Insurers' Dividend Pause Amid COVID-19 Concerns Likely Indicates Caution, Not Credit Risks

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Key Takeaways

- We don't believe that insurers' decision to suspend dividends, as recommended by various regulators in response to the COVID-19 pandemic, will hurt their credit profiles.
- Such a decision doesn't necessarily indicate constrained capital or cash, but rather the uncertainty regarding the pandemic and the hefty costs that could materialize as a result.
- Although we see no signs of systemic capital weakness across the global insurance industry, we acknowledge that, for some insurers, capital or liquidity deterioration, alongside suspended dividends, could have rating implications.
- We are actively engaging with insurers to understand the implications of COVID-19 on their capital positions.

Due to concerns about the financial impact of the COVID-19 pandemic, some insurance regulators are urging insurers to curb or suspend dividends, bonuses, and other discretionary capital distributions. While the response has been mixed, a number of insurers are heeding regulators' advice. S&P Global Ratings believes these capital management decisions will not have a material impact on insurers' credit quality as long as there are no underlying weaknesses in the companies' capital or liquidity positions.

In recent weeks, various regulators and supervisors in Europe, Australia, and Mexico have advised insurance companies to exercise prudence when establishing discretionary capital distributions, especially if those actions would materially affect their capital or liquidity positions. To date, Dutch insurers Achmea B.V., ASR Nederland N.V., AEGON N.V., and NN Group N.V., as well as U.K.-based RSA Insurance Group PLC, Aviva PLC, and Hiscox Insurance Co. Ltd., among others, have decided to suspend paying common dividends or share buybacks. Conversely, groups such as QBE Insurance Co. (U.K.) Ltd., Legal & General Group PLC, and Allianz Insurance PLC have decided to continue with the near-term distributions following careful consideration of supervisory guidance, while others have opted to delay annual shareholder meetings, in part to buy more time to weigh up considerations around dividend distributions.

In our view, suspending common dividends or share buybacks could be a cautious tactic. This decision may not indicate that an insurer's capital adequacy is under pressure or that it seeks to conserve cash, but rather the uncertainty as to the length of the pandemic and the resulting costs. While strains on liquidity are less likely for insurers, relative to banks, we do expect capital adequacy to feel some pressure from recent market volatility. That said, we do not see the recent wave of insurers electing to skip paying upcoming dividends as a sign of systemic capital weakness across the industry and do not consider this a trigger for rating actions. However, there are circumstances in which such decisions could have isolated credit implications. In this article, we outline the credit considerations we will assess as the trend develops.

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Canceling Dividends Doesn't Always Indicate Weak Capital

Regulators' motive for urging insurers to suspend common dividends and defer or cancel share buybacks could be to simply urge insurers to conservatively manage cash and discretionary payouts at a time of significant uncertainty. In fact, we have already observed this in the banking sector. In addition, if regulators or policymakers chose to implement relief measures--such as the U.S. National Association of Insurance Commissioners' (NAIC's) guidance to waive higher capital charges for troubled mortgage assets for the March 31 and June 30 reporting periods--then it is reasonable for them to expect that insurers refrain from distributing funds for the benefit of shareholders.

We also consider why some insurers are following these requests. It could be to err on the side of caution, or that they are taking the opportunity to conserve liquidity given the economic and credit distresses stemming from the COVID-19 pandemic. We've seen insurers and corporates, for example, draw down on credit facilities to secure cash in the event of a more pronounced or prolonged economic downturn. Furthermore, insurers could be seeking a bit of goodwill with policyholders or following a developing trend among their peers.

However, a more skeptical view is that regulators, or the insurers themselves, are concerned about capital and liquidity positions during this uncertain period, particularly given the financial market volatility observed in recent weeks that is likely to have material implications for solvency ratios for a few insurers. This is especially relevant for life insurers that have proportionally much larger investment portfolios than property and casualty (P&C) players, thus exposing them to market volatility.

Our reviews of global insurers over recent years have shown that the industry's capital strength has supported ratings stability and that it should help to stave off widespread downgrades across the insurance sector due to COVID-19 fallout. We observe robust regulatory capital positions globally. Additionally, in most cases, sensitivity to market shocks--while significant--do not bring insurers close to regulatory minimums. Moreover, capital adequacy across the industry as measured by our capital model is, on average, robust and credit supportive.

We will continue to assess insurers' capital strengths, however, and expect to engage with companies to better understand the implications of, and responses to when appropriate, recent market events. We note that a key element in our assessment of capital and earnings is our forward-looking expectation, so an insurer's ability to regenerate capital over the next two to three years will be an important consideration in our analysis.

Could The Decision To Suspend Dividends Constrain Future Market Access?

Capital markets are an important avenue of funding and a key backstop to insurers during times of stress. In many circumstances, capital markets can help support insurers experiencing systemic difficulties. Additionally, for those insurers with a compelling proposition for growth, in the aftermath of a financial crisis, injections of capital from the markets can enable them to underwrite the market recovery when it occurs.

Insurers opting to suspend or suspend dividends risk alienating investors who have come to expect regular dividend payments, particularly from insurers with healthy capital adequacy and solid liquidity positions. This is particularly the case in developed markets such as the U.K., where insurers have a sound track record of paying healthy and increasing dividends.

There is also safety in numbers, to some degree. If most insurers--and banks for that matter--in a market elect not to pay common dividends or to cancel share buyback programs, investors are less likely to single out any names when a call for fresh capital comes knocking. However, isolated actions by insurers could introduce concerns on particular companies and limit market access in the future.

How Suspending A Common Dividend Affects Insurers' Hybrid Debt

On the surface, a decision to defer a common dividend should benefit holders of the insurer's hybrid and senior debt--in addition to their policyholders--since the conserved cash could be used to support coupon or claims payments. However, for insurers that have issued hybrid debt instruments with optional coupon deferral, the decision to cancel dividends can remove obstacles in electing to defer coupons. This is particularly an easier path if the hybrids have a "look back" provision that limits the issuer's ability to defer coupons if distributions, such as dividends or buybacks, have been made to other more junior investors.

In addition, if insurers' capital becomes more significantly constrained, and the savings from suspended dividends aren't sufficient to stem the tide, regulators or politicians might more firmly insist that insurers defer or cancel coupons on hybrid debt to further preserve capital and conserve cash. Although these factors increase the possibility of deferred coupons, we view these risks as remote at this stage. We base our opinion primarily on our belief that issuers would be reluctant to defer coupons in advance of a solvency breach since it would signal capital weakness and could make investors skittish about the insurer's possible future needs to raise funds to improve their solvency position.

Because we view most rated insurers as sufficiently capitalized, we believe they are unlikely to defer coupons on hybrid securities to improve solvency, especially given a range of other actions available to de-risk or bolster capital. We also believe that regulators are reluctant to direct insurers' to defer on hybrid coupon payments to boost solvency, as the benefit is not typically as significant to insurers' capital adequacy. We estimate that common dividends range from 3x to 4x the size of a typical insurer's hybrid coupons. Further risks associated with such coupon deferrals would affect future market access and likely outweigh the minor capital benefit. Moreover, regulators in most jurisdictions have limited ability to enforce coupon deferral before a breach of regulatory solvency minimums.

However, underlying weaknesses in an insurer's regulatory solvency ratios that make coupon deferral, either optional or mandatory, more likely could result in a negative rating action on a hybrid security. In some instances, it could be a multi-notch downgrade. If an entity defers a coupon payment, even when permitted under the issue's terms, we would consider that as a default, resulting in the instrument rating going to 'D', unless we expect the investor to receive the full coupon amount (including compound interest where applicable) within a year.

There is significant uncertainty as to how long the COVID-19 pandemic may continue. We believe the enhancements in risk management practices since the last global financial crises mean the sector is well capitalized and better prepared for potential shocks. We will continue to engage with issuers and regulators to better understand the implications for issuer and issue ratings and will adjust our base-case assumptions to best capture those risks.

This report does not constitute a rating action.

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