

South Africa: Insurance Industry Update

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Introduction

While South Africa escaped some of the extreme warm weather affecting Europe and other parts of the Northern Hemisphere, there hasn't been much positive news for the insurance industry. Severe flooding again hit beleaguered KwaZulu-Natal (KZN) and hints of the July 2021 unrest appeared ahead of Jacob Zuma's momentary visit to prison.

New business margins and volumes remain under pressure, load shedding remains pervasive and business confidence and activity are low and, if anything, falling.

Some positive news hints at signs of the bottom. Consumer inflation reduced to 5.4% in June, falling below the upper limit of the Reserve Bank's target range for the first time since April 2022. Interest rate decreases may soon become possible.

Guidance on climate change risk has begun to develop in South Africa. This draws inspiration from emerging international good practice, particularly from the UK. The severe flooding across parts of South Africa this year, as well as the numerous other natural disasters, both locally and internationally, suggest that climate change risk regulation is well-warranted.

In this issue, we highlight forward-looking trends in mortality, discuss some recent topics related to climate risk and provide updates on regulatory developments.

Next wave of mortality improvements

A recent [report](#) from Swiss Re highlights that life expectancy improvements typically come in waves. These improvements are often a result of significant medical breakthroughs or major social trends. The most recent

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wave drove life expectancy improvement primarily through advancements in the diagnosis and treatment of cardiovascular diseases, as well as the widespread cessation of smoking.

This improvement lasted until about 2010. Since then, life expectancies in developed countries have plateaued or even reversed. Key contributors offsetting life expectancy improvements include increasing obesity, Alzheimer's disease and other forms of dementia, opioid abuse and unequal access to health services.

Japan and Switzerland, the countries with the highest life expectancies, are prime examples showing the impact of keeping the above factors under control. With an average life expectancy of 84 to 85 years, these countries are characterised by low obesity rates and excellent healthcare systems that provide widespread access to quality medical care.

The slowdown, pause or reversal in mortality improvements in many developed countries could be cause for concern. While it remains almost unheard of to allow for future mortality improvements in the pricing or provisioning for risk business, this is fairly common in Europe. If the modelled improvements don't materialise, insurers may face profitability pressures.

A 2020 [research paper](#) by Ronald Richman and Gary Velcich considered pensioner mortality in South Africa. This paper showed a marked slowdown in improvements in South Africa, and a reversal across some groups. South Africa has not even closely achieved the life expectancy and longevity of more developed markets yet. South Africa's life expectancy is usually estimated to be only around 65. This decline in mortality improvement is therefore particularly concerning.

However, at least according to Swiss Re, there may be some good news on the horizon. Swiss Re predicts the next wave of life expectancy improvement to occur over the next 20 years. This wave will likely be driven by further medical breakthroughs, with cancer and Alzheimer's disease being potential candidates. A move to personalised medicines away from more general therapies could also play a role in further improving life expectancy.

As societies continue to age, neurodegenerative and ageing-related diseases (such as Alzheimer's disease and dementia) are expected to become increasingly significant causes of death. Identifying medical solutions for these conditions is therefore essential to be able to further improve life expectancy.

Identifying the underlying factors linked to the next major wave of mortality improvement is crucial for insurers. It allows for increased credibility for actuarial assumption setting for pricing and valuations and also supports effective risk management strategies. By understanding the underlying trends and emerging medical breakthroughs, insurers can better adapt to changes in life expectancy.

The extent to which, and when, South Africa benefits from these advances depends in part on largesse from developed nations, and partly on our ability to improve the standard and access of healthcare to citizens. Insured lives may benefit more than the population as a whole, which might be good news for insurers in the short term but will result in extension of existing financial and health inequalities in the country.

EIOPA launches tool for modelling physical climate risk

The European Insurance and Occupational Pensions Authority (EIOPA) recently launched CLIMADA-app, an open-source modelling tool making use of a user interface built by EIOPA together with the open-source catastrophe model CLIMADA. CLIMADA-app can be used free of

charge by completing a registration form on the EIOPA website.

CLIMADA has been developed in Python, and models the impact of hazard events on assets and people. Examples of hazard events currently implemented include droughts, heat waves, floods, storms and wildfires. Users can also import their own hazard data into the model.

Examples of where CLIMADA-app can be used in practice include performing climate change materiality assessments (evaluating the materiality of the impact of climate change risk on an insurer) and allowing for climate change scenarios in an insurer's Own Risk and Solvency Assessment (ORSA).

There is also functionality to model the impact of "adaptation measures," which are actions taken to mitigate the frequency and/or severity of these hazard events. Users of this model can consequently perform a cost-benefit assessment of potential adaptation measures, which would then support decisions on their adaptation strategies.

EIOPA's view is that user-friendly open-source tools such as CLIMADA-app are extremely beneficial to the insurance industry, citing uses such as reducing the costs of performing analyses, increasing innovation and increasing risk awareness.

Catastrophe risk causes some US insurers to halt new business sales

In response to escalating catastrophe risks, a growing number of insurance providers in the United States are suspending new business sales in high-exposure areas. The recent decisions made by State Farm, Allstate and Farmers Insurance Group shed light on the challenges faced by insurers in covering properties exposed to wildfires, hurricanes and other natural disasters.

In California, [State Farm](#) and [Allstate](#) decided to stop new business sales for homeowners insurance. Increasing exposure to wildfire risks, high construction costs and rising reinsurance costs were cited as key contributors to these decisions. California has experienced an average of more than 7,000 wildfires each year over the past five years. Scientists and California authorities attribute the intensity of the fire seasons to the climate crisis.

State Farm stated that the decision to stop new business sales is necessary to improve the company's financial strength. It did not indicate when new business sales are

expected to resume, but stated that it will reevaluate according to market conditions.

On a similar note, [Farmers Insurance Group](#) has decided to stop writing new property policies in Florida. Farmers Insurance Group is not alone, as 15 companies have similarly halted new business sales over the past 18 months. As with State Farm's case, excessive catastrophe exposure and reconstruction costs are given as the primary drivers.

The decisions by these insurers highlight the growing challenges present in the face of climate change. As the frequency and intensity of extreme weather events increase, insurers are being forced to take on more risk. This is leading to higher premiums for policyholders and, in some cases, to insurers pulling out of certain markets altogether.

For many years, climate change has been a low-priority risk for many life insurers in South Africa. Recent progress reported on exposure to climate risks doesn't always filter down to product design, pricing decisions and reinsurance decisions. However, more recently we have seen some insurers recognising at least the climate-change-amplified uncertainty of future mortality and morbidity over the coming decades, and factoring that into premium guarantee periods and reinsurance structures.

Pre-emptive recovery planning

The Insurance Recovery and Resolution Directive (IRRD) is a comprehensive framework covering recovery and resolution planning in the EU. This IRRD is expected to be approved in 2023 or 2024. Many European insurers will therefore soon need to have in place both a pre-emptive recovery plan and a pre-emptive resolution plan.

The pre-emptive recovery plan is typically more burdensome for insurers, as the pre-emptive resolution plan is generally the responsibility of the national regulator (with relevant input from the insurer).

This Milliman Insight [briefing note](#) provides a summary of what to expect for a pre-emptive recovery plan, and highlights lessons learned to date in countries where insurers already have pre-emptive recovery plans in place.

Some of the key lessons identified in the briefing note include:

- Drafting a pre-emptive recovery plan requires considerable amounts of time and resources. While insurers can apply the principle of proportionality, in practice it can only be applied to limited sections of the plan.
- Therefore, a key decision needs to be made early on whether the plan is intended to be integrated into the risk management framework, or rather simply to comply with regulation. The outcome of this decision will influence the level of resources required to draft and implement the pre-emptive recovery plan.
- A recovery plan is distinct from an Own Risk and Solvency Assessment (ORSA). The ORSA aims to prevent an insurer from breaching its Solvency Capital Requirement (SCR) and coming under severe stress. The recovery plan starts with the insurer being confronted with severe stress and considers the actions needed to restore financial strength and viability.

If implemented correctly, a recovery plan can be a useful addition to an insurer's existing risk management framework.

In the related world of resolution planning, the UK government plans to soon implement a Resolution Regime. This would better equip the Bank of England to take the necessary action to help stabilise and manage insurers that are failing or likely to fail.

ASSA Information Note: SCR retrenchment risk considerations

The Actuarial Society of South Africa (ASSA) recently published an [Information Note](#) summarising the main considerations on retrenchment risk in the SCR standardised formula. The considerations outlined in the information note are designed to assist insurers when:

- Evaluating the appropriateness of the standardised formula
- Assessing their risk profiles and scenarios when performing their ORSAs
- Allowing for retrenchment risk in their internal models

The information underlying this note was from a survey completed by key insurers with reasonable retrenchment risk exposure. While retrenchment risk is not significant for all insurers, it can be material for those selling credit life products or risk products with a retrenchment benefit.

Some key insights from the information note include:

- The underlying survey results support the idea that the standardised formula is unlikely to be appropriate for an insurer with significant retrenchment exposure.
- The consensus view was that the current retrenchment stress in the standardised formula is too low.
- It may be appropriate to consider a retrenchment risk stress containing both a short-term catastrophe-type stress (of between six and 12 months) as well as a permanent stress to retrenchment level risk.

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:

- Guidance on Embedded Value reporting and key performance indicators (KPIs) in an International Financial Reporting Standard (IFRS) 17 world
- Capital allocation and optimisation
- Due diligence and buy- or sell-side support for mergers and acquisitions (M&As)
- 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 persistently high morbidity experience and greater uncertainty in future mortality experience
- Understanding the benefits of insurer-specific parameters, internal models, and iterative risk margins to improve capital efficiency
- 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
- Microinsurance products, distribution and licensing
- New licence applications



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