# Addendum to the 2019 Solvency and Financial Condition Report

The purpose of this addendum is to provide additional COVID-19 related disclosures following the publication of the 2019 Solvency and Financial Condition Report (SFCR) of MAPFRE MSV Life p.l.c. (the |Company) on the 7th April 2020 and subsequent to MFSA note dated 21st April 2020 whereby, inter alia, MFSA classified COVID-19 as a "major development."

**Additional information on the COVID-19 global pandemic**

On 11 March 2020, the World Health Organization declared the outbreak of COVID-19, a global pandemic. Information presented in the SFCR and the associated Quantitative Reporting Templates (QRTs) have been prepared based on conditions and best estimate assumptions at 31 December 2019 and have therefore not been adjusted for any impacts of COVID-19. On 21 April 2020 MFSA announced that COVID-19 should be treated as a "major development" as per Article 54(1) of the Solvency II Directive.

The authorities in Malta, like other Governments in affected countries, imposed a number of measures designed to contain the outbreak, including business closures, travel restrictions, social distancing, stay at home orders and cancellations of gatherings and events. The spread of COVID-19 has resulted in an economic downturn in all affected countries, including Malta and the global economy more widely, as well as causing increased volatility and declines in financial markets. If the pandemic is prolonged, or a second wave of the pandemic emerges, the adverse impact on the global economy could be deepened and may result in further declines in financial markets.

The outlook for the insurance industry, particularly for the life insurance industry, in the face of the COVID-19 crisis is still one of concern since the full economic and financial consequences of the crisis cannot yet be ascertained. The unprecedented COVID-19 crisis is being considered by insurers and particularly by life insurance companies as a high impact exceptional adverse situation. The full impact of the crisis occurred in the second half of March and markets recovered remarkably in April and May. The outlook for 2020 remains one of cautious optimism.

## A. Business and performance

Information presented in Section A of the SFCR report represents the performance of the business as reported in the Company's financial statements for the 12-month period to 31 December 2019. Although it is still not practicable to quantify the potential financial impact of the outbreak on the company at this stage, revenue is expected to fall mainly because of the restrictions imposed to contain the spread of the disease and the subdued economic activity. However, the Company's profitability is expected to be more resilient to the crisis. The Company is currently reviewing its 3-year business plan in the light of the COVID-19 pandemic.

## B. System of governance

MMSV's overarching risk management and internal control system is responding well to the challenges of the COVID-19 outbreak and remains robust. While adhering to the Business Continuity Plan, the Company's Board of Directors, oversight governance committees and the key functions continue to discharge their respective duties.

## C. Risk profile

The economic uncertainty led to a historical fall in equity markets and a spike in equity price volatility[1]. This, coupled with the persistent low yield environment result in a heightened risk profile for the Company. The Board of Directors is closely monitoring financial developments to ensure that the company's risk profile remains aligned with its risk appetite. In this regard, a number of management actions have already been taken and further measures will be taken depending on the economic, financial and market developments and outlook.

### C.1 Underwriting risk

The most visible life underwriting risks impacted by the COVID-19 pandemic is mortality risk, where MMSV's main geographic exposure is to the Maltese Islands. Whilst MMSV's life protection policies cover death caused by COVID-19, so far there is no indication that the COVID-19 is likely to result in an increase in mortality claims given the timely and effective response of the local health authorities in dealing with the pandemic outbreak

In order to mitigate against an increase in the claims ratio of Protection business, which might negatively impact the long-term profitability of the business, a COVID-19 Questionnaire was introduced for certain new life insurance applications and for the revival of all Protection policies over 6 months from the last premium due date. Applications from clients who disclose either symptoms or who have tested positive

[1] Volatility is now significantly lower than experienced in March when information regarding the severity of the virus was still emerging.

for COVID-19 will be assessed in accordance with our underwriting criteria having regard to the general state of health of the applicant. We would expect that in the majority of cases applications would be postponed rather than declined.

Going forward, there is also uncertainty over the impact this pandemic will have on future policyholder behaviour (e.g. a change in the rate of lapses and surrenders). However, in times of extreme market stress, MMSV's solvency capital requirement towards lapse risk increases significantly when surrenders are lower than expected, as the cost of guarantees increases, leading to a more onerous capital requirement.

### C.2. Market risk

Market risk remains the main risk faced by the Company. The financial dimension of the COVID-19 crisis on the Company will principally be manifested through Market Risk.

The marked diversification of the portfolio across asset classes, geographies, sectors, currencies and investment style led MMSV's investment portfolio to fall less than the overall market, however, the market shock experienced in Q1 2020 contributed to a marked deterioration in the regulatory solvency ratio. The deterioration in the company's regulatory solvency ratio, as at 31 March 2020 was more pronounced than the sensitivity considered and disclosed in the SFCR under Section C.7.1 page 54 that estimated the solvency ratio falling to 120% for a 25% fall in equities[2]. However, it is to be noted that, at time of writing, the subsequent recovery in the financial markets, lower volatility and the management actions undertaken helped to improve MMSV's solvency ratio from the March end position, though still not to the level registered at the end of 2019.

To date, the company has already taken steps to marginally reduce its exposure to equities / risky assets and is currently overweight in cash in terms of its Strategic Asset Allocation.

The company has performed additional stress tests to estimate the impact of a further deterioration/increase in equity markets.

The Company has available various options / measures that it can take to reduce Market Risk should its solvency ratio deteriorate. Some of these measures include reducing further the exposure to equities / risky assets, reducing the credit risk profile, reducing concentration risk and making greater use of currency hedging. Most of these actions would apply at the level of the With-Profits Fund.

[2] All other variables in the sensitivity are unchanged. The Q1 stress entailed a number of changing variables e.g. volatility, spreads widening, lower yield curve

### C.3 Credit risk

Given the quality of the credit standing of its counterparties and debtors, the Company does not expect its Credit Risk to materially increase because of COVID-19.

### C.4 Liquidity risk

Whilst, because of COVID-19, a fall in premium revenue and an increase in outflows due to higher levels of surrenders is expected, MMSV remains adequately liquid to meet these demands as they fall due.

### C.5 Operational risk

COVID-19 is resulting in an increased level of inherent operational risk through enforced remote working, staff absences due to the imposed health protocols and childcare, market volatility and through the impact on our business ecosystem. The Company continued to adapt and where needed re-engineered processes, controls and reporting to ensure operational risks remain at an acceptable level.

At the onset of the pandemic the Company triggered its Business Continuity Plan. Hence it has remained operational, with key activities such as collection of premiums, settlement of claims and transaction processing being maintained, IT systems remaining operational, and employees including frontline customer facing staff being supported to ensure that the company continues to be of service and support to its customers.

## D. Valuation for solvency purposes

The COVID-19 pandemic has resulted in declines in global financial markets with a corresponding impact on the valuation of certain financial assets held at fair value by the MMSV With-profits Fund and within the Company's balance sheet. The pandemic has also resulted in an increase in volatility in financial markets. The Company has taken a number of actions to reduce exposure to market risk and credit risk, as stated above, and will continue to monitor its balance sheet exposure.

Technical provisions have been prepared based on conditions and best estimate assumptions at 31 December 2019 and have therefore not been adjusted for any impacts of COVID-19.

Over Q1 2020, MMSV's balance sheet saw assets values falling by 8.25%, Technical provisions fell by 7.13%. While the Risk Margin increased as a result of the higher lapse risk capital requirement, the Best Estimate of Liabilities (BEL) decreased due to the loss absorbing capacity of technical provisions in the With-profits Fund. The deferred tax liability also reduced due to the fall in the markets. Notwithstanding, the Company excess of assets over liabilities amounted to €147million, a fall of 9.1% since 31 December 2019.

MMSV took a number of management actions to mitigate the impact on policyholders' assets and to strengthen the company's balance sheet in case markets deteriorate further. These management actions included:

- Cancellation of the shareholders' dividend in accordance with the statement issued by the European Insurance and Occupational Pensions Authority (EIOPA).
- Extension of the minimum term for new Single Premium Plan (SPP) business.[3]
- Reduction in the interim bonus.
- System upgrades to enable the application of a Market Value Adjustment (MVA).
- De-risking the MMSV With-profits Fund.

The subsequent partial recovery in the financial markets, lower volatility and the above management actions helped to considerably improve MMSV's solvency ratio from the March end position.

## E. Capital management

Although the Company entered 2020 with strong solvency and financial fundamentals, as explained in the previous sections, during the month of March, the market fall and increased volatility due to uncertainty induced by the COVID-19 virus had a marked impact on the regulatory solvency ratio of the Company. This resulted in MMSV's solvency ratio, as at 31st March 2020 being marginally above the Solvency Capital Requirement (SCR) but still substantially higher than the Minimum Capital Requirement (MCR). At time of writing, the regulatory solvency ratio has improved considerably as the financial markets have improved and volatility has decreased relative to the extreme levels touched in March, but it is still below the level registered at the end of 2019.

The Management actions described above also contributed to this improvement in the solvency ratio.

One of the first and also very important management actions taken which was mentioned above related to the cancellation of the Shareholders' dividend. This boosted the Eligible Capital available to cover the Solvency Capital Requirement.

Nevertheless, the Board of Directors cognizant that these are unprecedented times characterized by significant uncertainty with respect to the ultimate containment of COVID-19 and consequent market outlook, will continue to monitor closely the market developments and its impact on the company's solvency position in line with the

[3] To reduce new business strain

regulatory requirements and its articulated risk appetite. The Board of Directors will take any further measures it deems appropriate to ensure that the Company remains adequately capitalised at all times and well positioned for both business growth and with effective risk appetite controls and thresholds in place to maintain regulatory capital under the Solvency II framework.

The Company will continue to take all necessary measures in the best interest of its policyholders and to protect and if necessary restore its solvency position in these unprecedented times. The Company expects to continue to meet its Solvency Capital Requirements. It is expected that, given the measures already taken by the Company and the marked recovery in financial markets, the solvency position of the Company will continue to improve.

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