South Africa: Insurance Industry Update

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Introduction

As South Africa begins a new year, the insurance industry faces several challenges.

The insurance industry is dealing with the ongoing economic fallout from the COVID-19 pandemic and economic stress—including the load-shedding disruptions. Businesses and individuals are still struggling financially, putting pressure on insurers to offer more flexible and affordable coverage options. New business volumes and margins, particularly for wealthier customers with higher sums assured, are struggling. In response, insurers have introduced new products and coverage options to revitalise their markets, or have pushed products into the gap between funeral cover and fully underwritten products.

Continued and lengthened load shedding has driven an increase in short-term insurance claims for theft and electrical surge. Anecdotal evidence of solar panel theft has prompted some insurers and reinsurers to re-evaluate these risks. Insurers and lenders are pushing into turnkey curated, financed and insured solar/battery/inverter systems for clients, although they remain an inaccessible refuge for most South Africans.

While the South African government has made noise about plans for a national social security system including universal funeral coverage, this potential disruptive idea has no firm timeline for implementation. As National Health Insurance has languished due to the significant political and practical realities, so the vision of state funeral insurance is likely distant at best.

The Competition Commission's investigation into collusion within the life insurance industry appears to be at an early stage. News report on the progress of the Commission so far have raised questions around potential misunderstanding of price discovery and differences between products, but have also surfaced some of the evidence of collusion that prompted the Commission's raids and investigations.

In this issue, we provide updates on regulatory developments, discuss some of the lessons from 2022 (specifically with reference to herd immunity and greenwashing), and consider some machine learning implementations we believe are relevant to the South African market.

Status of IFRS 17 in Africa

The new standard 17 of the International Financial Reporting Standards (IFRS 17), dealing with insurance, came into effect on 1 January this year. The level of readiness among insurers varies by country and company. In Asia, some countries have delayed the implantation of the standard to allow their local insurance industries more time to prepare and migrate existing systems and processes. For example, Thailand has postponed the implementation of the standard to 2024, while Indonesia and the Philippines have postponed the implementation to 2025.

Africa, on the other hand, has not seen the same trend, despite its limited resources and data constraints. Zimbabwe's national regulator, the Insurance and Pensions Commission (IPEC), for example, aggressively pushed for its local insurance industry's dry run in late 2022, effectively ensuring that each insurer operating in the country has been through the process at least once before the standard's official implementation date.

In many sub-Saharan African countries (excluding South Africa), the local regulatory basis used IFRS to measure assets, liabilities and available capital. Therefore, the impact of IFRS 17 on solvency is direct, rather than the limited impact we expect for most South African insurers.

South African insurers await the results of the IFRS 17 impact assessment by the Prudential Authority (PA), which was due in January 2023, despite the new tax standard's implementation date being 1 January 2023.

The PA is yet to clarify whether IFRS 17-compliant numbers are to be reported on insurers' quarterly Quantitative Reporting Templates (QRTs), and from what date (i.e., will the December 2022 QRTs, submitted in January 2023, include updated IFRS 17-compliant numbers?).

It appears that the tax treatment of insurers under IFRS 17 has now been settled, with the outcome viewed as reasonable by most insurers. It will be some time before the transitional impact is complete, so 2023 won't be the last year of managing the transition to IFRS 17.

A noteworthy development is in the increasing use of the premium allocation approach (PAA) on insurance products that were previously viewed as long-term. The significant decrease in complexity of PAA versus the general measurement model (GMM) means that insurers have significant incentives to convince themselves and their auditors that the PAA applies in marginal cases. The treatment of credit life, for both individual and group policies, and, in particular, for revolving credit, is complex. Minor differences in product pricing and management can lead to quite different conclusions.

Then, in Zimbabwe, given its persistent high inflation, it is becoming common for insurers to offer products that are annually renewable rather than guaranteeing premium for cover for longer periods. This trend is observed across both life and non-life insurance products, leading to a debate on whether the shortened term of insurance products justifies the use of the PAA, using the coverage period argument stated in paragraph 53 of the standard.

The South African market has mixed views on the conditions that would shorten the coverage period under IFRS 17, and there are questions on whether these conditions are consistent with the definition around contract boundaries, as provided in the local solvency assessment and management framework.

COVID-19 is not gone: The lessons in herd immunity from China

After protests erupted around the country, China's ruling party has abruptly lifted all restrictions in its arsenal against the spread of COVID-19 in the country, causing chaos in an underprepared public healthcare system.

Since the end of 2019, China has adopted a zero COVID policy, shutting down whole cities and, sometimes, whole districts, based on a handful of infections, in the aim of beating the COVID-19 pandemic. Recently, as the Chinese entered their third year of the fight against the virus, the government abruptly cancelled its policy, to calm the masses and avoid a potential revolt.

The result is a mass wave of COVID-19 infections around the country, primarily due to the population's lack of herd immunity. For the first time in decades, the Chinese population has decreased due to deaths exceeding births by almost a million lives. (India is forecast soon to have a larger population than China, and the Chinese population is projected to fall precipitously to half its current size by the end of the century. While this is not a direct consequence of COVID-19, lockdowns in small urban apartments will likely exacerbate the decrease in fertility ratios and contribute further to China's rapidly ageing population.)

While the South African national lockdown was long relative to other lockdowns around the world, it was not as long or as extreme as that experienced in China. The new experience and new wave of infections will better allow governments, health organisations and insurers around the world to learn from herd immunity and lockdown experiences, which can then be built into stress testing scenarios, for example.

Greenwashing

Companies have come under increased pressure to demonstrate their commitments to environmentally friendly and sustainable business practices. This is a vital component towards managing climate change—and arguably should have come much sooner.

An unfortunate consequence of this pressure has been the rise of greenwashing, where a company presents a product or service, or the organisation itself, as being more environmentally friendly than it actually is. Several high-profile cases involving alleged greenwashing have hit the headlines in recent months, such as the police raid on Deutsche Bank's asset manager DWS last year and the ongoing investigations into TotalEnergies in France.

To combat the practice of greenwashing, the UK's Financial Conduct Authority (FCA) has recently issued a statement proposing a number of new measures, including restrictions on how terms like "environmental, social and corporate governance (ESG)," "green" and "sustainable" can be used. Climate-related disclosure requirements are also receiving greater attention from regulators in the UK and globally, driven in large part by the work of the Task Force on Climate-related Financial Disclosures (TCFD). The Milliman white paper "Current trends in climate-related disclosures" investigates the status of TCFD reporting in the UK insurance industry and discusses expectations for future regulatory developments.

Machine learning in insurance is on the rise

The increases in the sheer volumes of data collected by insurers have made the use of machine learning and artificial intelligence (ML/AI) a necessity rather than a luxury. ML/AI algorithms aid insurers in dealing with large amounts of both structured and unstructured data sets, including audio, video and images.

A common misconception of most companies looking to implement ML/AI algorithms is that the data used to train and develop the algorithms must be as close to perfect as possible, i.e., adequate in volume and completeness. However, some ML/AI algorithms, such as those in natural language processing (NLP), are used to interpret, understand and generate language, which can be trained on limited data sets to increase the efficiency of communication. For the insurance industry, NLP can be implemented, for example, with clients through ML/AI chatbots to handle claims processing and robo-advisors to handle the selling of products.

Insurance companies have a further competitive advantage over other industries implementing ML/AI where it comes to understanding the consumer. An insurer can profile its existing policyholders using either supervised or unsupervised learning to execute a lifetime value analysis of a policyholder. The benefits of such an exercise can aid in product innovation and design, as well as from a financial advice standpoint, ensuring that policyholders buy correct and sufficient cover.

The applications of ML/AI in the insurance industry are vast and advantageous, if correctly applied. Understanding how the algorithms and processes lead to results can be challenging at the start, and both guidance and training will likely be required. Milliman has dedicated resources to help better understand how ML/AI can help your business, offering tailor-made solutions with training and upskilling of your staff to ensure that your company makes the best use of the data available and offers the best to your policyholders.

If you have any questions on integrating ML/AI within your company, please reach out to eden.gross@milliman.com.

Capital market may be a key to help unlock cyber risk capacity

The cyber risk insurance market has been under pressure with the continuously increasing occurrence and severity of cyber attacks coupled with increasing demand for cyber risk protection. However, insurers and reinsurers remain cautious on cyber risk, with limited appetite and policy conditions.

Nonetheless, there may exist room for risk transfer deals in the capital markets, with the following ground-breaking deals already taking place in 2023:

- Hannover Re has created a $100 million cyber risk proportional reinsurance deal with an American asset manager that will allows investors to participate directly in Hannover Re's cyber risks experience.[1]
- The specialist insurer, Breazley, has launched the first ever tradeable cyber catastrophe bond.[2]

Cyber risk remains a complex and ever-evolving risk. Growth in cyber risk insurance capacity, whether via the insurance or reinsurance markets, is going to require increased sophistication in cyber risk underwriting, pricing and risk management.

Regulatory updates

GUIDANCE ON LIQUIDITY RISK MANAGEMENT FOR INSURERS (DECEMBER 2022)

In December 2022, the Prudential Authority (PA) published Guidance Notice 1 of 2022 on liquidity risk management for insurers (both life and non-life), together with the proposed amended liquidity risk return for life insurers.[3] These guidelines follow the first draft, originally published in 2021. The PA acknowledges that its guidance note was based on the Application Paper on Liquidity Risk Management, as published by the International Association of Insurance Supervisors (IAIS). The comment period closed on 3 February 2023.

The proposed amended liquidity risk return for life insurers—the liquidity shortfall indicator, LIQ, component in the annual quantitative report template—is a more detailed measure compared to the current LIQ measures. The changes include:

- Assessing the potential liquidity over three time horizons (from a one-month view to a 12-month view), compared to the current measure which considers a 12-month view only.
- Considering a more detailed definition of liquid assets, which should arguably result in more assets being considered liquid relative to the current measures.

[1] Gallin, L. (19 January 2023). Hannover Re and Stone Ridge in $100m retrocession cyber quota share. Reinsurance News. Retrieved 6 February 2023 from https://www.reinsurancene.ws/hannover-re-and-stone-ridge-in-100m-retrocession-cyber-quota-share/.

[2] Beazley (9 January 2023). Beazley launches market's first cyber catastrophe bond. Retrieved 6 February 2023 from https://www.beazley.com/en-us/news/beazley-launches-markets-first-cyber-catastrophe-bond.

[3] South African Reserve Bank (24 November 2022). Guidance Notice 1 of 2022. Retrieved 6 February 2023 from https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-documents-issued-for-consultation/2022/Guidance-Notice-1-of-2022.

- Considering a wider range of liquidity stress scenarios in comparison to the default solvency capital ratio of 1-in-200 scenarios under the current measure. In particular, the PA has provided a non-exhaustive list of possible scenarios, and insurers are expected to disclose the scenario with the most significant impact on the regulatory return.

Life insurers should expect additional effort in calculating the proposed amended measure. However, the proposed measure should hopefully be more useful than the current simplified measure.

JOINT STANDARD – CYBERSECURITY AND CYBER RESILIENCE REQUIREMENTS (NOVEMBER 2022)

In November 2022, the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA) published a revised draft Joint Standard on Cybersecurity and Cyber Resilience Requirements for public consultation following the first draft, originally published in 2021. This draft standard sets out the minimum requirements and principles for sound practices and processes of cybersecurity and cyber resilience for categories of specified financial institutions, which include insurers and their controlling companies.

Feedback from the prior round of consultation was generally positive, with most of the feedback recognising that the overall benefits will outweigh the potential costs. The PA and the FSCA propose a 12-month transitional period following the publication of the standard.

Smaller institutions are expected to have the most work to close any gaps. However, the PA and the FSCA have noted that the standard allows for implementation in a proportional manner that reflects the nature, size, complexity and risk profit of the implementing financial institution.

While the standard is being finalised, insurers could benefit from performing an initial gap analysis on this latest draft to have early insights into where they may need to close any gaps.

Comments close on 28 February 2023.

How Milliman can help

If you would like to discuss any of the above or anything else with us, then please contact us. Milliman can provide a range of services including:

- Insurance strategy on reopening closed lines of business, or expanding into new markets
- Dealing with regulatory change and approvals
- Product performance reviews and changes in light of COVID-19 lessons
- Solo and Group Head of Actuarial Function
- Independent review of actuarial and risk functions
- Own risk and solvency assessment (ORSA) and risk management maturity reviews
- Licence conversion and application assistance
- IFRS17 implementation and advice

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