2023 Africa Insurance Outlook

Balancing uncertainty with optimism

Contents

Introduction

The Deloitte Africa Insurance Outlook gathers cutting-edge thought leadership articles from experts across Africa each year. This year's edition (our third) is no different, boasting topics relevant to the insurance industry and its service providers, with a focus on regulatory and reporting changes as well as opportunities for growth.

In a post-pandemic environment, Africa is experiencing both economic recovery and continuing uncertainty. The overview of the 2022 financial results of the largest insurance groups in South Africa, on the one hand, illustrates that the industry is recovering, restoring, and enhancing its capabilities to pre-pandemic levels. Insurers in East Africa and Ghana echo this upward trend, continuing to look at growing the sector's efficiency and profitability.

Ghana has implemented several legislative and regulatory reforms to develop the insurance industry. However, the country's economic challenges have resulted in a Domestic Debt Exchange programme. Although the debt burden may be alleviated, the insurance industry's growth and profitability may well be impaired, and insurers need to explore new investment choices in response to this.

These positive developments aside, the African insurance industry is undergoing a massive transformation to respond to regulation, reporting requirements and global trends. Insurers need to keep pace with these developments while facing macroeconomic and geopolitical challenges, including rising inflation, a high interest rate environment, the fallout from the ongoing Russia-Ukraine war, and slow economic growth.

One shift facing insurers in Africa is anticipated implementations of risk-based capital (RBC) regimes. The report reflects on South Africa's journey to an RBC regime – the Solvency Assessment and Management (SAM) framework – and what lessons can be learnt from this for other African countries adopting RBC regimes.

The newly implemented financial reporting standard, IFRS 17: Insurance Contracts, is now effective for annual reporting periods beginning on or after 1 January 2023. As we've done in the last instalment of our Deloitte Africa Insurance Outlook, we continue to explore how financial reporting will change as a result of the new standard.

A further regulatory change focuses on fair treatment for customers, specifically conduct risk management. This was initiated through the local Treating Customers Fairly programmes. In what is being referred to as a seismic shift in UK consumer protection regulation, the UK Financial Conduct Authority has issued the so-called Consumer Duty. Our experts unpack this and the impact it may have on South Africa's Financial Sector Conduct Authority's (FSCA) intention regarding the fair treatment of customers. They also reflect on lessons from the UK's approach and its implementation.

An additional shift in the industry is being driven by South Africa's Sustainable Finance Initiative, which has published the country's first Green Finance Taxonomy. This framework is a move toward more environmentally friendly underwriting and investment and was launched to mobilise the capital urgently needed for climate mitigation, adaptation efforts, and broader socio-economic development.

With the economic, social, and regulatory challenges, and in a highly competitive and saturated industry, insurers can no longer simply protect their market share: they need to take advantage of opportunities to grow their businesses. Embedded insurance offers insurers new digital distribution channels to reach potential customers, helping to increase market access. This opportunity illustrates that digital and technological investment enables all domains of competitive advantage. Insurers must also carefully consider how to invest in meaningful partnerships with insurtechs and the non-insurance market.

This report offers a timely evaluation of the African insurance industry's current activities, operating models, and the integration between actuarial, accounting, and technology to identify potential improvements.

We believe that this report offers insight into the African and global insurance markets and we look forward to your feedback.

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Overview of the 2022 financial and embedded value results of the largest insurance groups in South Africa

Introduction and industry growth

In March 2023, the larger insurance groups in South Africa released their annual or half-year financial results for the period ended 31 December 2022. Despite these insurers operating in a hostile economic environment and having to deal with skittish investment markets, the 2022 results, when viewed in aggregate, underline the industry's ongoing recovery post the COVID-19 pandemic. Profit before tax increased by 5.6% from the previous year, which in turn was a substantial improvement on the year before.

A common theme in the analyst and shareholder presentations is how the industry has restored, or even enhanced, its distribution capabilities to pre-pandemic levels. The results of these efforts are apparent in the 2022 financial results. For example, Old Mutual reported a 10% increase in new life insurance annualised premiums and a 12% increase in gross written premiums during its 2022 financial year. Similarly, Sanlam reported that life new business volumes remain "well above pre-pandemic levels".

These same presentations show that it was not all plain sailing, however. In some instances, the new business volumes did not convert to improved value of new business (VNB) results. This was true where new insurance sales were made on lower margin business, dampening the overall new business margins. Distribution executives must focus on an appropriate mix of new business, rather than volume alone.

Premiums reported by **non-life** insurers also tell an interesting story. The South African Reserve Bank (SARB) statistics for the 12 months ended 31 December 2022 show that the non-life insurers (primary, cell captive, and captive insurers) generated a 7% increase in gross written premiums during the period. While on face value, 7% growth may seem satisfactory, the premium growth should be viewed against the backdrop of the sum of the country's growth in Gross Domestic Product (GDP) and Consumer Price Inflation (CPI) during the same period. Only once the non-life industry's premiums exceed the sum of these two metrics, which was 9% in the period, does it achieve real growth. On this basis, the non-life insurance industry did not grow in 2022. Executives are balancing growth while retaining underwriting discipline. This situation has led to increased corporate activity in the past year, with small and medium-sized insurers being acquired by larger insurers; for example, ONE Financial Services and GENRIC were acquired by Old Mutual Insure, and Renasa by Telesure Investment Holdings.

This article will focus on the themes reported by the five largest insurance groups in South Africa, referring to their International Financial Reporting Standards (IFRS) and embedded value (EV) results, which collectively represent more than 80% of the local industry's premiums and assets. An analysis of the results in aggregate is presented, forming an industry view, rather than commenting on the results of the individual insurance groups.

Summary of the industry results and capital position

Three of the five insurance groups referenced in this article have 31 December year ends, and two have 30 June year ends. For the latter two groups, 2022 interim results and historic announcements were used to calculate pro forma results for a 12-month period ended 31 December 2022. The table below summarises the IFRS results for the five insurance groups on the basis described. The "total" or "aggregated" calculations are the sum of the five insurance groups.

Consolidated results of the five large insurance groups as at and for the year ended 31 December 2022

Rand million *Restated	Old Mutual			Sanlam			MMH		
	2022	2021	*% change*	2022	2021	*% change*	2022	2021	*% change*
Total assets	1 064 456	1 053 854	*1.0%*	1 006 586	1 056 178	*-4.7%*	596 308	591 493	*0.8%*
Total liabilities	-997 910	-988 553	*0.9%*	-921 744	-973 282	*-5.3%*	-570 483	-568 920	*0.3%*
Equity	66 546	65 301	*1.9%*	84 842	82 896	*2.3%*	25 825	22 573	*14.4%*
Profit/(loss) before tax from continuing operations	9 151	13 427	*-31.8%*	15 179	15 338	*-1.0%*	9 199	3 284	*180.1%*
Tax	-1 352	-5 964	*-77.3%*	-3 297	-5 352	*-38.4%*	-3 703	-2 942	*25.9%*
Profit/(loss) after tax from continuing operations	7 799	7 463	*4.5%*	11 882	9 986	*19.0%*	5 496	342	*1507.0%*

Consolidated results of the five large insurance groups as at and for the year ended 31 December 2022

Rand million *Restated	Liberty			Discovery			Total		
	2022	2021	*% change*	2022	2021	*% change*	2022	2021	*% change*
Total assets	425 597	430 395	*-1.1%*	284 950	274 390	*3.8%*	3 377 897	3 406 310	*-0.8%*
Total liabilities	-404 276	-408 022	*-0.9%*	-227 766	-222 215	*2.5%*	-3 122 179	-3 160 992	*-1.2%*
Equity	21 321	22 373	*-4.7%*	57 184	52 175	*9.6%*	255 718	245 318	*4.2%*
Profit/(loss) before tax from continuing operations	2 417	1 804	*34.0%*	6 473	6 313	*2.5%*	42 419	40 166	*5.6%*
Tax	-1 208	-1 840	*-34.3%*	-1 356	-1 663	*-18.5%*	-10 916	-17 761	*-38.5%*
Profit/(loss) after tax from continuing operations	1 209	-36	*-3458.3%*	5 117	4 650	*10.0%*	31 503	22 405	*40.6%*

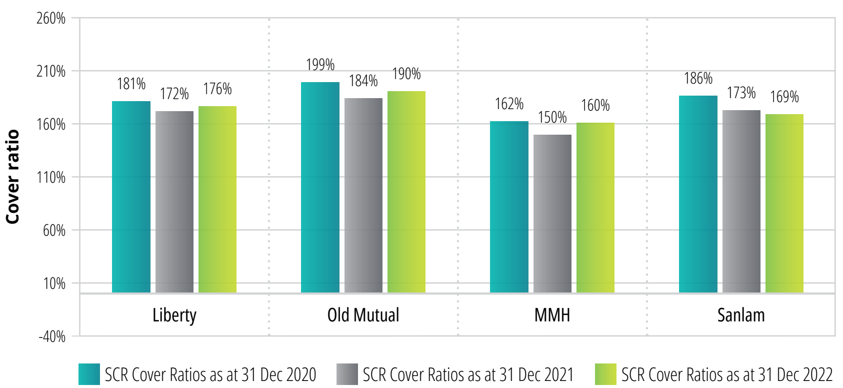
Although the JSE SWIX All Share Index shows that the South African equities market was volatile during the year, it closed within 1%, down from where it started at the beginning of the year. The volatility reflects the impact of rising inflation and interest rates on the economy. This environment is not fertile ground for insurance groups with products that have an investment element nor insurers with investment management offerings. Overall, the total **assets** decreased by 0.8% (2021: increase 12.1%), adding pressure to asset-based fees earned by insurance groups. Other factors that contributed to the decrease in assets are the disposal of subsidiaries or assets no longer regarded as core, for example, the disposal of Sanlam Life and Pensions UK.

Total liabilities decreased by 1.2% (2021: increase 12.9%), reflecting the muted investment markets and lower Covid-19-related policyholder liabilities. Also, the liabilities from the above-mentioned subsidiaries sold are excluded.

The aggregated **equity** for the insurance groups increased by R10.4 billion, or 4.2%. The increase in equity is after aggregated **profit after tax** from continuing operations of R31.5 billion (2022: profit: R22.4 billion) reported by the insurance groups less the ordinary dividends paid of R5.5 billion (2021: R5.7 billion). Insurance groups' dividend and capital management policies are varied. For example, Discovery Group's half year results at 31 December 2022 reported that while its operating profit had grown, with strong cash generation, its board had chosen not to declare a dividend, instead investing in growth. In comparison, Sanlam and Old Mutual did declare dividends and announced share buy-back programmes. This illustrates the careful balance between retaining sufficient profits to fund growth, while not being penalised by the market for retaining capital surplus to requirements.

Insurance groups continued reporting relatively healthy regulatory Solvency Capital Requirement (SCR) cover ratios, tracking in the range of 150%-200%. Over the past three years, a general trend of decreasing SCR ratios has been observed, with some insurance groups lowering their solvency target ranges. The graph below illustrates the group SCR ratios.

SCR Cover Ratios



Discovery did not disclose their Group SCR ratio

On an aggregated basis, the insurance groups reported **profit before tax** from continuing operations of R42.4 billion, an improvement on the R40.2 billion profit reported in 2021. The financial results include the impact of the following:

Lower levels of life-death claims as COVID-19 reached an endemic stage

The Association for Savings and Investment South Africa (ASISA) statistics show that in 2022 life insurers paid 26% fewer claims than in 2021. While this is encouraging, ASISA also noted that the 2022 number of claims is still higher than in 2019 before COVID-19. In its 2022 results, Old Mutual reported, "All remaining COVID-19 provisions were released but the impact was mostly offset by the strengthening of our mortality basis to allow for endemic COVID-19 claims, and worsened persistency as the challenging economic conditions continue to impact our retail customers."

Worsening persistency for life insurance policies

ASISA, as part of its 2022 statistics, reported that "hidden deeper in the statistics is evidence of South African consumers' unprecedented hardship." One such indicator is that 8.4 million risk policies lapsed in 2022 compared to 7.4 million in 2021. From the Old Mutual extract above, it is evident that some insurers have already assumed a worsening persistency experience in the immediate term.

Constrained non-life insurance underwriting results

The record books for non-life insurers will show that 2022 was not one of its better years. The year brought muted premium growth, increasing claims inflation, and significant catastrophe events. Santam reported an underwriting margin for its conventional insurance business of 5.1%, which is less than the 8.0% reported last year. The group highlighted the KwaZulu-Natal floods as the largest natural catastrophe event faced in the past 100 years, with claims amounting to R4.4 billion. Similarly, Old Mutual Insure paid claims of R1.4 billion relating to this event.

Insurers also had to deal with the increased cost of their reinsurance programmes. While reinsurers absorbed most of the 2022 catastrophe losses, the increased frequency and severity of catastrophe loss events in South Africa has had a cost. There have been reports of reinsurers asking for a 30% increase in catastrophe reinsurance premiums during the annual renewal.

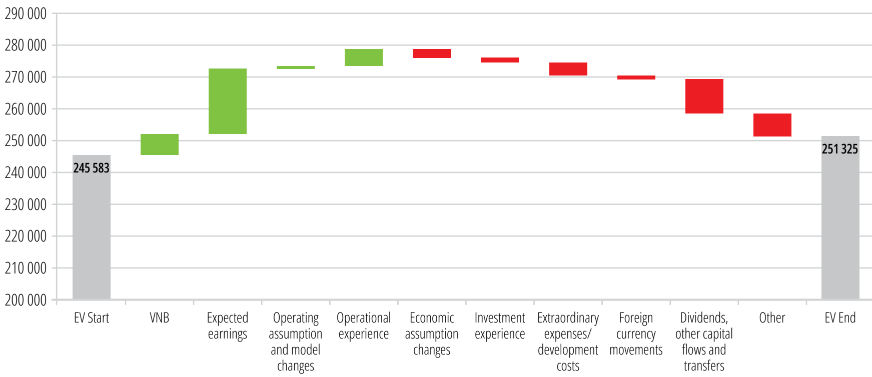
The motor risk class, which, for many non-life insurers is their largest contributor to premiums, also faced challenges, including rising inflation claims costs and increased frequency of theft in certain market segments. Insurers responded with focused premium rate adjustments, improved risk selection, and improved efficiency of their claims procurement processes. Their efforts did not go unrewarded, with the SARB statistics showing improved underwriting results in the second part of the year. All eyes are on a catastrophe-free 2023.

The Embedded Value (EV) remains an important metric in assessing the insurance groups' profitability, performance of existing business, and long-term financial sustainability. On an aggregated basis, the insurance groups (excluding Liberty) reported a 2.3% increase in EV from R245.6 billion to R251.3 billion.

The graph presents the aggregated EV position for the insurance groups, excluding Liberty.

Aggregated change in EV for the 12 months ended 31 Dec 2022

R'millions



Excludes Liberty, who did not disclose their EV results.

The observed decline in the national excess deaths, as reported by the South African Medical Research Council (SAMRC), is consistent with the lower levels of deaths claims experienced by the insurance groups. The impact is also evident in the disclosed EV results. In contrast to the previous year, all insurance groups showed positive **Operating experience** variances, driven by improved mortality experience.

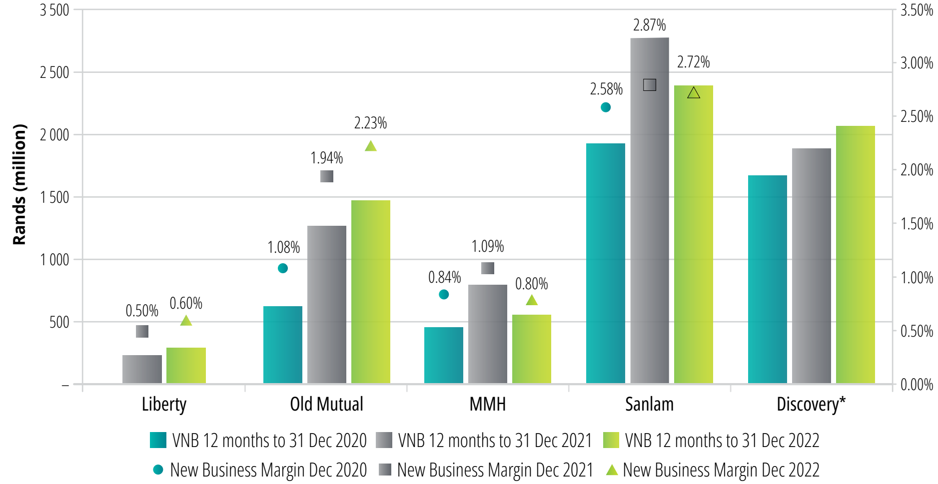
The aggregate net impact of **Operating assumption and model changes** was relatively small, but consisted of sizable offsetting changes. The positive impact of the release of COVID-19 reserves was offset by higher long-term mortality rate assumptions, as well as the strengthening of the persistency assumptions in response to poor persistency experience.

The **VNB** contributed R6.5bn to the insurance groups' EV (excluding Liberty).

The **new business volume** and **VNB Margin** results were a mixed bag of performance, as is evident in the graph.

Value of New Business and VNB Margins

for the 12 months ended 31 December 2020, 2021 and 2022



**Discovery group VNB margin not disclosed.*

Some insurance groups showed strong growth in new business volumes and stable or increasing VNB margins, demonstrating that these groups can continue to generate value in the competitive financial services landscape. Although some insurance groups' new business performance remained strained, it was evident that this is a strategic priority. For example, referring to the low new business value generated, the Liberty Group Limited Annual financial statements as at 31 December 2022 stated, "Strategic initiatives underway are expected to address the volume and margin challenges."

As in the previous year, insurance groups' mass-market product offerings continued to contribute to the increase in new business, while the trends of muted new business volumes and strained margins for the more affluent market offering also continued.

Conclusion

The 2022 financial year was a period of continued recovery for life insurers with death claims returning to levels more comparable to pre-COVID-19 periods. In turn, although non-life insurers were substantially impacted by the KwaZulu-Natal floods coupled with rising reinsurance costs, the non-life industry still was able to report results that were in the black.

Looking ahead to 2023, executives in the industry remain upbeat about their businesses but quickly point to the storm clouds that continue to gather in the form of an economy under strain. It is clear that the industry will have its work cut out to continue the profit trajectory seen in the past two years. Nonetheless, the South African insurance industry has an impressive track record of growth and profitability through a diverse product set and distribution capability. It normally does find a way.

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East Africa Insurance Overview

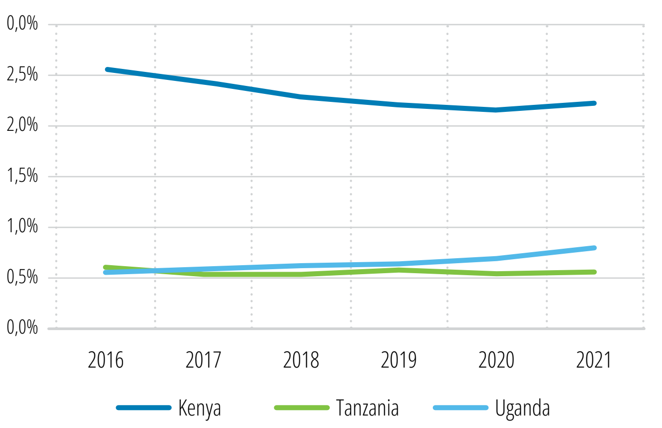
Overview

Overall, the East African insurance industry has been on an upward trend in the aftermath of the global COVID-19 pandemic. However, the industry faces various macroeconomic and geopolitical challenges that could impact the growth rate over the short to medium-term. Rising inflation and fallout from the ongoing Russia-Ukraine war are just a couple of the issues that executives need to navigate amid their strategic initiatives. A third challenge, slow economic growth, has had a particularly negative impact on insurance penetration.

East Africa insurance sector performance

Relative to established insurance markets in other emerging countries, East Africa's insurance market, particularly life insurance, is at an early stage of development. Total insurance penetration stood at 1.2% across the region in 2021, with insurance penetration at 2.2% in Kenya, 0.6% in Tanzania, and 0.8% in Uganda.

Insurance Penetration



Source: Fitch Solutions[1]

Kenya overview

Insurance penetration in Kenya witnessed a consistent decline leading up to the global pandemic. This decline can be attributed to the insurance industry's slower growth than the overall economy.

Tanzania overview

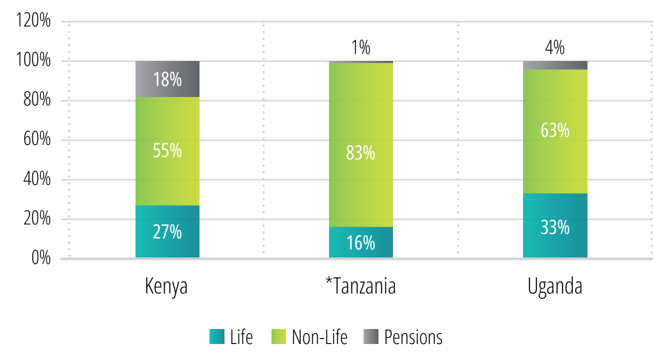
Tanzania has experienced a relatively inconsistent insurance penetration over time. This is due to fluctuations in the insurance industry's growth over the years, especially in the general insurance sector, while the economy steadily increased.

Uganda overview

Uganda has experienced a slight increase in insurance penetration. This is because the insurance industry has been growing more quickly and consistently than the rest of the economy. This growth is mainly attributable to the life insurance sector.

Across all countries, the increase in insurance penetration between 2020 and 2021 shows that the market is recovering from the pandemic.

Insurance Sector Market Composition by GWP – 2021



Source: IRA Kenya, IRA Tanzania, IRA Uganda Annual Industry Report[2]

*Tanzania composition as at 2020 due to data unavailability

Non-life insurance remains the largest contributor to insurance activity in East Africa, with this class of insurance contributing 61% of the industry's gross written premium. A growth driver for the sector has been the adoption of digitisation technologies. Pensions in Uganda and Tanzania are yet to be liberalised, while in Kenya, private schemes have been established alongside the existing public ones.

Aside from South Africa, East Africa is emerging as a vibrant fintech hub in Africa. The industry stands to further benefit from these innovative solutions, with greater affinity for life assurance and pensions in the long term. Going forward, a continued upward trend in gross written premium is expected with life insurers and pension providers forming strategic alliances with banks and telecommunication companies to improve inception rates and new business volumes.

Charting the path to the future of insurance

Globally, insurers continue to adopt digital mindsets to transform their customer and value proposition, attract talent, and operate more efficiently in the wake of increased regulatory requirements such as IFRS 17.

Insurtechs in the region

There is increasing competition from insurtechs and technology firms for both business and talent. To maintain a culture of innovation and a customer-centric standard operating model, insurance companies need to transform, adopt a digital mindset, and shift from being reactionary to proactively adapting to customer needs and expectations. As stated in this year's *East Africa Insurance Outlook Report,*[3] the future winners in insurance are the ones who make the most of technical capabilities

The war for talent

Deloitte East Africa Actuarial and Insurance Solutions Leader, Rebecca Kariru-Muriuki, notes in the East Africa Insurance Outlook Report:[4]

> *As the East African economy recovers from the adverse impacts of the pandemic, insurers should be preparing for top line growth. As a result of this, the great resignation and other forces impacting the talent pool in insurance, insurers need to rethink their strategies in retaining and attracting the right talent. The accelerated digitisation and virtualisation of insurance operations has led to a rising need of technological skills like cloud engineering, data science and analytics, machine learning, software development, and cybersecurity. Therefore, insurers will not only compete with industry peers for talent but also global tech giants.*

Regulatory compliance

IFRS 17 regulations for insurance contract reporting have now become effective. Insurers in the region, therefore, need to make significant progress in complying with IFRS 17 requirements before their first financial reporting cycle under the new reporting standard. Underestimated budgets, lack of access to the degree of expertise needed for IFRS 17 implementation, and a lack of technology and data necessary for a successful implementation are just a few of the challenges insurers will face during implementation.

Environmental, social, and governance landscape

The Environmental, social and governance reporting (ESG) landscape is changing rapidly, and firms are under increased pressure to assess, manage, and disclose their ESG positions and commitments. Insurers must demonstrate their principles by unlocking sustainable business practices (from underwriting to pricing) that encourage more sustainable customer behaviour.

As Deloitte East Africa Financial Institutions Services Team Leader, Charles Luo, points out in the East Africa Insurance Outlook report:[5]

> *An effective and well-rounded ESG framework can give an insurance company competitive advantage and influence positive underwriting results. Credit rating agencies are now incorporating ESG in their rating criteria. As a result, implementing an ESG framework may enhance an insurer's credit rating, enabling easier access to capital.*

Consumer trends

Companies that are preparing for the inevitable disruption (by, for example, the rapidly changing needs and evolution of consumers and the forces of change in ways of working) will have significant first-mover advantage in capitalising on the opportunities that these trends present to insurers. While macroeconomic factors have impacted the growth and profitability of the insurance industry, an increasingly sophisticated consumer is pressuring the industry to provide more customised services, including on-demand and real-time insurance, over multiple platforms.

Conclusion

In 2023 and beyond, the East African insurance market will face new challenges. Insurers must position themselves to protect their market share and take advantage of new opportunities to grow their businesses.[6]

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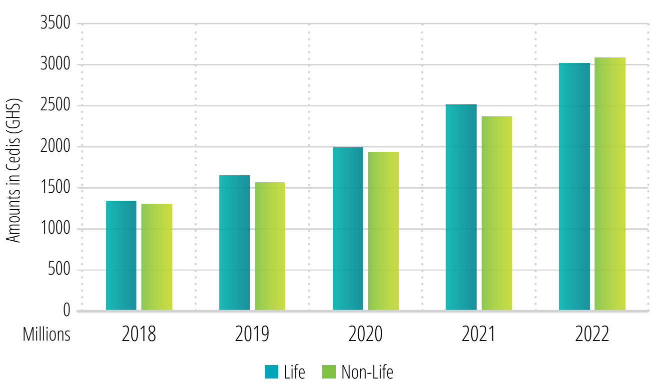
Ghana's Domestic Debt Exchange programme and its impact on insurers

Over the years, the insurance industry in Ghana has seen tremendous transformation, with the introduction of several legislative and regulatory reforms aimed at enhancing the sector's efficiency and profitability. Ghana's stable political environment and reputation for business friendliness have made it appealing to investors. These strategies have been extremely beneficial and contributed to total gross written premiums increasing by 232% from GHS2.6 billion in 2018 to GHS6.1 billion at the end of 2022.

Gross Premiums (GHS), 2018 - 2022



Source: National Insurance Commission Ghana website[7]

Ghana, like most African countries, has faced severe economic pressure following the COVID-19 pandemic and fallout from the Russia-Ukraine war. Inflation jumped dramatically from 13.6% in January 2022 to 54.1% in December of the same year. The depreciation of the GHS against the USD exacerbated an already tough situation, causing downgrades in Ghana's sovereign credit ratings.

The country's debt sustainability gains have been threatened by a lack of access to external capital markets and increasing borrowing costs. In July 2022, Ghana began bailout talks with the International Monetary Fund (IMF) and secured a staff-level agreement in December 2022 to restore macroeconomic stability and debt sustainability.

To secure the IMF's approval, the Ghanaian government announced its planned Domestic Debt Exchange (DDE) programme on 5 December 2022. This programme invites the voluntary exchange of approximately GHS137 billion in domestic notes and bonds for a package of new bonds to be issued by the Republic. According to the finance ministry, the DDE programme will restore sustainable debt levels and kickstart economic growth.

The National Insurance Commission (NIC) responded to the DDE by announcing various regulatory interventions to alleviate liquidity and capital constraints on regulated entities and ensure that they can continue to meet claim obligations.

Impact on profitability

In Ghana, insurers like banks have substantial holdings in bonds.[8] According to the Ghana Insurers Association (GIA), government securities account for GHS11.5 billion or 40% of the industry's total assets. This is anticipated to decrease slightly going forward.

Investment income frequently accounts for a sizable amount of insurance companies' earnings. At the end of the fourth quarter of 2022, it contributed GHS1.12 billion or 73% of total income. The DDE's impact on profitability will depend on several factors, including the terms of the exchange, the number of bonds agreed to be exchanged versus total government bonds held, and the pre-crisis financial soundness of the insurance company. If the terms of the programme are unfavourable, such as longer tenures and lower coupon rates, the company's expected investment income may suffer (assuming a decision is made to participate).

According to IAS 39, impairment is on an incurred loss basis; hence, evidence is required before impairment provisions are made. The government's announcement of a debt restructuring programme qualifies as a loss trigger. As a result, insurers are expected to make hefty impairment provisions, which will have a significant effect on financial performance.

Primary Source of Insurance Income (NIC Quarterly Reporting – 2022 Quarter 4)

Source: National Insurance Commission Ghana website[9]

IFRS 17 implementation

The implementation of IFRS 17 has progressed steadily. The NIC is developing a template for industry IFRS 17 reporting to update the current Supervision Department Returns (SDR). Following the announcement of the DDE, the NIC commenced discussions with the Institute of Chartered Accountants, Ghana (ICAG) to postpone the implementation date for IFRS 17 from 1 January 2023 to 1 January 2026.

Liquidity constraints

One of the most significant challenges to Ghana's insurance industry is liquidity risk. If the new debt instruments resulting from the DDE have longer maturities, an insurance company may need to hold onto them for longer than anticipated. Again, the tradability of the old bonds is expected to be limited, thereby reducing liquidity and potentially affecting the ability to pay claims. The regulator has approved revisions to the claims payment guidelines to address this. The number of working days within which non-life and life claims are to be paid will be increased from 5 to 15, and 3 to 15, respectively. The maximum period within which all processes leading to the payment of claims should be completed will also be increased from 4 to 8 weeks.

To shore up liquidity, the NIC will release up to 50% of the minimum statutory deposit to eligible regulated entities upon request.

Other regulator interventions

Additional regulatory interventions include the following:

- Moratorium on the enforcement of Minimum Capital Requirements (MCR) and Capital Adequacy Ratios (CAR): For an initial period of two years, regulated entities must follow operational guidelines and demonstrate the ability to pay claims and operating expenses.
- Reduction in NIC fees: There will be a 40% reduction in NIC product approval fees for products that are re-packaged and re-priced due to the DDE.
- Regulatory assets: Insurance companies may be allowed to create a "regulatory asset" to fill gaps in their balance sheets caused by the debt exchange, with 15 years to write it down.
- Spread of losses: The spread of day-one losses on new bonds may be written off over 4 to 5 years to prevent a negative net worth for some companies.

Next steps

Despite being in the early stages, there is consensus on the long-term impact of the DDE programme on the insurance industry.

While the programme is expected to alleviate the country's debt burden, it is also likely to impair the return on investment for insurance companies. Insurers are encouraged to take advantage of the regulatory interventions and explore alternative investment choices to boost returns.

Ultimately, the debt exchange programme underscores the importance of insurance companies having a diversified investment portfolio.

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Analyses of IFRS 17 disclosures from December 2022 year-end and half-year published reporting

IFRS (International Financial Reporting Standards) 17: Insurance Contracts is now effective for annual reporting periods beginning on or after 1 January 2023 and replaces the current reporting standard, IFRS 4. The new standard introduces more consistent and detailed disclosures, providing the investor community greater comparability within and across jurisdictions. The complete overhaul of reporting has renewed the enthusiasm of investor markets and consequently increased the pressure on entities, not only to get the implementation right the first time, but also to find opportunities to capitalise on their implementation programmes. Most insurers have undertaken this unenviable task with a minimal view of what industry peers are doing and what will emerge in a stable state.

The requirements of IAS (International Accounting Standards) 8: Accounting Policies, Changes in Accounting Estimates and Errors necessitate the disclosure of the impact of effective, but not yet adopted, financial reporting standards; however, these disclosures have generally left the users of financial statements wanting. This has been evidenced in the South African market, where published annual reports generally contain the bare minimum IAS 8 disclosures. Consistently entities have qualitatively disclosed the impact of transitioning to the new standard by, for instance, outlining new accounting policies and providing implementation progress updates. From a quantitative perspective, entities have disclosed equity impact estimates as at the transition date and high-level earnings commentary. This has elevated tension among analysts who require detailed disclosures and early explanations to help them understand and prepare for live reporting.

This article will explore past IAS 8 disclosures, other market communications on IFRS 17, and expected shareholder communication under IFRS 17. It will look at the insights gathered from the disclosures by insurers, analyst expectations and thoughts on future results releases.

Insight gleaned from South African and global insurance markets

Communication of the impact of IFRS 17 on an insurer's reported results is a critical element of the last phases of the IFRS 17 journey. To understand what has been communicated, and what may still be coming, the authors have reviewed the financial statements, disclosures, and market communication through investor updates and transition reports produced by a sample of South African insurers and insurers in the European and Asian markets.

The communication to the market of the impact of IFRS 17 can be seen in two parts:

Part 1

Transition impact at 1/1/2022 (for December year-end companies)

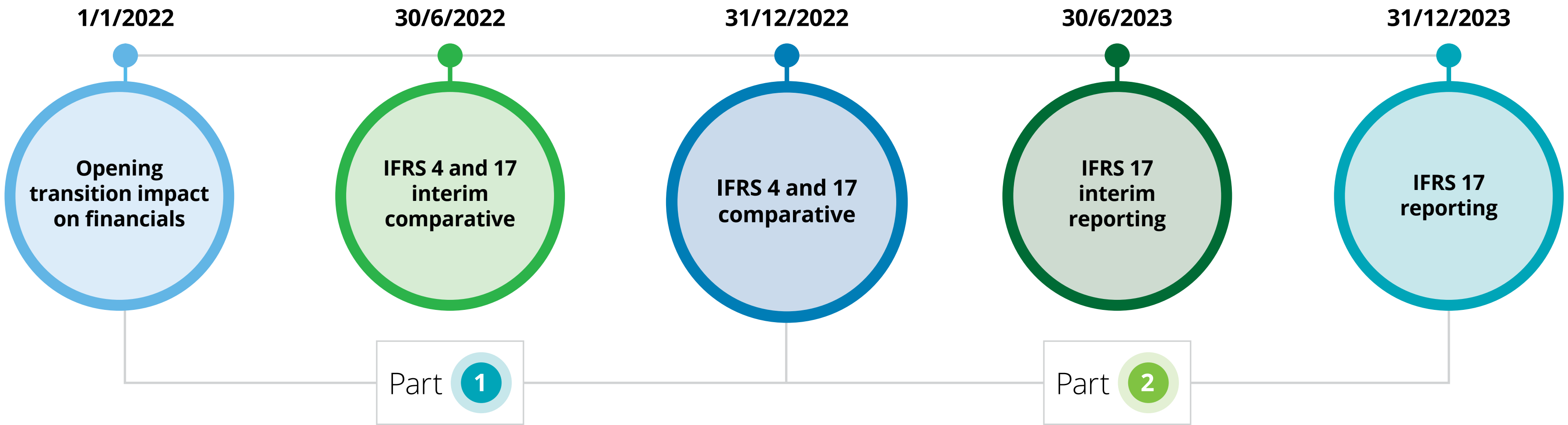
As part of the 31 December 2022 year-end reporting, communication from the South African market was mostly through financial statements. The statements offered insight into the net equity impact at the transition date, highlighting some significant upward or downward ranges and/or directional impacts in the movement of net equity. Profit earnings were discussed more qualitatively, and it is likely that the quantitative change in profit earnings patterns under IFRS 17 will be observed in interim reports, subsequent annual financial reports, or quarterly investor communications.

Part 2

Financial year-end 2022 and 2023 performance under IFRS 17

These reports will give the market its first view of how companies performed from one reporting period to the next, as well as an understanding of performance under IFRS 17 relative to IFRS 4 for the comparative period. For the first time, the users of the financial statements will be able to see the impact of changes in market conditions, new business volumes, inflation rates and changes in non-financial assumptions have had on the financial results. Furthermore, users will be able to benefit from the increased transparency under IFRS 17 and start comparing old and new key financial performance metrics.

The diagram below illustrates, for a December year-end company, the minimum reports containing IFRS 17 information that South African insurers will prepare in 2023 and 2024 calendar years.



Although not an IFRS reporting requirement, one of the investor updates insurers might produce is an IFRS 17 transition report that could be expected before the reporting of the interim financial statements. The expectation is that these reports will expand on previously reported transition results, including the disclosure of balance sheet bridges between IFRS 4 and IFRS 17, metrics segmented per IFRS 17 measurement methodology, line of business, and more detail on assumptions made and future profit releases (to the extent available). The transition balance sheet report is unlikely to include full-year comparative year information. However, some insurers might take the opportunity to warm the market to interim comparative IFRS 17 results and to continue educating the reader on the expected impacts on earnings and perhaps more complex design decisions (e.g., OCI, risk mitigation). Beyond this, the impact of IFRS 17 on key performance indicators should be discussed, and expectations set for interim reporting.

Disclosures to date

Equity and earnings

As part of the IAS 8 disclosures, insurers had to disclose known or reasonably estimable information relevant to assessing the possible impact on the financial statements of shifting to IFRS 17 in the initial application period. For December year-end insurers, this would have been as at 1 January 2022. For insurers to comply with the IAS 8 requirements, they would need to have disclosed the quantitative impact of the initial application of IFRS 17 if they could reasonably do so. If unable to estimate the impact reliably, insurers could report qualitatively. For this type of disclosure, the market could expect the impact on net profit after tax and the impact on company's net asset value or equity position.

In their disclosures to date, insurers in South African, European and Asian markets have made a point estimate, or, if a point estimate is unavailable, a range on the impact of equity at initial application. Most insurers have made qualitative statements around the impact on earnings at transition or the expected impact of earnings post-transition. A select few in the European and Asian markets disclosed line-by-line balance sheet impacts at the transition date. Most South African insurers should include this disclosure in their transition reporting as part of their investor updates in 2023.

A study of a sample of insurance entities across Africa, Asia, the Europe Union (EU), and the United Kingdom (UK) focused on the largest insurers with December year-ends which had recently published their annual financial statements, including their IAS 8 disclosures on the impact of IFRS 17. Additional information in the form of press releases or investor information was used to enrich the IAS 8 information focusing on the impact of IFRS 17 on equity and earnings. While some insurers indicated the expected quantum of their earnings impact at transition, the following diagram only highlights whether there is an expected increase or decrease in earnings in the near term as a result of IFRS 17.

Region	Insurance Group	Equity impact from shift to IFRS 17 at 1/1/2022	Near term earnings impact of shift to IFRS 17	Source
Africa	Old Mutual	6-7% Reduction	Reduction	Old Mutual Limited Annual financial statements for the year ended 31 December 2022
Africa	Sanlam	14-18% Increase	Earnings marginally accelerated	Annual results for the year ended 31 December 2022; Investor presentation on IFRS 17 Insurance contract 12 October 2022
Africa	Liberty	6% Reduction	No indication	Liberty Group Limited Annual results for the year ended 31 December 2022
Africa	Momentum Metropolitan*	Increase expected	Small negative impact	MMH interim results presentation as at 31 December 2022
Europeon Union	AXA	27% Reduction; Excluding OCI 3% reduction	Largely unaffected	Annual financial report as at 31 December 2022; IFRS 17 and IFRS 9 investor presentation 3 November 2022
Europeon Union	Allianz	23% Reduction (mainly driven by OCI on insurance business)	Largely unaffected	Annual financial report as at 31 December 2022
Europeon Union	Generali	1% Reduction	No indication	Annual financial report as at 31 December 2022
United Kingdom	Lloyds Banking Group	4% Reduction	Reduction	IFRS 17 Transition document April 2023
Europeon Union	CNP	9% Increase	Reduction	Press release: Application of IFRS 17 to the 2022 published financial statements
United Kingdom	Legal & General	52% Reduction	Reduction	Communication by Group CFO: An introduction to IFRS 17
United Kingdom	Aviva	11-16% Reduction	Reduction	Annual financial report as at 31 December 2022
Europeon Union	Munich Re	8% Reduction	Increase	Media information released 14 December 2022; Group Annual Report 2022
Asia	AIA	7% Reduction	Largely unaffected	Annual financial report as at 31 December 2022
Asia	Prudential	11-16% Increase	Reduction	Annual financial report as at 31 December 2022

*Momentum Metropolitan have a June year-end and were not required to disclose transition impacts as part of their interim disclosure as at 31 December 2022. Their IAS 8 disclosures should appear with their 30 June 2023 Annual financial statements.

The impact of moving from IFRS 4 to IFRS 17 on the equity position of an insurer does, to a large degree, reflect adjustments to the level of prudence when moving from IFRS 4 to the more aligned IFRS 17 framework. The impact of transitioning to IFRS 17 on a company's equity position varies between the different insurers. An analysis of the impact on net equity as a percentage of IFRS 4 equity for the sample of insurers shows significant variability. Given the inconsistencies in the level of prudence applied under IFRS 4 across different insurers, this variability is unsurprising.

Additional disclosures

There has been reasonable consistency in disclosures by insurers within South Africa. Globally, some insurers have disclosed significantly more information than required. AXA and Allianz included a detailed bridge between their IFRS 4 and IFRS 17 balance sheet at the transition date in their year-end reporting. CNP and LBG have already produced a report showing their comparative year results under IFRS 4 and IFRS 17 through a press release; while the report included disclaimers and did not have all the required granularity, it does provide reasonably specific income statement and balance sheet implications of IFRS 17. Similarly, Prudential released, as part of their year-end results, a walk for FY22 between IFRS 4 and IFRS 17 operating profit (with a range of impact between US$650m and US$850m) and explained key drivers of change in the walk. Some, including SCOR, have set targets for FY23 already and disclosed these targets as part of a press release.

Varying degrees of detail are evident in respect of:

- Segmentation of transitional disclosures: Liberty disclosed information by measurement model and line of business
- Design decisions such as coverage units: Old Mutual have clearly defined their decisions by line of business
- Attributable expense percentages: AXA have specified their non-attributable percentage
- Confidence levels: Old Mutual is the only South African insurer to specify the percentage
- Expected future communications

New Key Performance Indicators (KPIs)

There is a big question in South Africa and Asia around whether IFRS 17 will drive out Embedded Value, given IFRS 17's overlap with the principles of Traditional Embedded Value (TEV), Market Consistent Embedded Value (MCEV) and European Embedded Value (EEV), and the potential for overlapping effort. Some insurers in South Africa have already moved away from Embedded Value reporting, while others are considering the move. With the aim of IFRS 17 bringing a globally consistent view of insurance service and financial results, market analysts will adopt new ways of analysing insurers' value using the audited IFRS 17 results; however, supplementary management reporting might still have its place in providing additional insights. In South Africa, embedded value information will likely be published for the next few years, while market participants better understand IFRS 17 and the new information that the IFRS 17 disclosures provide.

Investor communication from insurers on the impact of IFRS 17 on key metrics such as return on equity (RoE) and value of new business will be a focal point in transition reporting, interim reporting and the first set of IFRS 17 annual financial statements. The investor market is looking for necessary clarity on KPIs. For example, metrics that show sustainability, growth, sources of performance and dividend generation capability will likely change under IFRS 17 and therefore investors' understanding of these new metrics will be key to managing the move to IFRS 17 beyond transition figures. A number of IFRS 17 specific metrics make this possible. A selection of possible Contractual Service Margin (CSM) KPIs are described below:

CSM KPI	Calculation
New Business CSM margin	CSM on new business/Insurance revenue
CSM Margin	CSM/Insurance revenue
CSM Run off	CSM Run off %
CSM balance growth	Year over year CSM balance growth
CSM new business growth	Year over year new business CSM
Loss components splits*	Size of loss component + splits based on underlying business
Onerous loss %	Loss component/Liability for incurred claims

*There is a lot of discussion around the CSM in the recent disclosures but very little is said on the loss component dynamics. The view from the market seems that it will not be scrutinised in much detail.

There is an expectation that these CSM-related KPIs might replace embedded value-type metrics such as Value of New Business (VNB) and Value of In-force (VIF) produced as part of additional shareholder reporting. The CSM and VIF for in-force business are somewhat similar in that they represent the insurance business's value to shareholders[10]. The mechanics behind the calculation of the CSM and the future release of CSM is more standardised and transparent than the VIF and release of VIF numbers, which allows for more reliable comparisons to be drawn between insurers. The new business margin that life insurers commonly determine as the VNB under the EV basis divided by the present value of new business premiums might be replaced with the CSM on new business as a proportion of Insurance revenue determined under IFRS 17. Additional information might be needed to communicate value effectively under IFRS 17, such as the present value of new business premiums and multiples to use for short contract boundary business.

The CSM is subject to external audit, which provides additional confidence to the reported balance. Metrics such as VNB and VIF are often not part of the audited financials. The CSM is also produced at a granular portfolio level with information about the future release pattern of the CSM, which makes for a very informative future-looking metric.

Conclusion

The recent set of annual reports and press releases provide valuable insight into the impact of IFRS 17 on insurers' financials. Communicating the impact of IFRS 17 on insurers' financials to the market will be a critical focus area in the years ahead. As financial reporting results production settles, internal key performance metrics, information used by market analysts, and the implications for business strategy, pricing and forecasting will be the focus.

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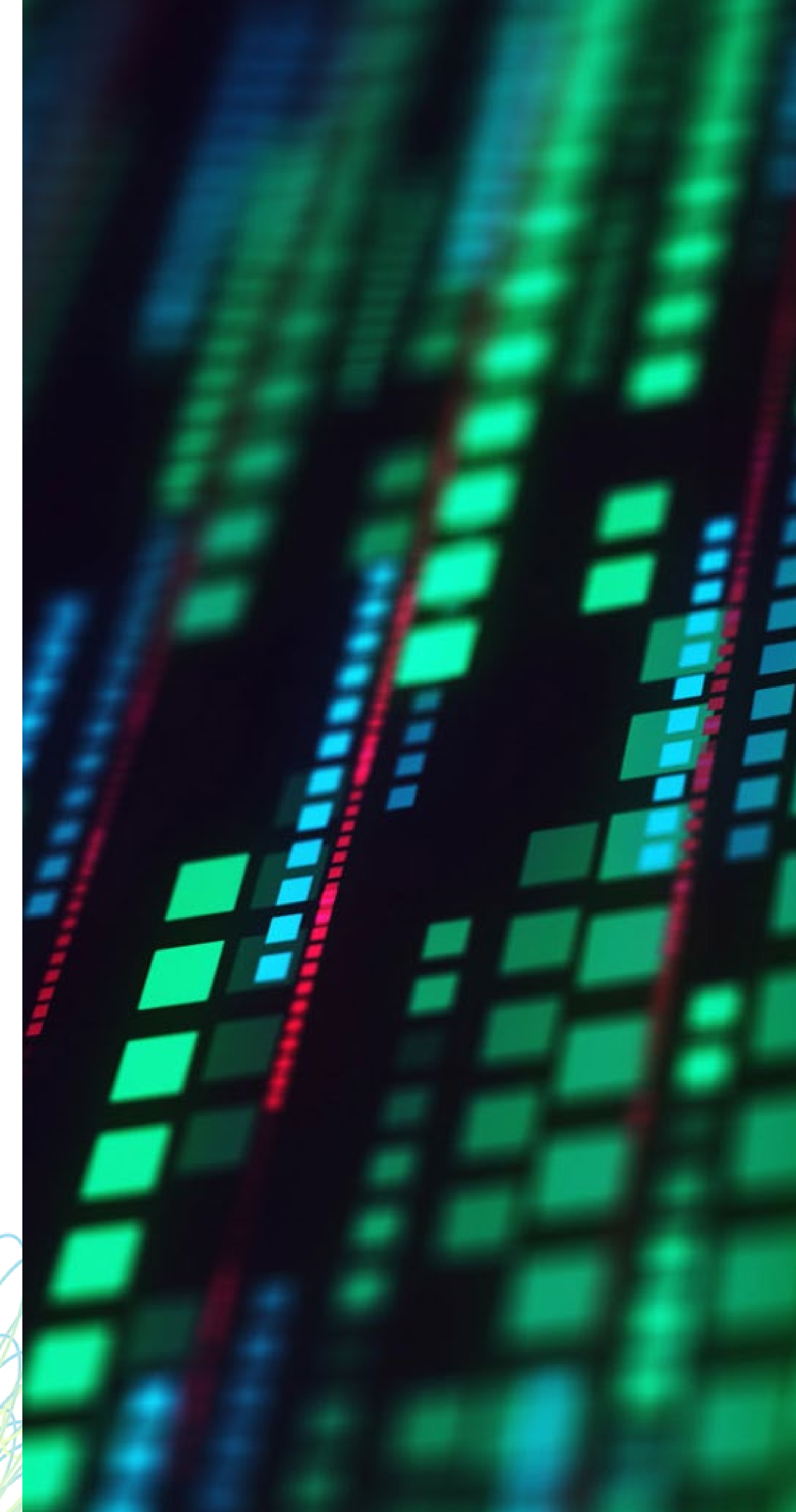

Impact of IFRS 17 on transfer pricing

The introduction of International Financial Reporting Standard 17 Insurance Contracts (IFRS 17) means insurers are likely to face challenges from tax authorities: IFRS 17 requires changes to the measurement of insurance contract assets and liabilities and the revenue/profitability recognition. These changes will impact multinationals' existing transfer pricing policies, which will need to be assessed for compliance against IRFS 17 and may need changes.

The transition to IFRS 17 may have a significant impact on the South African insurers' operating margins, which in turn, may create a risk: tax authorities may consider that there has been profit shifting from South Africa to low tax jurisdictions where a multinational's captive entity is situated, for instance, reinsurance captives. Therefore, to mitigate this risk, multinationals will need to consider the impact of this transition on their operating margins which in turn will need to be addressed in the group's transfer pricing policy.

From IFRS 4 to IFRS 17

The current accounting standard for insurance contracts, IFRS 4, deals mostly with disclosures of, rather than the measurement of, insurance contracts. This requirement has created many issues regarding comparability between insurance companies and between insurance companies and non-insurance companies. For example, there is a lack of comparability between insurance companies across various jurisdictions, the different accounting policies applied and how key profit drivers are determined. Under IFRS4, entities had a certain latitude when deriving interpretation of revenue recognition and measurement of insurance contract assets and liabilities. In contrast, IFRS 17 is more prescriptive.

The transition to IFRS 17 should also enhance comparability of revenue recognition between insurance and non-insurance companies. For example, multinationals will find it easier to compare their operating margins against third parties' margins and hence determine whether they are achieving returns at arm's length.

Scope of IFRS 17

An entity will apply IFRS 17 to:

- Insurance and reinsurance contracts that it issues
- Reinsurance contracts it holds
- Investment contracts with discretionary participation features (DPF) it issues, provided it also issues insurance contracts.

IFRS 17 requires significant data collection, storage and processing to enable higher levels of granular measurement. It also requires more advanced forecasting and simulation capabilities.

Impact on transfer pricing

Changes to valuation methods of both current and future insurance contracts will directly impact the statement of financial position (balance sheet) and the statement of comprehensive income (income statement) of companies, which in turn, will impact a company's financial performance. This will impact return on equity and combined indexes (which are common profit level indicators used by insurers) on a standalone and a consolidated basis. As the pricing of insurance and reinsurance contracts may be impacted, reinsurance transfer pricing policies and allocation keys used in intercompany contracts may also be impacted. The quantum of intercompany recharges and other flows will need to be assessed in the context of the profitability of the local operations under IFRS 17.

Conclusion

With such a comprehensive overhaul of the accounting for insurance contracts and related data requirements, it would be prudent for insurers to assess the tax and transfer pricing implications that may arise from the implementation of IFRS 17.

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Learnings from the South African risk-based capital regime (Solvency Assessment and Management) implementation

This article traces the journey of South Africa's risk-based capital (RBC) regime, solvency assessment and management (SAM), from the initial announcement to date. Sharing lessons learnt from the implementation may be helpful to other African countries that are about to adopt RBC regimes. At the moment, South Africa is the only country in Africa that has fully implemented an RBC regime similar to Europe's Solvency II.

South Africa's SAM journey began in 2009, when the insurance regulator (both for market conduct and prudential regulation), the Financial Services Board (FSB), announced plans to establish a single risk-based capital and supervisory regime to regulate both long-term and short-term insurers in South Africa. Previously, long-term and short-term insurers fell under separate legislative acts and governing capital standards.

The FSB announced that SAM will be based on the European Solvency II and the Insurance Core Principles (ICPs) determined by the International Association of Insurance Supervisors (IAIS).[11] SAM was intended to be a principles-based regulation based on an economic balance sheet, utilising a three-pillar approach to regulation. The FSB announced that SAM would be calibrated to allow for the unique circumstances and requirements of the South African insurance industry.[12]

Pillar 1

Quantitative Requirements

- Use market-consistent basis to determine liabilities (technical provisions)
- Valuation of assets and capital (MCR and SCR)
- Identification of eligible own funds (surplus assets) to cover the capital requirements

Pillar 2

Qualitative Requirements

- Set out requirements for risk management
- Also set out the details of the supervisory process with the prudential regulator

Pillar 3

Disclosure & Transparency

- Focuses on transparency, reporting to supervisory authorities and disclosure to the public
- Enhancing market discipline and increasing comparability

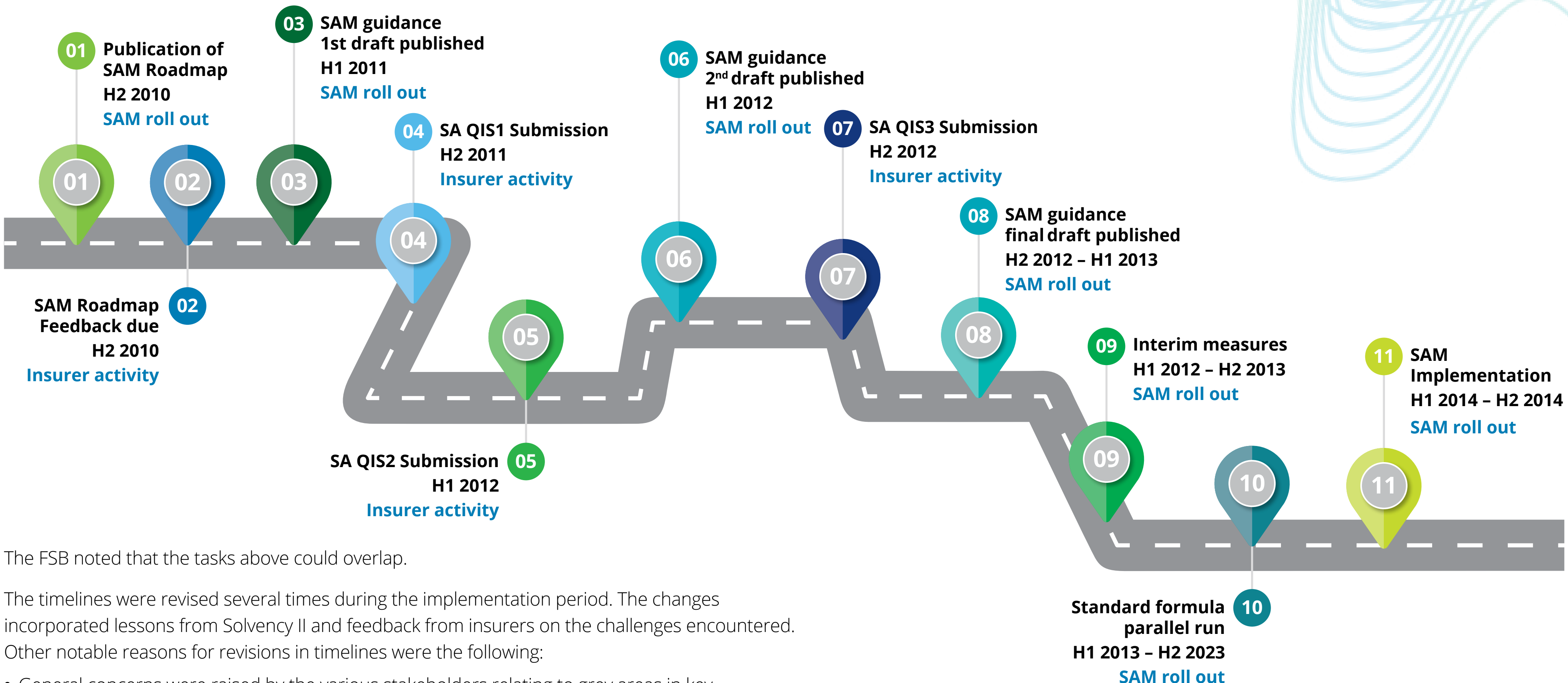
The FSB outlined the primary purpose of SAM as being to enhance the protection of insurance companies' policyholders and their beneficiaries.[13] The SAM regime also aimed to align the solvency capital requirements of insurers with the risks they face.

The initial target date of SAM implementation was January 2014. However, due to a number of implementation delays, SAM only became effective in July 2018.

Implementation roadmap

In November 2010, a year after the announcement of SAM, the FSB issued the first version of the SAM implementation roadmap detailing the milestones and timelines for the project. The roadmap was based on lessons from Solvency II. The FSB noted that although the timelines were realistic, industry consultation and feedback from various stakeholders could result in revision of the timelines.

The figure below contains some of the milestones included:



Source: Financial Services Board, "Solvency and Assessment (SAM) Road Map", November 2010[14]

The FSB noted that the tasks above could overlap.

The timelines were revised several times during the implementation period. The changes incorporated lessons from Solvency II and feedback from insurers on the challenges encountered. Other notable reasons for revisions in timelines were the following:

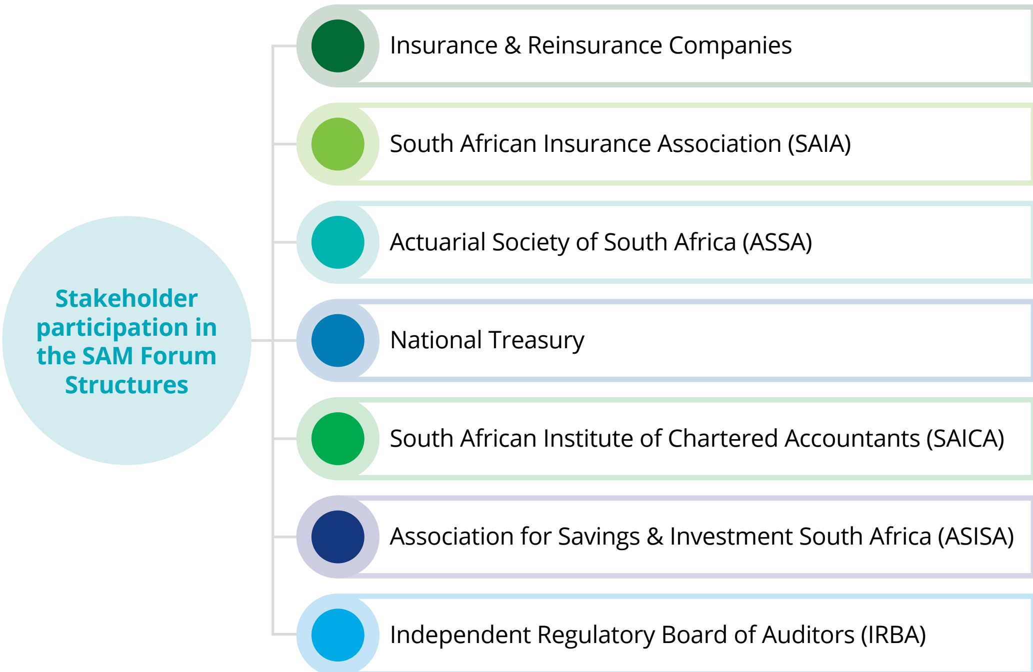
- General concerns were raised by the various stakeholders relating to grey areas in key technical items.
- Greater clarity on the SAM implementation process and steps were required.
- The SAM parallel run was extended to facilitate a smooth transition.

Industry engagements

The FSB highlighted the importance of involving insurers and other insurance stakeholders in drafting and implementing SAM.[15] Insurers were encouraged to comment on what should be prioritised within the project and to nominate an internal coordinator who would liaise with the FSB directly. The FSB also had a dedicated email address for SAM queries that insurers could use for questions, comments, or suggestions.

In addition, the FSB set up a number of SAM forums and task groups spanning all three pillars. The task groups covered all the core elements of SAM, including technical provisions, capital requirements, internal models, insurance groups, internal control, risk management, own risk and solvency assessment and disclosure.

Various industry stakeholders participated in the task groups, as highlighted in the diagram below:



Source: Financial Services Board, "Solvency and Assessment (SAM) Road Map", November 2010.
Available: https://www.fsca.co.za/Regulated%20Entities/SAM%20DOCUMENTS/FSBSAMRoadmap.pdf

Quantitative impact studies

Quantitative impact studies (QIS) were deemed vital to prepare insurance companies and the industry in general for a smooth transition to SAM. The FSB noted that some of the requirements of Solvency II would not naturally apply to the South African market without deliberate calibration and adaptation. Therefore, it was important to effect a process for calibrating the SAM standard formula (used for calculating capital requirements) to South African insurance market dynamics.

Three quantitative impact studies were carried out for this purpose, namely QIS1, QIS2 and QIS3. The first two QISs were not compulsory. QIS3, however, was mandatory for all insurers.

For each QIS, the FSB issued draft specifications for the insurance industry's comments. The comments were discussed by the FSB and relevant SAM task groups, with responses and decisions provided to the industry after the consultation process. In addition, the FSB held workshops to discuss the technical aspects of the QISs to help insurers interpret the specifications.

QIS1 requirements were issued in May 2011, based on initial proposals from the various task groups and focused on the impact and readiness of the insurance industry to meet the technical requirements. The QIS1 report was released in December 2011 and identified the focus areas for QIS2, including the treatment of ring-fenced funds and tax under SAM.

QIS2 requirements were released in May 2012 and included changes to QIS1 technical specifications. The QIS2 results were released in January 2013 and saw increased participation from the insurance industry. This report heralded the first opportunity to calculate own funds (excess assets) and solvency capital requirements at an insurance group level. The QIS2 report highlighted issues ranging from challenges with the data required for the calculations to the methodology for calculating the solvency capital requirements (SCR) and the treatment of tax.[16] Some insurers experienced challenges in completing the QIS2 study, such as a lack of skilled individuals and limitations in IT systems and valuations models.

The **QIS3 specifications** were released in 2013, focusing on testing calculations that were expected to be in the final regulatory requirements, and therefore with fewer alternative calculations. The report was issued during 2014. Although QIS3 was compulsory, some insurers were exempted on a case-by-case basis.

Internal models

The FSB noted that the proposed standard formula may not fully capture the risks some insurers face. SAM allows insurers to use either a standard formula, an internally developed model, or a combination. The use of an internal model (or partial internal model) was subject to approval by the FSB. Internal models allowed insurers to parametrise and quantify their capital requirement based on their own risk profile. This is something the standard formula may not be able to capture, therefore enabling insurers to monitor and manage risks in line with their risk appetite and to ensure optimum capital allocation.

Insurers were given timelines to approve the use of internal models. However, no life insurers (or reinsurers) currently use an internal model for regulatory capital calculation.

Parliamentary approval

Any legislative change in South Africa is enacted by parliament, and SAM was no exception. Several documents were produced for comment by the SAM task groups, National Treasury, and the general public for comments before being sent to parliament for approval. The FSB released a detailed plan to ensure that by January 2014, all the approvals required from parliament would be in place.

Key lessons

Although SAM is currently in force, the Prudential Authority and other insurance stakeholders have identified SAM phase II items that need to be refined. Regulators, insurers, and other stakeholders can learn the following from the SAM journey to date:

- Industry involvement and collaboration: Regulators should obtain buy-in from industry stakeholders, including insurers and professional bodies.
- Planning is key: Regulators should not underestimate the time and effort it takes to implement a risk-based capital regime. It takes time to transition to a new regulation. Conducting both qualitative and quantitative studies to prepare the market is advisable.
- Upskilling: While practitioners who have been involved in SAM implementations in South Africa and risk-based implementations elsewhere are available in Africa, lessons can be learnt across most roles (staff, executives, board members and various control functions).
- Avoid concurrent projects: The insurance industry is busy implementing IFRS 17. Insurance professionals are thus stretched by the IFRS 17 implementation on top of their usual projects. It may be advisable to wait until IFRS 17 is fully implemented and commence with RBC projects as resources become available.

Deloitte Actuarial and Insurance Solutions have played a vital role in providing comments on discussions held with the FSB, drafting papers and providing input on technical aspects and practicability of SAM, as well as assisting several insurers in different countries with their capital management and reporting.

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South Africa's first Green Finance Taxonomy: What does it mean for the non-life insurance industry?

On 1 April 2022, South Africa's first Green Finance Taxonomy was published as part of South Africa's Sustainable Finance Initiative. The taxonomy is a classification system used to create a consistent framework for reporting on the contribution of assets, projects, activities, and sectors towards achieving a positive environmental impact. The taxonomy aims to create transparency and consistency in the labelling of "green" assets and activities in South Africa, in order to attract local and international funding to support our markets as the country moves to a carbon-neutral future.

The launch of the South African Green Finance Taxonomy follows the development of similar taxonomies in other markets. The South African taxonomy mirrors that of the European Union (EU) Taxonomy, which is one of the world's most comprehensive, science-based, and highly regarded taxonomies. Some necessary moderations adapted certain eligibility criteria to the South African context, including local environmental legislation, regulation, policies, and developmental needs.

Is reporting on taxonomy alignment mandatory in South Africa?

No – not yet. The South African Green Finance Taxonomy was launched to mobilise the capital urgently needed for climate mitigation and adaptation efforts as well as socio-economic development in the country. South Africa needs to scale investment in green infrastructure projects at an unprecedented pace to meet the Nationally Determined Contributions (NDCs) and align with the goals of the Paris Agreement. Hence, a platform is crucial for those who want to attract this financing and need to consistently and transparently demonstrate their green credentials to investors.

There is currently no regulating agency in South Africa overseeing taxonomy alignment.[17] However, because South Africa often follows leading global reporting standards, it is useful to monitor international developments. The EU requires mandatory reporting of taxonomy alignment by companies and financial market participants in the scope of the EU's Non-Financial Reporting Directive (NFRD) and the Sustainable Finance Disclosure Regulation (SFDR). The British government has recently indicated that they will develop their own Green Finance Taxonomy, which will call for voluntary disclosure for at least the first two years.

South Africa's taxonomy already provides disclosure guidance closely following the EU taxonomy's reporting requirements. Furthermore, the Taxonomy Working Group[18] is currently exploring ways of supporting the implementation and embedding it into the country's reporting landscape.[19] Although there has been no formal communication on mandatory reporting as yet, the expectations are that it will follow.

Why is the Green Finance Taxonomy relevant to the non-life insurance[20] industry?

Non-life insurance has been specifically addressed in the taxonomy and classified as "Enabling activities, system resilience and innovation". By allocating non-life insurance to this category, the taxonomy recognises the role of insurance in climate risk adaptation and positions the industry as a vital facilitator of South Africa's transition to a low-carbon economy.

The taxonomy sets out the technical screening criteria relevant to non-life insurance. It lists the insurance activities which potentially qualify for taxonomy alignment. However, the relevant and appropriate metrics depicting the overall alignment of insurance activities with the taxonomy are unclear. The current disclosure guidance primarily caters for non-financial undertakings by recommending disclosure of the proportion of turnover, capital expenditure, and operational expenditure derived from taxonomy-aligned assets and activities. These ratios must still be translated to comparable key performance indicators (KPIs) relevant to insurers and reinsurers.

In the EU, the European Insurance and Occupational Pensions Association (EIOPA) has been tasked with this responsibility and has put forward two KPIs addressing insurers' two main activities: **underwriting** and **investment.** EIOPA has proposed that insurers disclose the following two KPIs:

- The proportion of the insurer's investments that are directed at funding, or are associated with, economic activities that qualify as environmentally sustainable.

- The proportion of the non-life "gross premiums written" corresponding to insurance activities identified as environmentally sustainable.

The rest of this article will consider the potential impact on the local insurance industry if the South African taxonomy reporting follows the EIOPA proposal.

How should insurers use the taxonomy?

The taxonomy provides a framework that insurers can use to consistently track, monitor, and demonstrate the credentials of their green activities. By reporting on their underwriting and investment activities' alignment with the Green Finance Taxonomy, insurers can provide meaningful and relevant information to discerning investors pursuing green investment opportunities. These insurers can also report to regulatory bodies concerned with the extent to which insurers contribute to climate change adaptation and mitigation efforts.

As mentioned above, while reporting on taxonomy alignment is not yet mandatory in South Africa, and the uptake thus far has been slow, insurers should start familiarising themselves with the taxonomy to understand how their current underwriting and investment profiles are likely to be assessed from an environmentally friendly point of view. This exercise will firstly provide insight into where they may want to focus their business and investment strategy going forward, and secondly, it will help to establish an understanding of what taxonomy reporting will ultimately require from a data, systems, and skills point of view.

What can the insurance industry expect going forward?

Several trends are likely to emerge in insurers' underwriting and investment activities in their pursuit of taxonomy alignment.

Trends in underwriting activities: New and innovative insurance offerings

Insurers need to start rapidly creating services and products to match the needs of the broader economy as it looks to decarbonise and meet the demand for cover against losses from climate hazards. This will require structuring new insurance products, enhancements to existing insurance products, and more sophisticated risk advisory services.[21] The accelerated demand and creation of the following are anticipated.

Insurance products that cover new green economic activities and assets that are covered by the taxonomy

This would include insuring low-carbon technologies, renewable energy infrastructures, or nature-based solutions. Including these new green technologies in the taxonomy will likely encourage a flow of funding towards their development and deployment and a corresponding demand for appropriate insurance coverage. The role of insurance in de-risking the development of these technologies is critical, and there is, therefore, a benefit to being a first mover in this space.

Product features that incentivise policyholders to decarbonise their assets or activities or protect their assets from climate change

Incentivisation features can contribute towards both climate mitigation and climate adaptation efforts.

Climate **mitigation** efforts limit or reduce the emissions of policyholders' activities. Insurance products could include rewarding customers, via premium discounts, for opting for low-carbon solutions (e.g., solar-powered solutions, electronic vehicles, sustainable building materials) or taking steps to reduce the carbon footprint of their activities (e.g., reduced energy usage, reduced use of personal vehicles). Incentivisation features can also extend to claims where insurers require energy-efficient replacements of damaged goods or choose repairs or recycled parts over replacements.

Climate **adaptation** efforts are activities that adapt or limit the impact of climate change. Examples include rewarding customers for taking steps to protect their assets from physical climate risks such as storms, floods, or wildfires (e.g., premium discounts for installing early warning systems, requiring minimum resilient building standards, or adherence to build-back-better principles).

Innovative risk transfer solutions to protect against the physical impact of climate change

As climate change triggers more frequent droughts and flooding, demand for cover for physical climate hazards will grow. Standard insurance products against climate-related hazards (e.g., temperature-related, wind-related, water-related, and solid mass-related hazards) are included in the taxonomy. The taxonomy also provides some examples of more innovative physical risk cover, such as offering multi-peril (yield) crop insurance, which insures against both annual yield variations and extreme climate-related hazards. There are opportunities for further innovation in risk transfer mechanisms to align with client needs. Some recent innovations include parametric insurance products that insure against the revenue shortfall of solar or wind farms.

Sharing of data and expertise to help customers better manage their climate-related risks

As risk management experts, insurers can access a wealth of data and risk models to help their clients and communities better understand and manage their climate-related risks. The taxonomy lists many ways in which insurers can contribute to their clients' risk management programmes, such as offering customers their risk engineering expertise, developing online tools or early warning methods to allow clients to detect risks to property from climate-related hazards, and improving natural catastrophe models.

Engagement with wider stakeholders to address the ongoing insurability of extreme weather events

The severe flooding in KwaZulu-Natal in 2022 highlighted the increasing concern about the affordability and insurability of such events. The taxonomy acknowledges that insurers can advocate for climate adaptation measures to be implemented by using their data and knowledge to influence zoning and building code regulations, standards, construction requirements, and local adaptation plans, thereby reducing the potential impact of climate-related hazards.[22]

Trends in investment activities: Greener investment portfolios and extensive disclosures

Reporting on taxonomy alignment will also involve reporting on the extent to which the insurer's activities are directed toward funding economic activities that the taxonomy identifies as environmentally sustainable. These are likely to include all investments regardless of the purpose for which they are held and all assets capable of funding such activities (i.e., investments in equity and debt instruments, collective investment undertakings, loans, mortgages, and property, etc.). The following are likely trends:

- **Investment strategies will lean** towards funding and financing economic activities that qualify as environmentally sustainable under the taxonomy. As the green funding market matures in South Africa, insurers may start to direct a portion of their investments towards **sustainable finance instruments** such as green bonds, sustainability-linked bonds, or social bonds. Global insurers are already setting target allocations toward these asset classes.
- There will be **greater scrutiny of the investment portfolios** of both life and non-life insurers, with more **in-depth disclosures** of investment products.

What resources and capabilities will insurers need to support them on this journey?

There are several steps that insurers can take now to ensure they keep pace with these developments and are well-positioned for taxonomy reporting.

Upskilling of underwriting functions

Underwriting functions will need to recruit subject matter experts in emerging environmental technologies to fully understand and appropriately price their risk exposure. Insurers are unlikely to have loss histories for emerging green technologies; hence, it may be challenging to price insurance coverage accurately.[23]

Recruiting new skills in taxonomy assessment

The effort required to determine and report on alignment with the taxonomy can be onerous and may require ongoing evaluation and monitoring. Experts will be required to sign off on whether the insured activity and/or asset complies with the taxonomy's Technical Screening Criteria and "Do No Significant Harm" (DNSH) thresholds.

Enhanced data and IT infrastructure

To be able to screen, check and report their eligibility alignment, insurers will need to start collecting more specific information on their clients and the nature of the insured activities and assets. Similarly, on the investment side, insurers will require much more in-depth information from their investee companies and asset managers on the taxonomy alignment of underlying investment portfolios. Measurement and disclosure of taxonomy alignment will be a complex challenge, requiring intensive resources and time, and likely require bespoke reporting platforms.

Engagement with regulators and key policymakers

It is imperative that the insurance industry engages with the Taxonomy Working Group as well as the Prudential Authority to ensure that the taxonomy caters for the nuances of the industry.

The South African Prudential Authority Climate Think Tank (PACTT) has a working group looking at the Green Finance Taxonomy. However, it is unclear at this stage what its mandate and agenda are regarding taxonomy reporting for insurers.

Conclusion

In the shift toward more environmentally friendly underwriting and investment portfolios, the just transition and social aspects of the transition cannot be ignored.

Simply cutting insurance cover or stopping investments in carbon-intense industries on which the South African economy and communities rely is not viable. As risk managers and institutional investors, insurers have a stewardship duty to engage with policyholders and investee companies alike, particularly in hard-to-abate industries, to understand their transition pathways and support them on their journey to credibly and soundly decarbonise their operations. As one global insurer stated in their 2022 annual report, "Simply divesting from companies with carbon-intensive footprints is less effective than engaging with them to drive the shift to sustainable practice."[24]

The hard question is whether the Green Finance Taxonomy aids or detracts from that goal. With its focus on disclosing the proportion of turnover, operational, and capital expenditure attributable to environmentally friendly activities, reporting on taxonomy alignment could simply encourage a move away from industries that do not qualify, regardless of how critical they are to the economy. Others believe there is sufficient scope within the taxonomy to recognise and encourage the significant role insurers could play toward transitioning these industries, while supporting broader economic and societal needs. In this interpretation, the intention of taxonomy reporting is to satisfy only one aspect of disclosure, which needs to be considered in the context of the broader ESG reporting suite. Reporting on compliance with the UNEP FI Principles for Sustainable Insurance (PSI) and Principles for Responsible Investment (PRI), as well as reporting in line with the Taskforce for Climate-related Financial Disclosures (TCFD) and the International Sustainability Standards Board's (ISSB) Sustainability Disclosure Standards[25] will provide a more comprehensive view of the insurer's business, which is the likely trend.

The insurance industry needs to engage key policymakers and regulators to debate and influence the course of reporting in line with the Green Finance Taxonomy in South Africa. This is crucial in establishing meaningful reports demonstrating a complete picture of the genuine impact and progress insurers are making in transitioning the country toward a climate-resilient and socially inclusive economy.

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Embedded insurance – distributing insurance to customers as they need it

Embedded insurance – insurance integrated into the purchase of a product or service – provides insurers with new digital distribution channels to reach potential customers, helping to increase market access and market share. This is often done smartly as a value-add to the customer's purchase. Insurers can leverage embedded insurance to underwrite insurance products for non-insurers, thereby increasing their customer base without incurring broker and agent costs.

Embedded insurance is not a new concept and should not be confused with bancassurance, which has been around for decades. Unlike bancassurance, embedded insurance is not limited to banks and can be sold by non-insurance companies. This allows insurers to expand their market share by tapping into a new customer base using alternative distribution channels.

The COVID-19 pandemic accelerated the adoption of digital shopping, leading to a rise in consumer confidence in using digital platforms. This has spurred growth in the digital insurance market. Embedded insurance is an example where consumers can purchase insurance online as needed, rather than being sold insurance when it is not required. In addition, with the evolution of online shopping, consumers are seeking quick, seamless purchases, presenting insurers with an opportunity to increase their market share and customer base.

To date, only straightforward insurance products that consumers find easy to understand and require minimal underwriter involvement have been tested in a digital environment. However, as data becomes more readily available through digitisation, expanding the embedded insurance market to new market segments will be easier. Underwriting for these products can be automated, as data can be obtained from third-party/non-insurance company partners. Embedded insurance products may soon cover more complex lines of business.

A recent Swiss Re study, focused on Opportunities for Embedded Insurance Partners,[26] emphasises that the success of an embedded insurance offering depends on three key factors:

- Providing a product or service that is highly valued by consumers or is essential to the successful operation of business customers
- Having long-term relationships with customers
- Possessing data and information about customers' use of provided products and services and about the customers themselves, which can be used to create attractive insurance offers.

Embedded insurance case studies

Embedded insurance is becoming more popular in the insurance industry, as evidenced by the following case studies.

IKEA and iptiQ Insurance – property and casualty insurance

IKEA, a Swedish home-furnishing company, partners with iptiQ Insurance to offer property and casualty insurance as part of its online shopping experience. Customers can purchase homeowners' or renters' insurance while checking out their purchases on the IKEA website, making the process seamless.

SweepSouth and M&F Insurance – household contents insurance

SweepSouth, a South African home-cleaning service provider, partners with M&F Insurance and a technology enabler to offer home contents and breakage insurance as part of their cleaning service. Customers can opt-in for insurance for the duration of the cleaning service without having to interact directly with the insurer.

EasyEquities and Sanlam Indie – term life insurance

EasyEquities, a South African low-cost investment platform, has launched a term life insurance product called EasyProtect on its trading platform. Customers can purchase term life cover through a completely digital customer journey embedded on the platform, with the cover amount linked to the investor's portfolio value. This example shows an insurer leveraging a technology provider to access potential new customers and to offer insurance as a value-add to their main purchase.

EasyEquities and Compass Insurance Company Limited – investment fraud insurance
EasyEquities provides its customers with the opportunity to purchase investment fraud insurance through its product, Investsure. This insurance offering is seamlessly embedded into the Easy Equities platform. It protects customers against fraudulent activities or misleading information that may result in a decline in the value of listed shares purchased. Customers can easily buy the insurance by selecting the option while finalising their investment; the premium is calculated as a percentage of the total value of the shares purchased.

JPAR Real Estate and Bubble Insurance Brokers – comprehensive home insurance
JPAR, a US-based real estate brokerage, assists their customers by taking advantage of Bubble's data-driven integration. Each time a new home buyer signs a purchase agreement with JPAR, the integration combines data available from the transaction and automatically sends a personalised set of insurance quotes to the buyer.

What's next?

Through embedded insurance, purchasing insurance products can be simplified, saving customers time while simultaneously providing value-add and market access. These examples demonstrate how embedded insurance uses the non-insurer's existing customer data, allowing for a seamless insurance purchase without requiring additional data capture.

The *2023 Deloitte Global Insurance Outlook*[27] notes that premiums in the global embedded insurance market are expected to grow by as much as six times to US$722 billion by 2030, indicating that there is potential to capitalise on this market. Insurers should consider partnering with insurtech companies and commercial/non-insurance providers to embed their products into online purchasing and integrating insurance purchasing into the customer's online purchasing journey. To be successful, insurers must carefully consider how to invest in meaningful partnerships with the non-insurance market.

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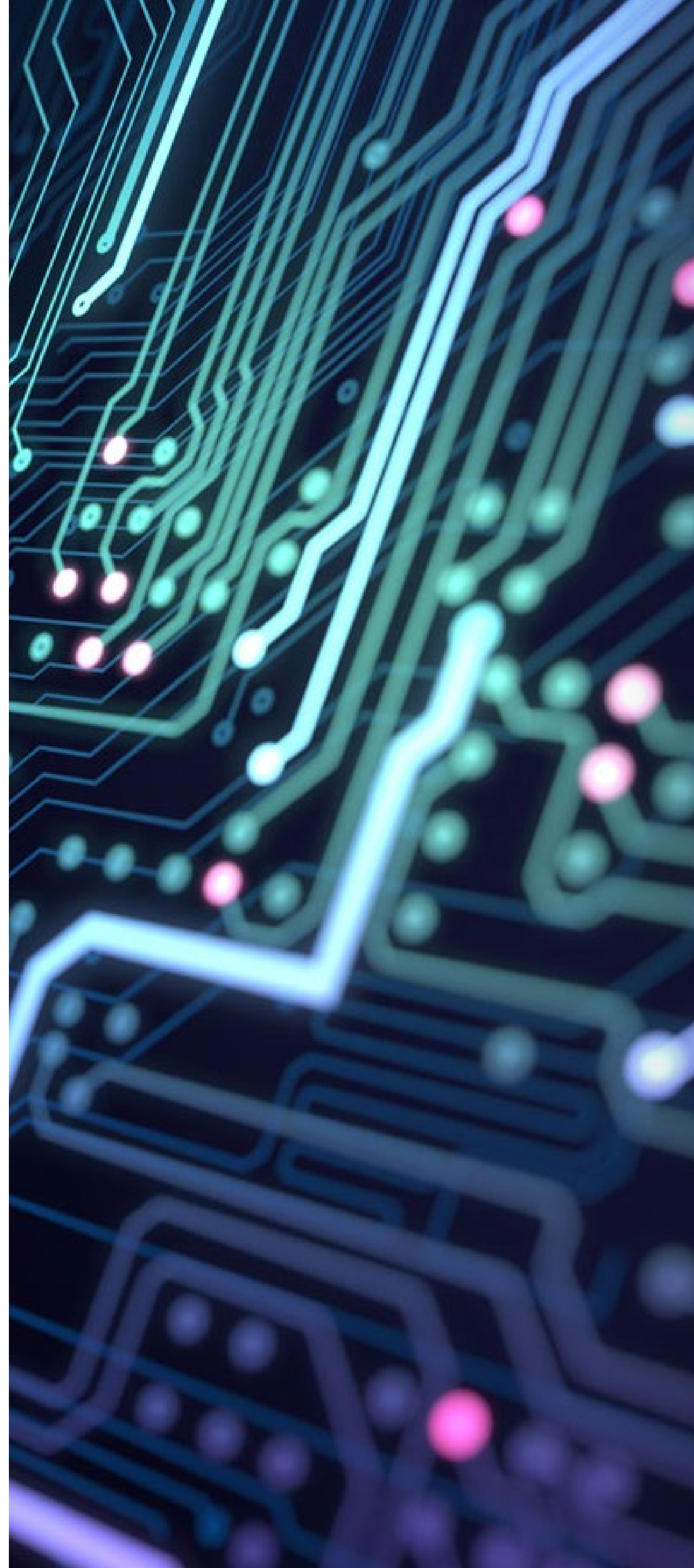


Principles alone will not suffice: A closer look at the UK's Consumer Duty

The past decade has seen a significant shift in how firms in the financial sector are regulated worldwide. Rules-based supervisory approaches have been replaced with a mix of rules and principles-based supervision. In addition, a key focus of regulators has been the treatment of customers and the need to place the customers' financial wellbeing at the centre of the financial institution's work. In many geographies, including South Africa, the principles-based approach is intended to result in customers receiving fair outcomes.

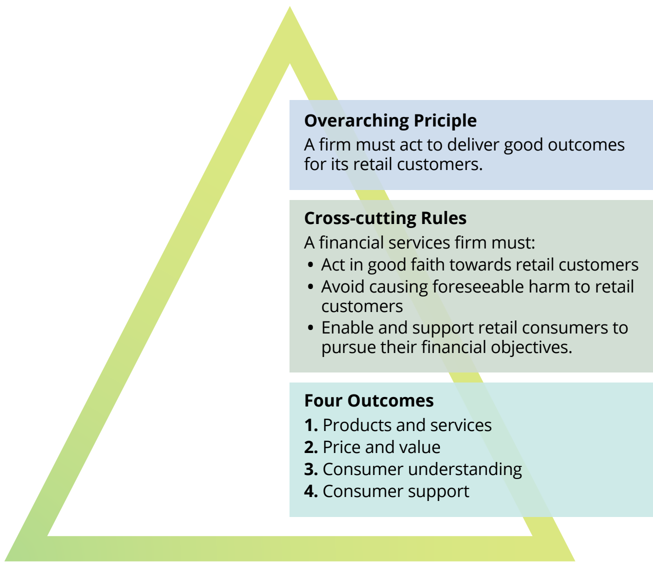
In several countries, the focus on fair treatment for customers, specifically conduct risk management, was initiated through Treating Customers Fairly (TCF) programmes. These three words, which on the surface seem very simple, have challenged the achievement of conduct risk management. Very few organisations intend to mistreat customers; however, the behaviour of employees can result in clients being treated unfairly, even if the customer doesn't realise this. Organisations tend to see TCF as something that happens naturally when, in fact, the regulators require firms to be proactive in ensuring and demonstrating that the organisation is treating customers fairly.

Shifting to actively evidencing treating customers fairly

In what is being referred to as a seismic shift in UK consumer protection regulation, the Financial Conduct Authority (FCA) has issued the so-called Consumer Duty (the Duty). Regarding retail clients, financial services institutions must comply with the Duty in a phased approach from 31 July 2023 to 31 July 2024. The Duty was initiated in a discussion paper in July 2018, where concerns were raised that the current FCA regulatory framework does not adequately protect customers. Given that the Duty is designed to deliver higher consumer protection standards, it is clear that principles-based regulation alone was not providing the intended consumer protection. One of the critical changes that the Duty brings is a departure from the previous requirement that "Firms must 'pay due regard to […]'." The wording now states, "Firms must act […]". The Duty changes the principles-based approach encapsulated in TCF to a more demanding consumer outcomes-focused approach.[28]

> *In short, a duty of care would effectively deliver what TCF is intended, but so clearly fails, to do.*

What is the Consumer Duty?



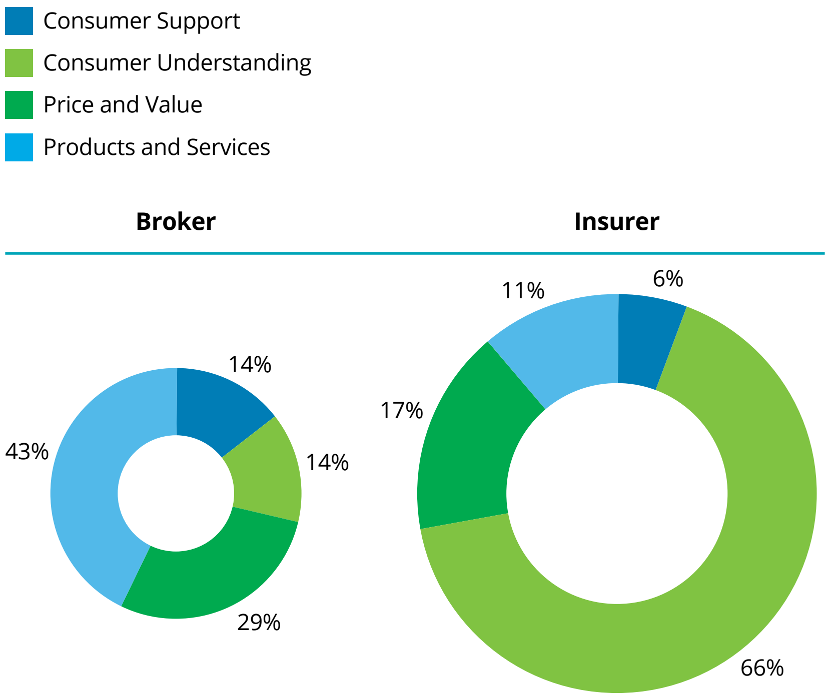
The proposals are framed as **proactive** actions which firms must take. Firms must assess **good customer outcomes** and compliance with the Duty, as approved by their board, at least annually. Concepts of **reasonableness** and **foreseeable harm** will require firms to demonstrate greater judgement in determining how their actions and processes deliver good outcomes. The Duty also brings with it increased accountability.

Undoubtedly, the Duty requires firms to act, and the guidance goes so far as to give examples across the rules and outcomes. This shift is demonstrated through the replacement of Principle 6, which states, "A firm must pay due regard to the interests of its customers and treat them fairly," with Principle 12: "A firm must act to deliver good outcomes for its retail customers."[29]

Under the Duty, firms will need to go beyond existing TCF practices to assess and evidence the extent to which they are acting to deliver good outcomes. The rules require firms to consider the customers' needs, characteristics, objectives, and behaviour, throughout the customer journey.

Insurers' view on the challenges of the Duty

In September 2022, Deloitte conducted research in the UK to determine which of the four outcomes presents the greatest challenge to insurers. The study showed that the biggest challenge to insurers is the Consumer understanding outcome. While it is more balanced across brokers, the predominant challenge in the broker environment is Products and Services.



Outcomes from Deloitte UK research

When considering what underlying elements of meeting the Duty are of greatest concern, both insurers and brokers identified data quality as a significant challenge. Interestingly, the third-largest concern was the size and scale of the programme. While not entirely unexpected, the responses demonstrate the anticipated burden of achieving and evidencing good customer outcomes.

Practical implementation for UK-based firms and firms operating in the UK

The Duty is expected to have a sizeable impact on the retail sector. The Duty's first implementation deadline of 30 April 2023 required firms to work at pace to ensure they were prepared for this paradigm shift in regulation. Firms have been required to map out the end-to-end customer journey for all products and services that are within scope, identify weaknesses, and determine enhancements. This has generally been executed through multi-streamed programmes.

South African considerations

While there is no Duty-equivalent regulation within the South African context, the intention of the Financial Sector Conduct Authority (FSCA) regarding fair treatment of customers is no different to that of the FCA. A vital component of the FSCA's strategy is achieving equitable customer outcomes.

It is not inconceivable that should the FSCA believe customers are not receiving the desired outcomes through the current principle-based framework, they may consider an approach aligned with the Duty. Irrespective of the FSCA's requirements, the Duty is an excellent guide for what firms should consider in their conduct risk programme and may well represent best practice.

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Actuarial modernisation – rethinking ways of getting the required work done

Introduction

The insurance industry continues to change at a rapid pace. Several market and technology trends are generating new opportunities, as well as new threats, for insurance companies across all industry segments.

Customer, competitor, and operational threats and opportunities include the following:

- Increase in tech-savvy, nimble Insurtech startups
- Increasing partnerships that enable value extraction through collaboration and operating efficiencies (banks and insurers, micro-insurers, and telecommunication companies)
- Increasing interest rates
- Expectations of a digital and personal customer experience
- Demand for simple products

However, the one place where change is slowing down is in the requirements of regulations governing financial and risk reporting. Insurers will not have a regulatory reporting change burden for the first time since the solvency assessment and management (SAM) regime was developed (i.e., over 12 years). Now that reporting requirements have achieved longer-term stability, it is an ideal time to evaluate current activities, operating models, and the integration between actuarial, accounting, and technology to identify potential improvements.

The central role of the actuarial processes

In recent years, the role of the Chief Actuary has expanded beyond being a calculation guru to encompass the responsibilities of a business advisor, risk manager, and industry leader, thus inheriting much of the old Statutory Actuary role. As reporting requirements have evolved, so have the expectations of actuarial functions, which play a crucial role in delivering accurate data. Today, actuarial teams must provide valuable insights to C-suite executives, business unit leaders, and board members, while simultaneously addressing the needs of regulators and users of financial statements. To improve their overall value as an essential contributor to strategic business and financial decision-making, actuaries must be aware of and respond to these increased expectations. They must design processes with other key corporate functions, especially finance and IT, and build their ability to contribute to the insurer's technology journey. There is a risk that the actuarial function's increased responsibility might catch insurance companies off-guard, leading to burnt-out staff, misaligned expectations of roles, and a sub-optimal design of activities.

In the context of technology, actuaries need to know far more than specialist actuarial software. Instead, modernisation can only occur on the back of the facilitated collaboration across functions, each with deep expertise in their own parts of the technology environment. This can either be developed in-house or tapped into through specialist outsourced functions.

Are we ripe for a season of actuarial modernisation?

Actuarial modernisation involves a combination of vital components that, when harmoniously implemented, can significantly enhance an organisation's efficiency. To thoroughly update their actuarial operating model, companies must first grasp the traditional and new aspects of their operational elements and their interactions.

These seven key components are:

- **People and talent,** which form the backbone of any successful team
- **Processes,** which streamline operations
- **Data,** critical for accurate analysis
- **Technology,** which empowers teams with cutting-edge tools
- **A fit-for-purpose service delivery model**
- **Well-defined policies and procedures** to ensure consistency
- **A robust governance structure** for effective oversight

Each company will have a unique target operating model with agreed-upon principles for determining a modernised actuarial function's delivery model. One dimension to consider is which activities should be insourced, which are more suitable for traditional outsourcing, and which activities are best suited to a **managed service**[30] approach.

There are four principles for determining this allocation:

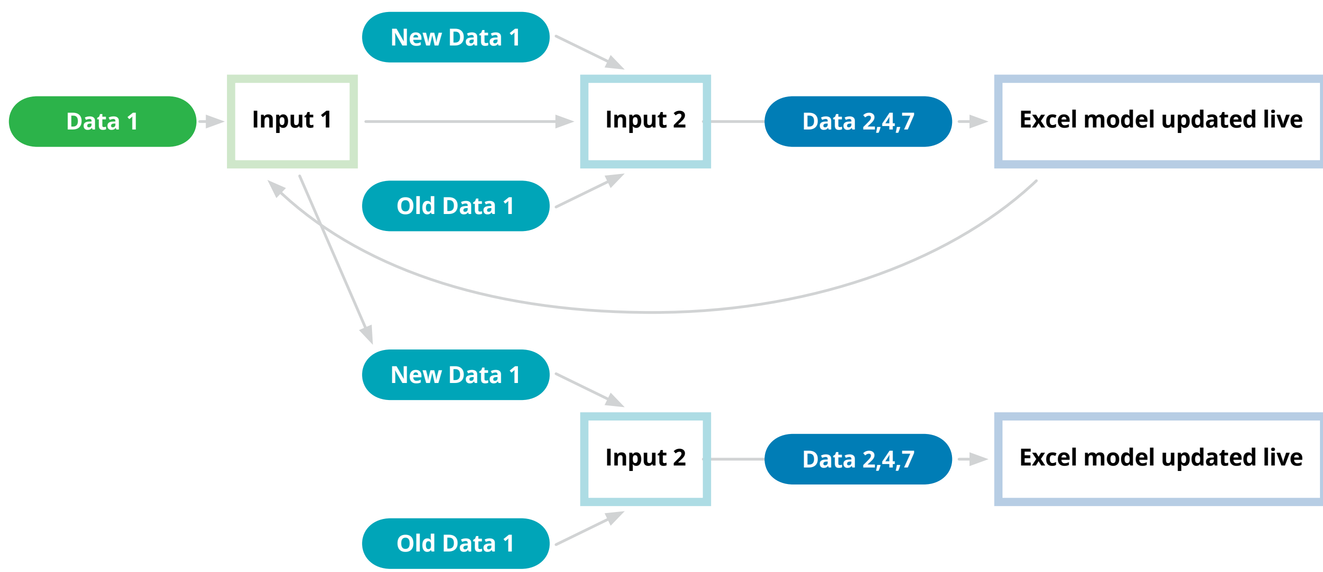
- To what degree would a failure of this function increase enterprise risk?
- What is the extent of competitive differentiation created by this activity?
- Does the activity demand highly specialised expertise?
- Do the technical skills associated with this function demonstrate a high velocity of change?

For example, consider pricing and developing a new insurance product for a specific target market. This task is strategically important, and any failures along the way could result in wasted expenditure, potential brand damage, and even put the insurer at risk. Naturally, this activity is about setting your brand apart from the competition. Moreover, it requires specialised expertise to determine the correct price and establish the necessary systems and processes to support the product. The technical skills associated with this function exhibit a relatively low velocity of change, except for the incremental new features each product introduces. The drive for simpler products further reinforces this trend. Given the strategic importance, specialised expertise required, and the need to maintain a competitive edge, it is unlikely that companies would choose to outsource this function.

Contrast this with the production of IFRS 17 results and reporting. Clearly, a failure to produce accurate financial records would be a significant issue for the insurer. Marginal competitive differentiation is created through reporting (although the ease of understanding the impacts of business decisions on future IFRS 17 results might be a key priority). Significant expertise is required to understand the intricacies of results; however, the skills are not subject to a high velocity of change once the standard has settled. Thus, outsourcing this function could be a strategic decision for organisations seeking to optimise their resources and concentrate on core competencies.

Many insurers use manual processes, leading to excessive model reruns, development overlap, physical handoffs, limited tracking, and skilled teams focusing on data crunching instead of business insights.

Example of manual data process



Through an effective outsourced model, insurers can tap into and learn from existing structures that place data as the central thread, bringing discipline to data and significantly improving the efficiency of results production, controls on accuracy and access, and flexibility to add or test new modules.

Outsourced component data platform model

Input setups, validators
IFRS 17 PAA
IFRS 17 GMM, VFA
Results visualiser
Financial statement/ Return populator

DATA

SAM underwriting risks
SAM market risks
Forecasting & capital management tools
Basis conversions

Large insurers in the African insurance market typically choose a self-build approach, which has met their needs thus far. However, this approach may have diverted attention from other opportunities, unless supported by a comprehensive modernisation strategy. Medium-sized and small insurers have generally opted for a traditional outsourced or managed services approach, leveraging the scale of a central provider that can provide quality design, build, and implementation support. The best providers should align with a company's modernisation strategy, which ideally involves connecting the seven critical components for actuarial modernisation (see above) with key strengths in the combination of actuarial, finance, and IT functions.

Lastly, consider an entity-wide migration or implementation to a large cloud hyper-scaler (e.g., AWS). This would be a costly and time-consuming exercise, and failure would strain the insurer. The agility achieved would likely increase competitive differentiation and require highly specialised expertise. Even once implemented, new services and offerings would require an evolving skillset. The best model would probably involve a combination of internal resources for steady work and outsourced resources for specialist expertise or phases of the work that need more capacity.

Conclusion

The focus of the actuarial function has shifted from getting numbers out to answering critical and growing business questions. Actuarial leaders in insurance businesses should therefore collaborate to set a clear strategy for their expanding areas of responsibility, address the interdependencies between teams, and appropriately use internal and external skills and resources to allow them to answer the questions asked. Strategic partnering to source the skills, expertise, and processes from outside their organisations may be the most appropriate approach where skills are scarce.

While the next year will still focus on adapting to the regulatory-driven change, insurers must continue to explore what actuarial modernisation looks like and make the necessary changes to capitalise on existing opportunities.

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Investing in data and technology is not a competitive advantage, it is table stakes

The insurance market is highly competitive and saturated

South Africa's insurance industry has grown in recent years, with many new competitors entering the market and the regulatory landscape maturing significantly to protect clients. Most market participants have improved their value propositions through experience, value-for-money improvements (e.g., pricing, fees, or other monetary implications for customers), or innovation. Collectively, these factors have resulted in a more competitive environment, better products, and a safer environment for clients.

However, the global economy is under pressure. Many consumers worldwide are feeling the pinch, including in South Africa and other emerging markets.

This economic reality, coupled with the mass entry of new tech competitors into the insurance market and the fact that South Africa has one of the world's highest insurance penetration rates[31] despite a relatively low GDP per capita, has saturated this market, making it highly competitive.

An investment in data and technology lays the foundation

Like adjacent financial services providers, such as banking or investments, insurance companies have had significant margin compression over the past decade. Last year's *Insurance Outlook*[32] explored the customer gold rush and market leaders' tactics to retain and attract customers beyond pricing. Price and fees, experience, and product innovation all contribute to lasting competitive advantages. True market leaders, however, understand that a significant investment in data and technology is required to lay the foundation for competitiveness, as many use cases hinge on solid, dependable data and technology. The need to transform to virtual engagements with intermediaries and clients during the lockdowns due to the COVID-19 pandemic motivated insurers to make some of these investments.

Case studies using a foundation of solid, dependable data and technology

Machine learning models and data dashboards provide real-time analysis of client and distribution channel behaviour, allowing investment managers to pre-empt and proactively influence behaviour and provide meaningful input into individualised value proposition design.

Data structures and reporting provide an overview of product combinations bought by a client, linked to client metadata, to price and evaluate risk smartly.

The application of robotics or business process outsourcing eliminates routine tasks such as the population of standard certificates, regulatory submissions, or reporting, requiring operational staff only to review.

Structuring data flows proactively allows insurers to comply with likely regulations by considering lessons learnt from developed market counterparts, such as the UK or EU, which South Africa has traditionally followed.

Why is focusing on data and technology not considered a competitive advantage but a necessity?

Data and technology enable all domains of competitive advantage (i.e., price and fees, experience, and product innovation) and are, therefore, non-negotiable.

- Competing on price and fees requires large-scale technological efficiencies, such as robotics process automation and straight-through processing, to reduce overheads.
- Competing on experience requires data to analyse behaviour and design experience, enabling insurers, agents, and brokers to be proactive. It requires digital interfaces for and technological platforms to service and provide reporting to clients.
- Competing on product design and innovation requires data and technology to build innovative models for pricing, cross or up-sell, and integration with potential partners.

For example, a decade ago, having a digital front end with basic functionality was a competitive advantage. In 2023, it's a business necessity. Market leaders use foundational data and technological investments to create innovative customer solutions. This is no longer a question of using data or technology but a foundational function of how well customers are understood and their needs translated into requirements.

The need for investment and prioritisation

On average, between 2020 and 2022, market leaders spent 14% of their gross premiums received on technological transformations and innovations, such as large data warehousing and business intelligence or cloud transformations. Those who lost market share spent significantly less, about 1-2%.[33]

Due to the industry's rapid evolution over the past decade, compounded by the high volume of M&A transactions, many insurers grew faster than operational systems allowed, leading to fragmented datasets. The incompatibility of technology, coupled with inadequate spending on technological transformations and innovations, created friction in the customer journey, leading to a loss of market share, as it is easier than ever for consumers to simply switch insurers.

While it is true that most insurers have not invested adequately in data and technology, not all project budgets should go towards these items. It is essential to distribute resources in line with chosen customer segments and the outcomes they will value given existing realities instead of looking to copy competitors under the guise of "best practice."[34] Some customers may appreciate cross-selling to provide them with a better holistic financial experience, whereas others may view it as intrusive. When an insurer decides to target a customer segment that values cross-selling, rapid investment into behavioural data models is likely required, should the potential revenue from this segment justify the cost.

Partnerships and outsourcing as alternatives to re-platforming

Quality post-sale service remains vital for a successful insurer: effective service keeps operational costs low and acts as a powerful retention mechanism for customers, as the level of servicing impacts satisfaction levels.

As sizeable multinational platform providers have started expanding into Africa, many client, product, and asset administration platform transformations have been launched in the South African market since 2018. These projects are forerunners in client value delivery, as insurers try to capitalise on customers' increased technology adoption. However, the cost and effort of these projects are often underestimated, with many projects exceeding their allocated costs and timelines.[35] While South Africa may be a minor contributor to global net premiums, the regulatory environment is sophisticated with mature requirements. Additionally, many divergent customer segments with different service requirements must be accommodated.

This broad set of additional requirements is further exacerbated by the fact that most insurers in South Africa have a complicated legacy product set with similarly complex system architectures and data integration challenges, as regulations between different financial services products overlap. Separate companies and data records are maintained with limited ability to share.

For those who see re-platforming as the only option, the biggest challenge is to, at least, maintain service levels through the transition. While transitioning to a different platform and re-engineering processes is taxing on operational staff, requirements, and processes must be continuously evaluated for necessity and client fit. A re-platforming exercise is an excellent opportunity to rationalise duplicated or non-value additive products.

Improving service levels alone, however, does not warrant a re-platforming exercise. Insurers not seeking to make a sizeable technological investment are increasingly partnering with fintech companies and business process outsourcing.

Like choosing a platform provider, this process requires the insurer to stay true to their and their customer segments' requirements and consider elements such as culture fit, way of work, and financial metrics.

While working with a single partner for the whole suite of processes within the insurer is comfortable, it may not be the ideal solution for them and their customers; a combination of partners may be the answer.

What next?

If an insurer's data and technology investments have been inadequate, and they are seeking to start modernising their architecture, they need to consider three issues.

Ensure a solid strategic foundation

In this highly competitive industry, it is easy to fall behind. In an effort to catch up, insurers are defaulting towards spending on technological solutions that competitors are spending on. Data and technology investments should always follow the corporate strategy and resultant customer requirements. If they are not defined, invest time defining them before spending on technology. In many instances, the correct strategic decision involves a combination of data, technology, and partner integration spending instead of just technology. Successful technology transformations are always business-led.

Ringfence the technology transformation budget

Similarly, adequate time and money should be ringfenced for technological transformation. Technology transformations are not cheap or easy, especially in large insurance companies with significant legacy architecture or fragmented strategies.

Ensure adequate expertise

Lastly, while current staff may have a high level of organisational know-how, many projects fail when insurers try to resource their transformation projects solely with their own staff, who are expected to undertake this task in addition to their already demanding activities. To avoid mounting technical debt or losses (whether time or money), resource data and technology transformation projects using people with sufficient time and the right skill and experience.
The insurance market leaders of the future will be forged during this period of transformation. Winners of this battle will be the ones who make the best technology modernisation choices now.

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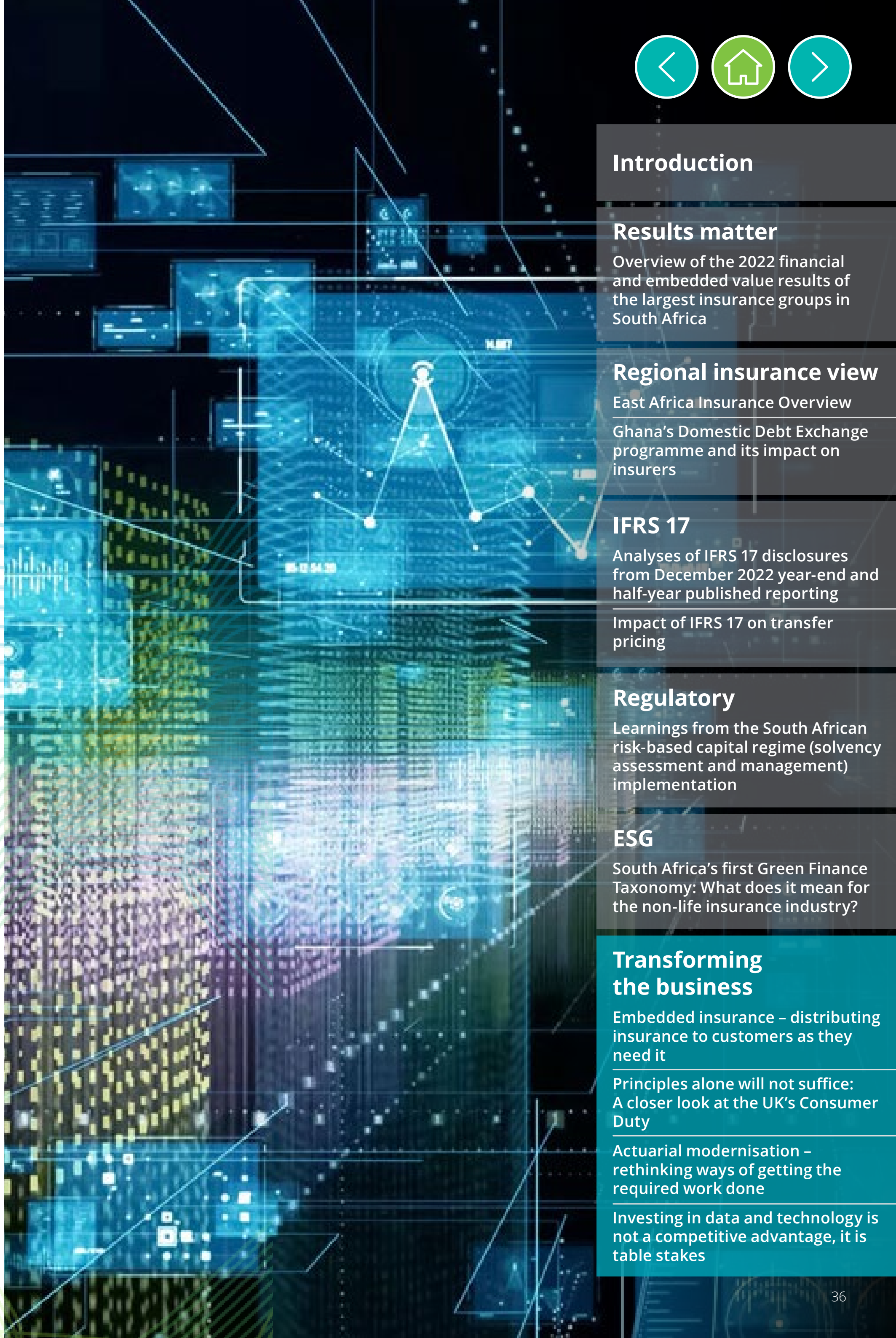

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[16]Financial Services Board, "Solvency Assessment and Management - Report on the results of 2nd South African Quantitative Impact Study ("SA QIS2")", January 2013. Available: *https://www.fsca.co.za/Regulated%20Entities/SAM%20DOCUMENTS/SAM%20SA%20QIS2%20Report.pdf*

[17]*http://www.treasury.gov.za/comm_media/press/2022/SA%20Green%20Finance%20taxonomy%20-%201st%20Edition.pdf*

[18]The Taxonomy Working Group was established under the Climate Steering Committee to develop South Africa's first Green Finance Taxonomy and governance framework for future iterations. The Taxonomy Working Group is chaired by the National Treasury and comprises representatives from national government, financial sector regulators and the financial services sector.

[19]*https://www.treasury.gov.za/comm_media/press/2022/2022111101%20Report_A%20Comparison%20Between%20the%20EU%20Green%20Taxonomy%20and%20South%20Africa's%20Green%20Taxonomy.pdf*

[20]This article focusses on the impact on the non-life insurance industry. Impact on the life insurance industry will be explored in a coming feature.

[21]*https://www.cisl.cam.ac.uk/files/climatewise_climate_product_innovation.pdf*

[22]While initiatives of engagement with customers and stakeholders would not necessarily contribute to the turnover disclosures of the taxonomy, it could be potentially be accounted for in the capital expenditures disclosures, qualifying as expenditure for prevention and protection measures to support environmental objectives.

[23]Highlighted as a technology risk in Swiss Re's 2022 TCFD section within their Financial Report: *https://www.swissre.com/dam/jcr:ec822a14-a4d7-4b6b-b0e2-49ae6036058c/2022-financial-report-doc-en.pdf#page=148*

[24]Our year in review | Zurich Insurance *https://www.zurich.com/year-in-review-2022*

[25]In June 2023 the International Sustainability Standards Board (ISSB) issued its first two IFRS® Sustainability Disclosure Standards, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures.*

[26]*https://www.swissre.com/insurance-partners-celent-report.html*

[27]*https://www2.deloitte.com/us/en/insights/industry/financial-services/financial-services-industry-outlooks/insurance-industry-outlook.html*

[28]The briefing paper of the Financial Services Consumer Panel: A duty of care for financial services providers, January 2017 at *https://fs-cp.org.uk/sites/default/files/duty_of_care_briefing_-_jan_2017.pdf*

[29]*FG22/5: Final non-Handbook Guidance for firms on the Consumer Duty (fca.org.uk)*

[30]Managed services refers to an app-based approach which automates results and insights production.

[31]South Africa accounts for an estimated 80% of the continent's total gross premiums. Source: StatsSA, Fintechnews.com

[32]Deloitte 2022 Africa Insurance Outlook, The customer gold rush

[33]Deloitte analysis on listed insurers' financial statements in South Africa – 2020 - 2022

[34]For example, assuming a particular insurer has no digital CRM messaging system, the solution is not to look at competitors and acquire one. The targeted customer segment may have a preference for paper-based communication, and therefore the funds to create a digital CRM messaging system could rather be rerouted to a more value-additive project.

[35]As per published financial statements, integrated reports and shareholder presentations of listed insurers.