could have longer-term implications for demand, particularly on discretionary lines.	Increasing	If the economic recovery were disrupted or long lockdowns returned, insurers' top lines in 2020 and 2021 would face more-significant and longer-term consequences.	Moderate	Moderate	Moderate	Elevated
Financing conditions	Financial market volatility and investor uncertainty makes it difficult to issue new instruments.	Improving	Financial market disruptions that hit liquidity and significant widening of issuance spreads could hinder market access for new issuance or make refinancing difficult for insurers.	Low	Low	Low	Low
Hybrid ratings	Volatility in regulatory solvency ratios could heighten deferral risk.	Unchanged	If financial markets do not recover, solvency deterioration could crystalize. From Q2 onward, an increase in downgrades and claims could force the realization of impairments and mounting losses.	Low	Moderate	Low	Low
Sovereign risk	Weakening credit quality of sovereigns could constrain insurers' ratings and make operating conditions tougher.	Increasing	Sovereign creditworthiness could weaken if ineffective policy responses eat into tax revenue, making debt service more difficult. Sovereign downgrades could weaken capital positions or trigger rating actions for exposed insurers.	Moderate	Moderate	Low	Elevated

Asset Devaluation | Capital Buffers Will Erode

Secondary Market Spreads (bps)



Global Equity Markets YTD (% Change)

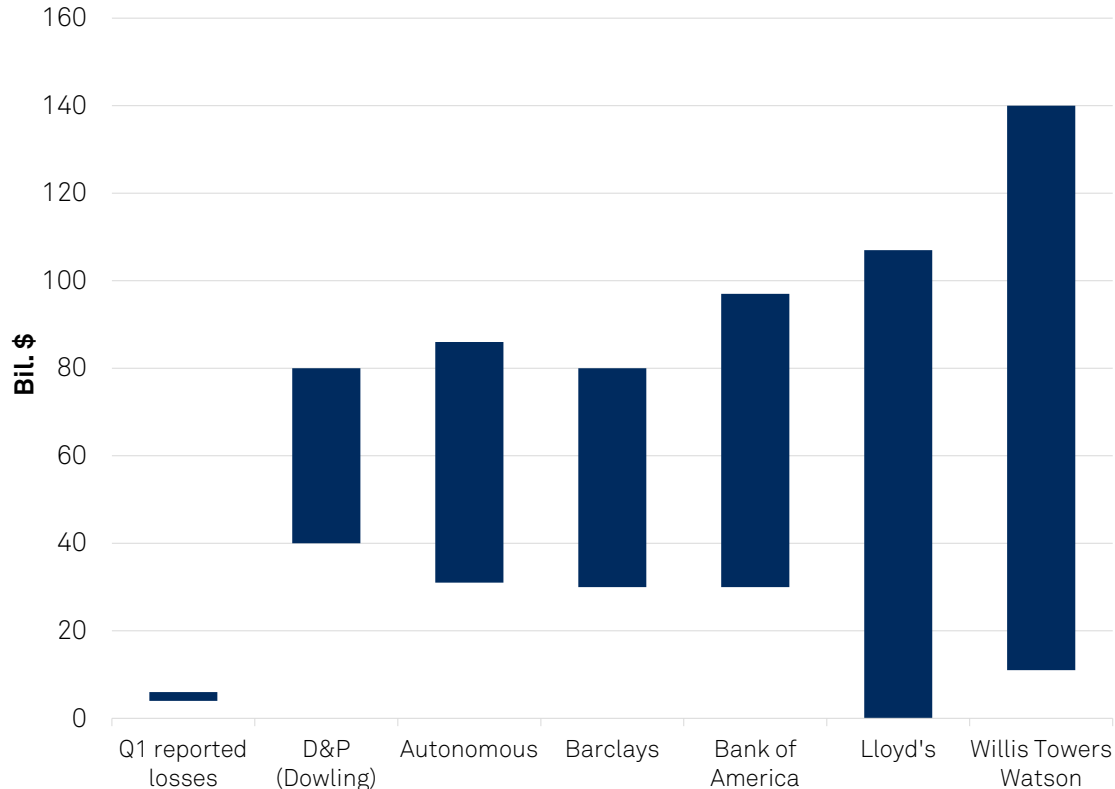


bps--Basis points. Source: S&P Global Ratings.

- Asset value declines will **eat into capital buffers** for many companies, which could lead to rating changes.
- **Rating migrations and heightened default rates** will exacerbate the erosion of capital through loss of value and higher charges.
- Corporate speculative grade defaults forecast to increase to **8.5% in EMEA, 12.5% in the U.S.**
- More **fallen angels**. We estimate **\$640 billion** of debt will fall to speculative grade from investment grade in 2020.
- However, **strong asset quality** should help to insulate most insurers from rating migration.

Insured Losses | Growing, But Manageable

Market Observes Wide Range Of Estimated Losses

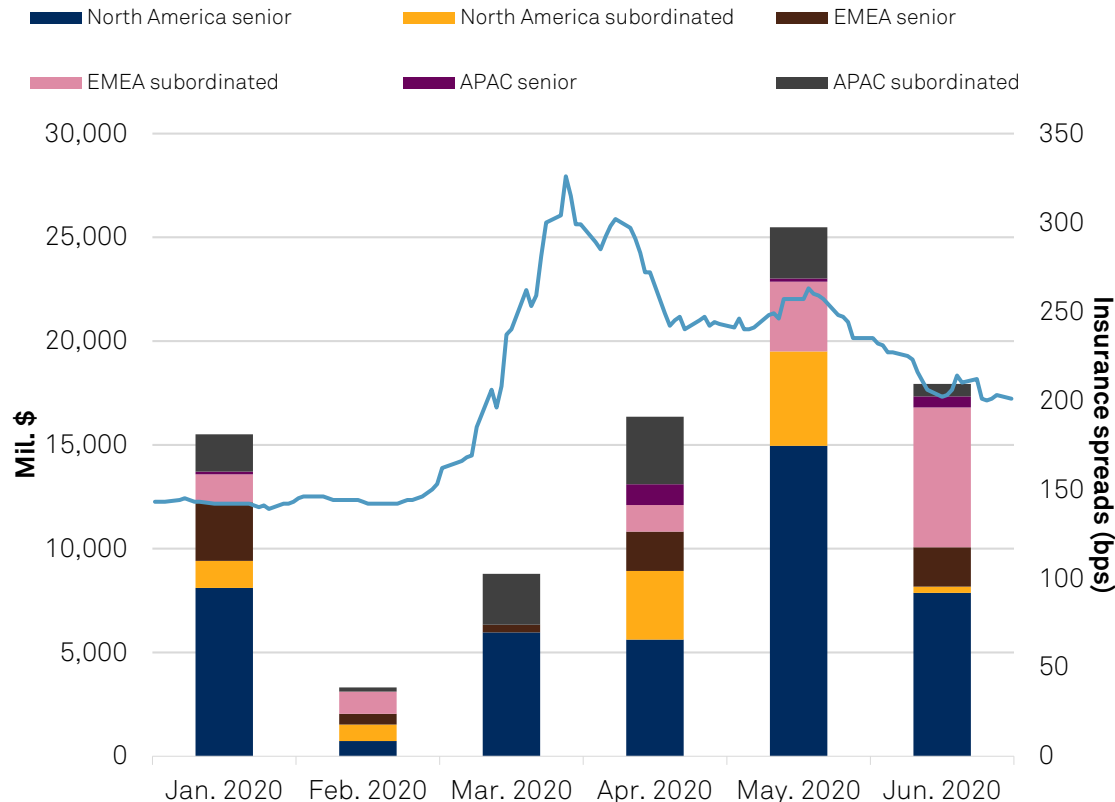


- Market observers estimate that insured losses from COVID-19 could be up to **\$140 billion**.
- The bulk of the losses will come from **commercial non-life business**, particularly event insurance, business interruption, and entertainment.
- Claims in **life insurance should be less onerous**.
- We expect the bulk of claims to be reported in **Q2 and Q3**.
- Losses could escalate if conditions worsen beyond our base-case recovery scenario.

Source: S&P Global Ratings, Artemis, HSBC, VJ Dowling, Autonomous, Barclays, Bank of America, Lloyd's and Willis Towers Watson. Lloyd's point estimate is \$107 billion.

Financing Conditions | Insurers Have Retained Access

Insurance Debt Issuance Has Resumed As Spreads Have Tightened



bps--Basis points. Source: S&P Global Ratings.

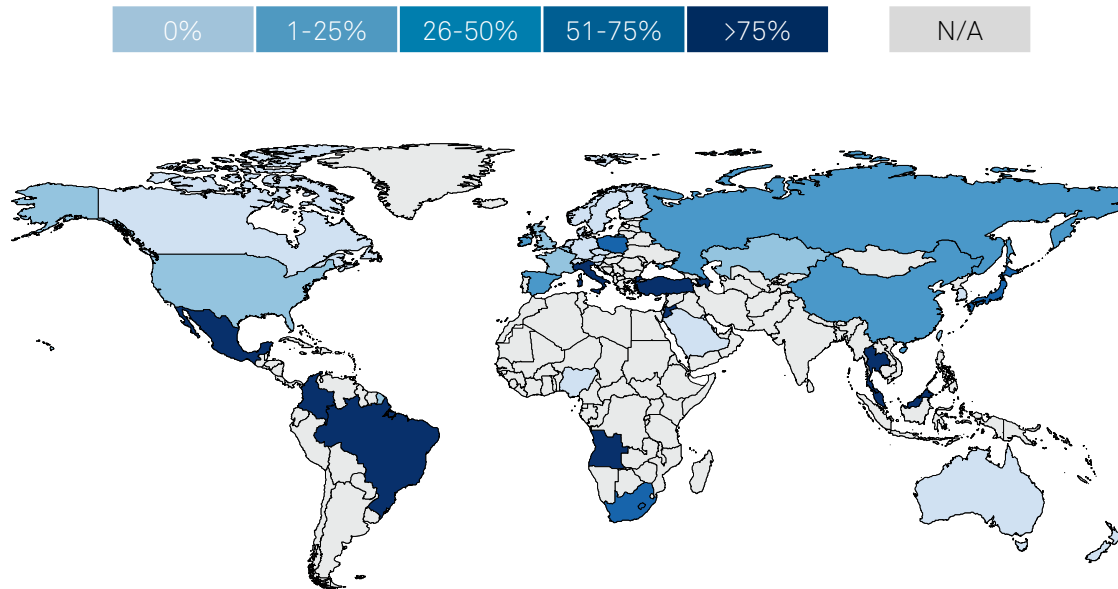
- Despite a dip in issuance in February and March, insurers retained access to debt markets.
- Insurance spreads have tightened since a peak in March.
- We observe strong demand for insurance debt, with most deals significantly oversubscribed.
- Issuance coupons have been favourable relative to maturing or callable debt, despite spread widening, as lower rates have partially compensated.
- Refinancing needs for the remainder of 2020 are manageable and we expect insurers to retain access.

Hybrids | Solvency Sensitivity Is A Rating Risk

- Market volatility is leading to swings in regulatory solvency ratios for insurers, with an **average drop of 20%** in Europe in Q1.
- **Further declines are expected in Q2** as the impact of insurance claims and rating downgrades on invested assets start to flow through.
- This may not put ratings on issuers under pressure, but it could **heighten deferral risk for hybrid investors**, and thus call into question whether wider notching between the issuer credit rating (ICR) and the issue rating is warranted for hybrids that have mandatory deferral triggers.
- This risk is most prevalent in markets such as **Europe and Bermuda**, where mandatory coupon deferrals can be triggered by breaches of going-concern capital levels.
- We may determine that the increase in payment risk to the hybrid should be reflected by **widening the notching** between the rating on the hybrid and the issuer credit rating.

Sovereigns | Asset Risk and Rating Constraints

Proportion of Insurance Ratings That Could Be Impacted By a Sovereign Rating Change



Note: Some countries have very few ratings, so proportions may look inflated. Source: S&P Global Ratings.

- **83%** of insurance downgrades since March were driven by sovereign rating changes in Mexico, South Africa, and Angola
- Insurers hold **significant asset risk** as investors in sovereign debt, particularly in their home nations
- The ultimate fallout of the global recession on sovereign ratings will depend on the **shape and trajectory of the recovery**, as well as governments' policy responses to the COVID-19-related economic pressures.
- **Wealthy nations should withstand the initial shock**, but any long-term damage to their ability to create wealth could damage creditworthiness.

Sector Outlooks

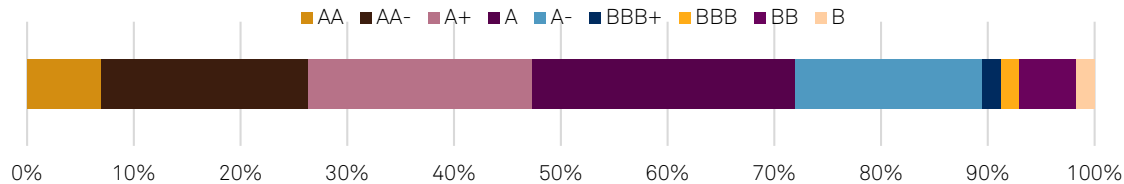
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Sector Outlooks | Stability In Most Regions

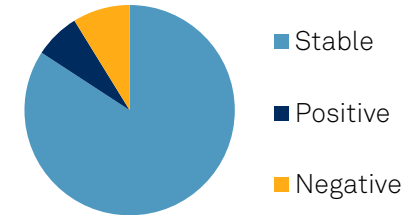
Sector / Region	Current Outlook	Outlook as of 25 March	Rationale
Western European Primary Life	Stable	Stable	Capital buffers and profit-sharing characteristics reduce the impact of volatility and reduced investment margins.
Western European Primary Property/Casualty	Stable	Stable	Healthy technical margins and robust capital positions outweigh potential for limited claims increases and asset volatility.
U.S. Property/Casualty	Stable	Stable	Strong capital and earnings, supported by rate increases, help to absorb limited claims increases and asset volatility.
U.S. Life	Stable	Stable	Robust capital and liquidity, effective hedges, and profit-sharing characteristics reduce the impact of volatility and reduced investment margins.
APAC Primary Life	Negative	Negative	Capital buffers are thinning in the wake of the investment market rout and higher reserving due to lower interest rates. Reinvestment risks heightened by the volatile capital markets.
APAC Property/Casualty	Stable	Stable	Prudent asset allocation, stable underwriting margins, and robust capital adequacy should absorb the impact of higher claims, asset price volatility, and lower discount rates.
Latin America	Negative	Negative	Recessions in the region have weakened credit quality and stressed insurers' operating conditions. That said, adequate underwriting and sound capital and liquidity offer a cushion against the tough conditions.
Global Reinsurers	Negative	Stable	Pandemic-related losses, combined with volatile capital markets and lower investment returns, will likely prevent the global reinsurance sector from meeting our earnings expectations for 2020. The sector has struggled to earn its cost of capital for the past three years, and will not do so this year.

EMEA Life Insurers | Credit Overview

Ratings Distribution



Outlook Distribution



Our sector outlook for the EMEA life insurance sector is stable.

Key rating factors:

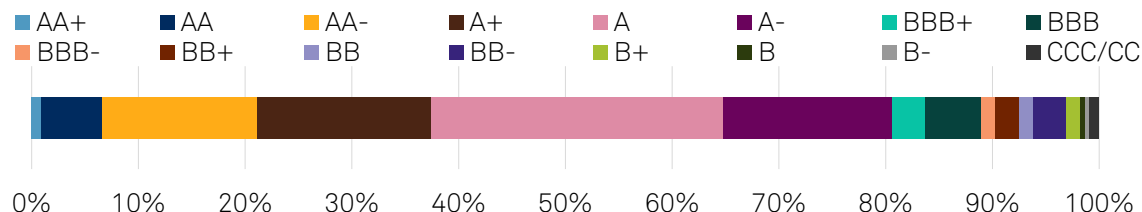
- Material capital buffers.
- Slow, but steady shift to less-risky products with lower capital requirements.
- High-quality asset allocation.

Negative outlook trigger:

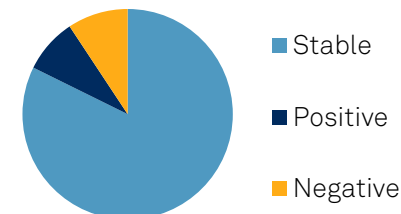
- Low interest rates continue to squeeze investment margins and increase the cost of guarantees.
- Asset impairments hit unrealized investment gains.
- Heightened corporate defaults erode investment results.
- Corporate rating migration increases capital requirements.

EMEA Non-life Insurers | Credit overview

Ratings Distribution



Outlook Distribution



Our sector outlook for the EMEA non-life insurance sector is stable.

Key rating factors:

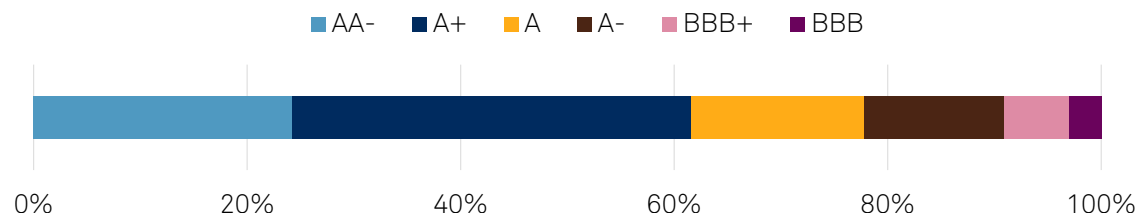
- Ongoing strong technical profitability in many EMEA non-life insurance markets.
- Solid capital adequacy and prudent investment exposures.
- Well-diversified portfolios over products and regions.
- COVID-19-related claims limited to some writers of industrial lines.

Negative outlook trigger:

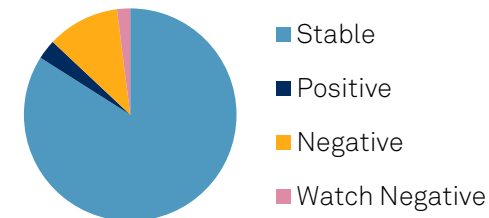
- Capital market volatility cuts into investment income.
- Strong technical profitability might increase willingness to compete on price.
- Expected recession to dampen gross written premium, but lower claims frequency should provide an offset.

APAC Life Insurers | Credit Overview

Ratings Distribution



Outlook Distribution



Our sector outlook for the Asia-Pacific life insurance sector is negative.

Key rating factors:

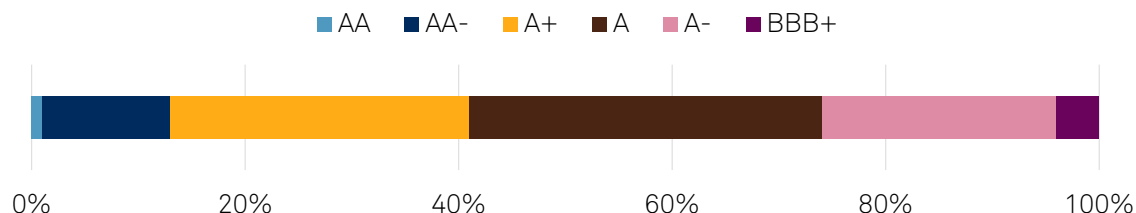
- Capital buffers enable insurers to weather investment market volatility, although these buffers are contracting.
- Lower-for-longer interest rates increase reserve provisions.
- Inherent asset-liability duration mismatch.
- Slower growth momentum amid economic slowdown and social distancing initiatives.

Stable outlook trigger:

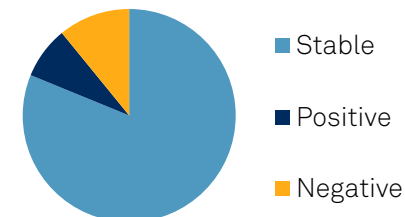
- Our view that the insurers' earnings are improving on a sustainable basis and supporting the restoration of capital buffers.

APAC Non-Life Insurers | Credit Overview

Ratings Distribution



Outlook Distribution



Our sector outlook for the Asia-Pacific non-life insurance sector is stable.

Key rating factors:

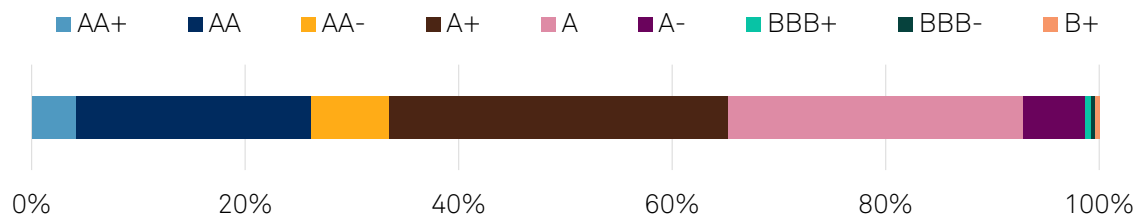
- Strong profitability on the back of sound underwriting and product diversification, despite rising claims in business interruption and medical indemnity, as well as motor lines as traffic volumes increase post-lockdown.
- Robust capital adequacy and prudent investment exposures will help to absorb asset volatility and the need to strengthen reserves due to lower discount rates.
- The pricing environment is challenging for personal lines and small-to-midsize enterprises, but rates continue to harden for large commercial accounts.

Negative outlook trigger:

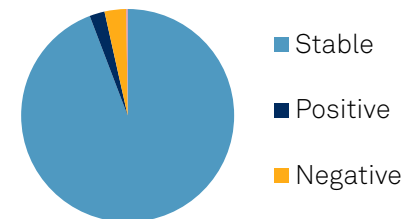
- Weaker macroeconomic outlook will depress growth momentum.
- Capital market volatility will erode investment income.
- Increasing frequency of nonmodeled risk, amid rapid urbanization and changing weather patterns.

U.S. Property/Casualty Insurance | Credit overview

Ratings Distribution



Outlook Distribution



Our sector outlook for the U.S. property/casualty insurance sector is stable.

Key rating factors:

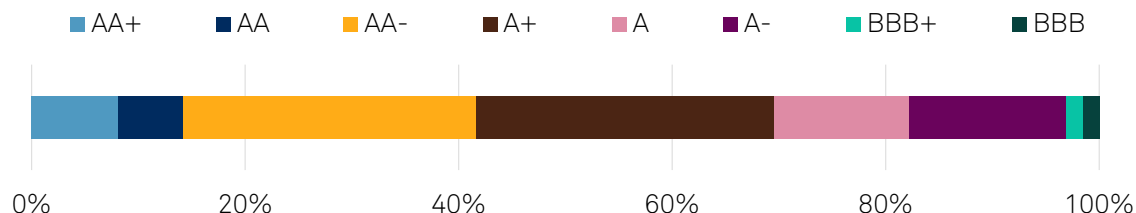
- Capital remains very strong and supportive of the ratings.
- The pricing environment is challenging in personal lines and small-to-midsize enterprises, but rates continue to harden for large commercial accounts.
- COVID-19 insured losses will be a moderate tail event; reported losses are expected to increase.
- The continuation of reserve releases is likely unsustainable.
- Investment portfolios remain relatively unchanged, although the proportion of common stock is meaningful.

Negative outlook trigger:

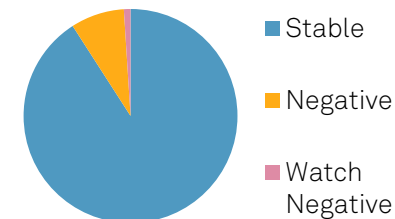
- A confluence of events that could materially impair capital, such as a sizable catastrophe event (or series of events); a sustained spike in inflation; emergence of a “silent” asbestos-type claim; expansion of coverage related to COVID-19 claims; or greater asset losses due to higher-than-expected equity volatility or corporate downgrades.

U.S. Life Insurers | Credit overview

Ratings Distribution



Outlook Distribution



Our sector outlook for the U.S. life insurance sector is stable.

Key rating factors:

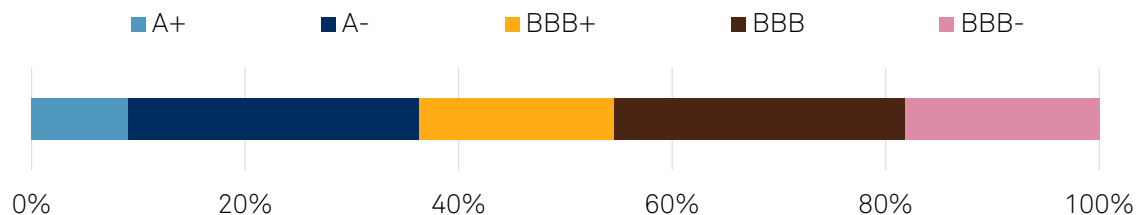
- Asset risk: Most significant and immediate risk, but life insurers are well-positioned with capital buffers.
- Most have reduced equity exposure via increased hedging, repricing, and moderating guarantees on new products.
- Capital markets remain accessible, providing financial flexibility in times of stress.
- Rather than a "race to the bottom" to find growth, we expect the sector to focus on capital conservation.
- In our moderate pandemic scenario, we anticipate current capital buffers will absorb excess net mortality claims.

Negative outlook trigger:

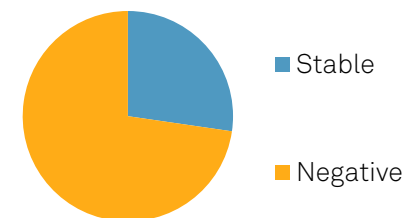
- Higher-than-expected asset losses from corporate bond downgrades or equity hedge breakage.
- Substantial reserve increases, which could occur due to persistently near-zero or declining interest rates.
- Mortality claims increasing substantially over the coming months.

Latin America – Insurance | Credit overview

Ratings Distribution



Outlook Distribution



Our sector outlook for the global reinsurance sector is negative.

Key rating factors:

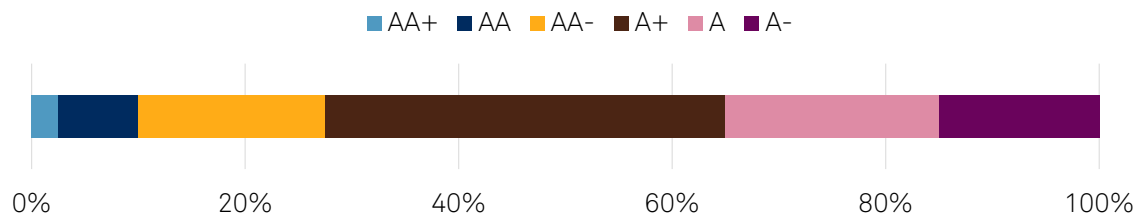
- Reinsurers won't meet their cost of capital in 2020 due to COVID-19 insured losses and lower investment returns.
- Although capitalization remains robust, it has been hit by the volatile financial markets and lower reserve releases, combined with the loss creep seen in 2017 and 2018, which were active catastrophe years.
- Alternative capital and retrocession capacity will be constrained.
- Hardening reinsurance prices throughout 2020 and stable life reinsurance earnings so far.

Stable outlook trigger:

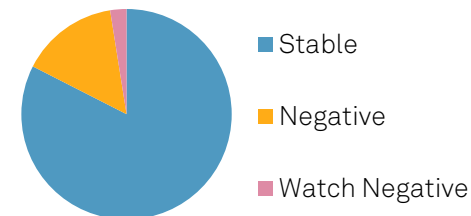
- Our belief that reinsurers are maintaining disciplined underwriting and risk selection, supported by hardening pricing, such that they can meet their cost of capital on a sustainable basis.

Global Reinsurance | Credit Overview

Ratings Distribution



Outlook Distribution



Our sector outlook for the global reinsurance sector is negative.

Key rating factors:

- Reinsurers won't meet their cost of capital in 2020 due to COVID-19 insured losses and lower investment returns.
- Although capitalization remains robust, it has been hit by the volatile financial markets and lower reserve releases, combined with the loss creep seen in 2017 and 2018, which were active catastrophe years.
- Alternative capital and retrocession capacity will be constrained.
- Hardening reinsurance prices throughout 2020 and stable life reinsurance earnings so far.

Stable outlook trigger:

- If we believe that reinsurers maintain disciplined underwriting and risk selection supported by hardening pricing such that they can meet their cost of capital on a sustainable basis.

Note: Rating and outlook distributions for the Top 40 Global Reinsurers.

Emerging Risks

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On The Horizon | The COVID-19 Aftermath

As the initial shock of the pandemic recedes, the industry must look ahead to assess how the effects of COVID-19 will be felt, and how they might reshape the landscape.

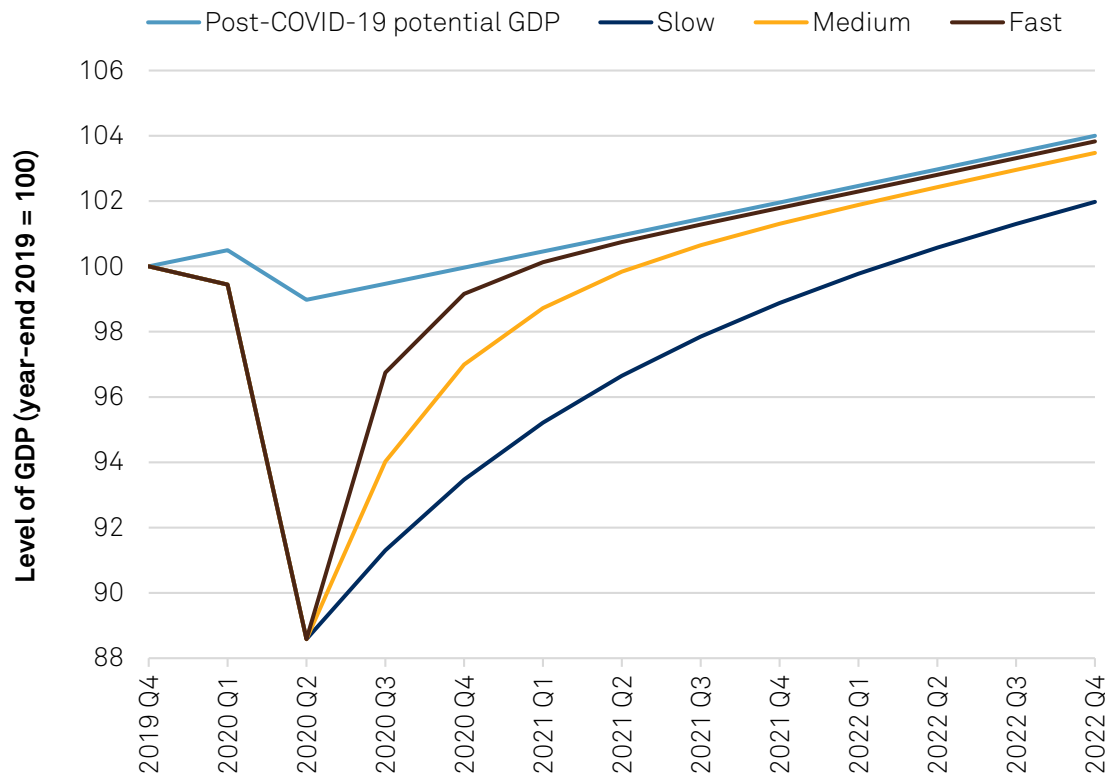
Emerging trend	Description	Impact and severity	Time horizon	Rating impact
COVID-related litigation	Safety concerns for employees could increase lawsuits against employers, and thus more D&O claims.			Capital and earnings
Growth of digital distribution	Development of digital sales platforms to offset social distancing measures could ease client access going forward.			Competitive position
Awareness of Insurance	Heightened focus on the need for protection, particularly in life and health lines, could boost demand.			Competitive position
New product development	Demand for new or nascent products, such as nondamage business interruption (NDBI), could increase.			Competitive position
Reputational damage	Failure to pay BI claims, even if not covered, could present a reputational problem for the industry.			Competitive position
Second wave / disrupted recovery	Disruption to the economic recovery or the widespread reintroduction of lockdown measures could disrupt financial markets further, deepen the recession, and increase claims.			Capital and earnings, competitive position

Source: S&P Global Ratings

Shape Of The Recovery Will Impact Credit

COVID-19 Recovery Paths

Convergence to post-COVID-19 potential (2% GDP lost)



Source: S&P Global Economics

- Our base case assumes economic recovery by the end of 2021.
- However, prolonged lockdown scenarios, a severe second wave, or fiscal policies that prove ineffective in insulating economies could lead to a permanent loss of production and additional financial market dislocations.
- These could weaken insurers' asset portfolios and capital positions more severely than we've seen to date.
- Lower economic growth, higher unemployment, and rising inflation could also depress insurers' underwriting profitability.

Macro Risks

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Market & Economic Risk | Pressure From All Angles

- Market risk factors will have a more-immediate impact on insurers' credit profiles, particularly on capital positions in 2020.
- Economic factors should have less direct impact, but will be felt over 2021 and 2022 as they flow through to top lines and earnings through demand for insurance, claims experiences, and expenses.

Indicator	Impact on Insurers' Creditworthiness	Global	Asia-Pacific	EMEA	Latin America	North America
GDP Growth	Slower economic growth could dampen demand, particularly in discretionary lines of business.	Moderate	Moderate	Moderate	Moderate	Moderate
Unemployment	Higher unemployment could reduce demand for discretionary lines and lead to higher claims in other lines, such as income protection.	Elevated	Moderate	Moderate	Elevated	Elevated
Inflation	Inflation could lead to higher claims, both directly and as an indicator for claims inflation.	Moderate	Moderate	Low	Moderate	Moderate
Government interest rates	A more-prolonged period of low interest rates will depress investment returns and could encourage increased risk-taking. In regions where liabilities are marked to market, low rates will increase liabilities.	Elevated	Elevated	Elevated	Elevated	Moderate
Corporate bond spreads	Similarly, volatile spreads will eat into investment returns and asset valuations, and worsen discount rates on liabilities. They could also make conditions more difficult for debt issuance or refinancing.	Moderate	Moderate	Moderate	Moderate	Moderate
Foreign exchange	Claims costs could increase if reporting currencies devalue relative to policy or replacement currencies, a particular risk for motor and medical cost insurers.	Moderate	Moderate	Moderate	Moderate	Moderate
Mortgage / loan performance	Poor loan performance leads to devaluation of loan assets and increased capital charges.	Moderate	Low	Moderate	Low	Elevated
Real estate	Loss of asset valuation could deplete available capital.	Low	Low	Low	Low	Moderate
Credit defaults	Default of fixed-income investments leads to loss of asset value and available capital. A less-likely risk is that a reinsurer could default, which could increase claims exposure.	Moderate	Moderate	Moderate	Moderate	Moderate
Rating migration	Asset downgrades, particularly to the 'BBB' range from the 'A' range and to the speculative grade range from 'BBB', will result in higher risk charges and impairments of asset values, hitting capital positions.	Moderate	Moderate	Moderate	Moderate	Moderate
Equity markets	Loss of value on equity investments will deplete available capital.	Moderate	Elevated	Moderate	Moderate	Moderate

Related Research

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Related Research | Global & Cross-Sector

- [S&P Global Ratings COVID-19 Research Page](#)
- [The Global Economy Begins A Slow Mend As COVID-19 Eases Unevenly](#), July 1, 2020
- [The Shape Of Recovery: Uneven, Unequal, Uncharted](#), July 1, 2020
- [Insurers' Debt Remains Attractive To Investors During COVID-19 Uncertainty](#), June 22, 2020
- [The European Speculative-Grade Corporate Default Rate Could Reach 8.5% By March 2021](#), June 8, 2020
- [The U.S. Speculative-Grade Corporate Default Rate Is Likely To Reach 12.5% By March 2021](#), May 28, 2020
- [COVID-19 Pushes Global Reinsurers Farther Out On Thin Ice; Sector Outlook Revised To Negative](#), May 18, 2020
- [Credit FAQ: In A Correlated Market, Catastrophe Bonds Stand Out](#), May 18, 2020
- [Insurance Industry And Country Risk Assessment Update: May 2020](#), May 7, 2020
- [COVID-19 Will Test Insurers' Resilience](#), March 25, 2020
- [Insurers' Dividend Pause Amid COVID-19 Concerns Likely Indicates Caution, Not Credit Risks](#), April 15, 2020

Related Research | North America

- [Industry Report Card: North American Insurers' Earnings Results Held Up In The First Quarter](#), May 19, 2020
- [Business Interruption And COVID-19 Coverage For U.S. Property/Casualty Insurance Examined In Credit FAQ](#), April 27, 2020
- [Credit FAQ: How COVID-19 Risks Factor Into U.S. Property/Casualty Ratings](#), April 27, 2020
- [Refinancing Risk For North American Insurers Amid The COVID-19 Pandemic Remains Muted So Far](#), April 20, 2020
- [COVID-19 Market Volatility Tests North American Reinsurers' Resilience](#), April 17, 2020
- [What To Expect When U.S. Insurers Report First-Quarter Results Amid COVID-19](#), April 14, 2020
- [Despite The COVID-19 Pandemic, The Outlook For the U.S. Health Insurance Sector Remains Stable](#), March 26, 2020
- [Assessing the Top Risks COVID-19 Poses To North American Life Insurers](#), March 26, 2020
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Analytical Contacts

Dennis Sugrue

London
+44-20-7176-7056
dennis.sugrue@spglobal.com

Alfredo Calvo

Mexico City
+52-55-5081-4436
alfredo.calvo@spglobal.com

Johannes Bender

Frankfurt
+49-69-3399-9196
johannes.bender@spglobal.com

Volker Kudzus

Frankfurt
+49-69-3399-9192
volker.kudzus@spglobal.com

Neil Stein

New York
+1-212-438-5906
neil.stein@spglobal.com

Taufik Gharib

New York
+1-212-438-7253
taufik.gharib@spglobal.com

Eunice Tan

Hong Kong
+852-2533-3553
eunice.tan@spglobal.com

Craig Bennett

Melbourne
+61-3-9631-2197
craig.bennett@spglobal.com

Simon Ashworth

London
+44-20-7176-7243
simon.ashworth@spglobal.com

Ali Karakuyu

London
+44-20-7176-7301
ali.karakuyu@spglobal.com

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