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Unlocking the Potential

Insurance Outlook Report 2018

May 2018

Content

Setting the Agenda

Insurance company leaders have a lot on their plates. Political and regulatory upheavals around the world are changing some of the ground rules about how insurers may operate. An accelerating evolution in the way business is conducted is being driven by innovation and higher customer expectations, while disruptive newcomers are looking to take market share from incumbent insurers. In particular, insurers have been racing to keep up with insurance technology development.

However, in preparing our annual insurance outlook, we recognize that most insurers remain focused on two overarching goals: growing top-line sales while bolstering bottom-line profitability. Standing in the way of insurers achieving these objectives are a wide range of challenges. Not all of them are within the industry's control, such as increased cost of regulatory compliance and inefficiencies in the insurance value chain. How effectively insurers anticipate, prepare and adapt to their shifting circumstances, both strategically and operationally, is well within their control and can help differentiate themselves in the market.

In this report we pinpoint key opportunities and threats that should demand attention from insurers over the next 12 to 18 months. We will look at why it could be important for companies to address each of these issues sooner rather than later, including examples of how these developments seem to already be affecting the market and offer suggestions on what could be done to respond proactively.

As always, regulation and compliance requirements are important and seem ever changing, and this report will touch on some of the broader implications that are likely to result from the most significant shifts in policy. The Deloitte Center for Regulatory Strategies is publishing a companion paper dealing with these issues in detail, leveraging the expertise of our insurance practice and research team.

Our outlook is based on the firsthand experience and insights of Deloitte's subject matter specialists, supplemented with research and analysis by the Deloitte Center for Financial Services. We hope you find it thought provoking as you contemplate your strategic priorities and adjust your agenda for the year ahead.

Rebecca Kariru- Muriuki
Insurance Industry leader
Deloitte Consulting
East Africa
rmuriuki@deloitte.co.ke
+254 (20) 423 0000

Bernadette Wahogo
Leader
Deloitte Consulting
East Africa
bwahogo@deloitte.co.ke
+ 254 (20) 423 0000

Please share your feedback or questions with us. We would welcome the opportunity to discuss our findings directly with you and your team.

Where do Insurers Stand as they enter 2018

Kenya

According to the EIU (Economic Intelligence Unit), the diminishing political uncertainties are expected to result in GDP growth remaining stable and increasing from 5.3% in 2018 to 5.8% a year on average in 2019-22. Inflation is expected to ease to 5.5% in 2018, due to the impact of improved rainfall patterns on food supplies and prudent monetary policies. [1]

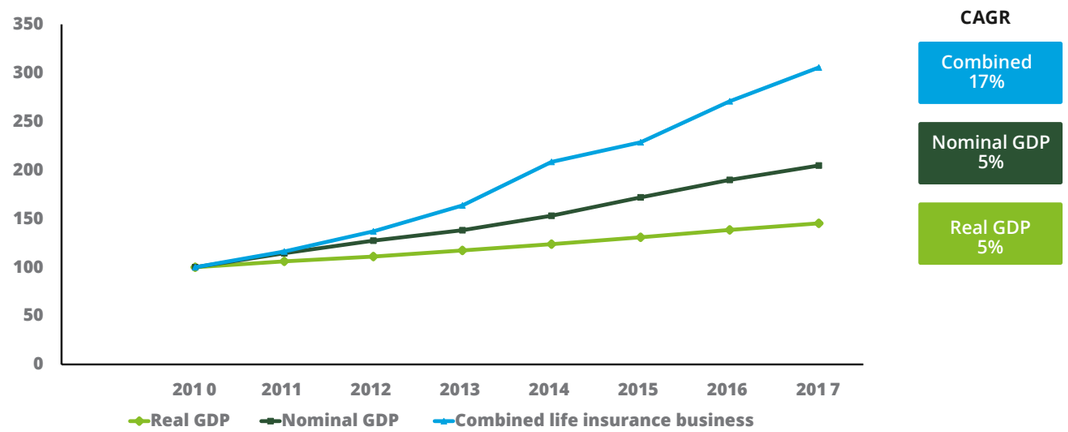
The political stability of the economy is expected to fuel increased public and private investment, and disposable incomes and expenditure. This is an opportunity for the insurance sector to provide solutions that are relevant to the specific sectors that are expected to grow from increased investment namely manufacturing, transportation and infrastructure.

The forecasts above indicate an expected growth of 19,7% in the insurance industry, given the historical positive correlation between industry premium growth and GDP growth.

Performance over the past 8 years is as illustrated below.

Life Insurance- Kenya
GDP growth versus premium growth

Index of GDP and total life insurance industry direct premiums 2010 - 2017[2]



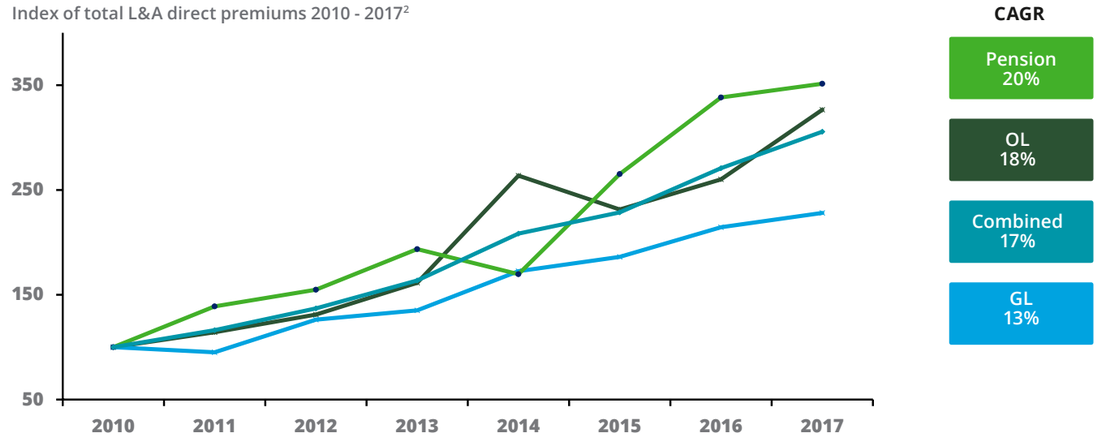
Source: IRA Kenya Industry reports 2013 - 2016, IRA Q4 2017 Industry Release, BMI Economic data

As seen above, there has been a rapid growth in the life insurance market relative to the nominal GDP. This has been driven by the growth in the pensions market, which has been spurred by increased demand of retirement solutions as life expectancy increases.

However, poor performance in the capital markets, regulations on Risk Based Capital and interest rate caps are likely to have an adverse impact on profitability of savings and investment products.

Constituents of industry life insurance premiums

Index of total L&A direct premiums 2010 - 2017[2]



Source: IRA Kenya Industry reports 2013 - 2016, IRA Q4 2017 Industry Release, BMI Economic data

Group Life (GL) business has had a slower growth compared to the combined Life Insurance business due to the price wars amongst industry players.

On the other hand, Pension and Ordinary Life (OL) are expected to continue driving the growth of the industry.

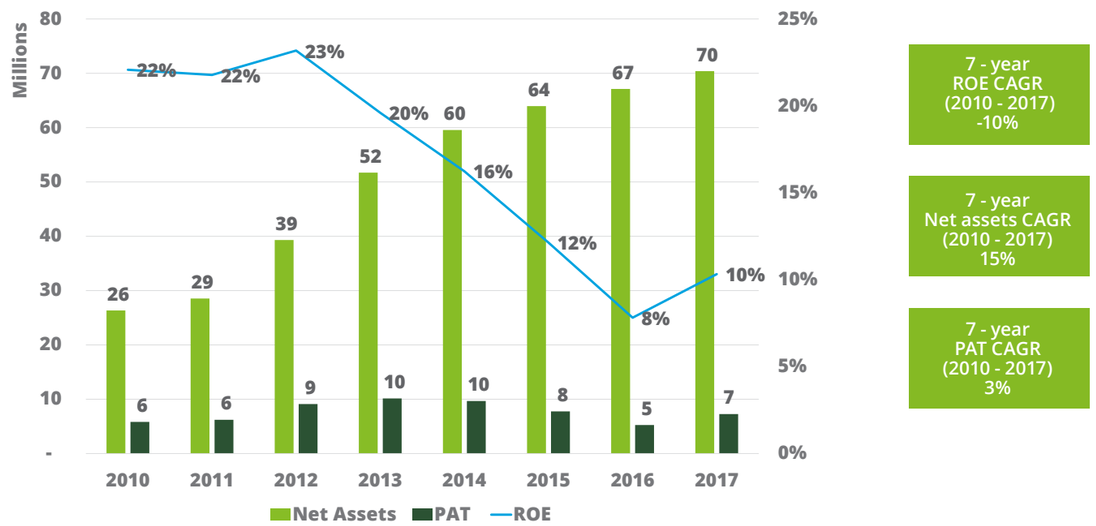
General Insurance- Kenya

Insurers are struggling to earn high returns on equity

Insurers started 2018 on a strong financial base with Net Assets at its highest level in the history of the industry.

However, overcapacity is undermining profitability, as seen by falling net income and return on equity (ROE). This is shown below.

General Insurance Industry performance, 2010 - 2017 (KES Billion, %)[2]



Source: IRA Kenya Industry reports 2013 - 2016, IRA Q4 2017 Industry Release, BMI Economic data

In 2018, a slow-growth economy together with high capacity is expected to continue exerting downward pressure on premium rates and consequently return on equity, as insurers compete with new and existing players for market share.

Uganda

The EIU predicts that real GDP growth is expected to stabilize to an average of 5.3% per year from 2018 – 2020, supported by the growth in the agricultural and oil and gas sectors. However, the political environment could threaten stability in the economy nearer to elections in 2021.[3]

Additionally, the insurance industry is poised for growth due to rising disposable incomes (especially for the life insurance industry) and foreign investment in the sectors mentioned above. The 3-year oil pipeline project between Uganda and Tanzania is expected to attract significant FDI inflows.

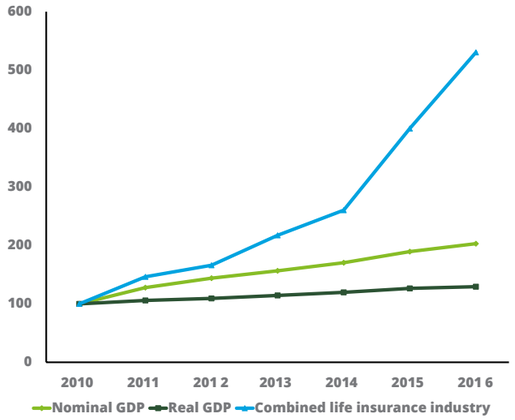
Insurers would need to position themselves and improve on process efficiencies to provide solutions that are tailored to the needs of the consumers of insurance services in a cost effective way.

Performance over the past 7 years is as illustrated below.

Life Insurance- Uganda

Premium growth is outpacing GDP growth

Index of GDP and total life insurance industry direct premiums 2010 - 2016[4]



CAGR

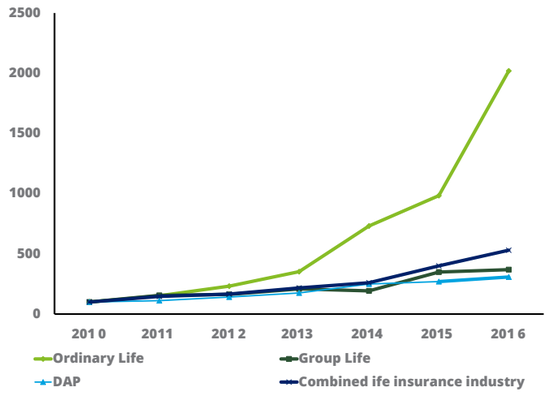
Real GDP 4% | Nominal GDP 13% | Combined 32%

Source: IRA Uganda Industry reports 2010 - 2016, BMI Report data

The rapid growth of the life insurance market relative to nominal GDP has been due to growing demand for insurance products in a growing economy.

Constituents of industry life insurance premiums

Index of total L&A direct premiums 2010 - 2016[4]



CAGR

DAP 21% | OL 13% | GL 13% | Combined 32%

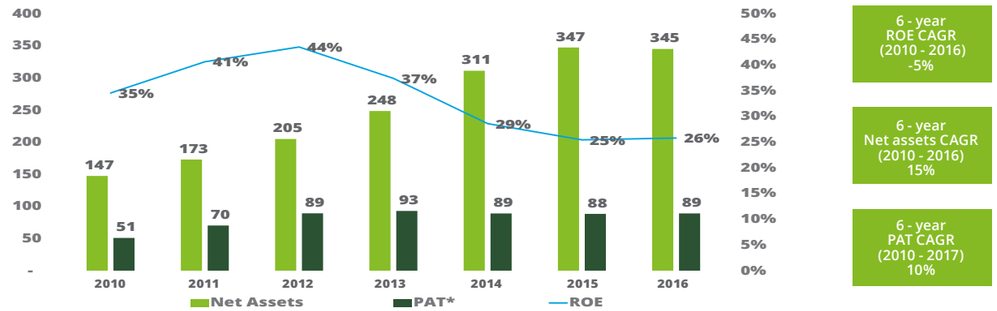
Source: IRA Uganda Industry reports 2010 - 2016, BMI Report data

Ordinary Life (OL) has the highest contribution and is expected to continue driving the growth of the industry.

General Insurance- Uganda

Insurers are experiencing diminishing returns on equity

General Insurance Industry performance, 2010 - 2017 (UGX Billion, %)[4]



Source: IRA Uganda Industry reports 2010 - 2016, BMI Report data

** PAT refers to change in retained earnings*

The historical profits after tax have been stable but the return on equity has been generally on the decline between 2011 and 2016.

Tanzania

Tanzania's GDP is expected to grow at an average rate of 6.2% per year between 2017 and 2026.[5] There however exists political and regulatory uncertainties that could hamper foreign and private investment in the country.

Private consumption is the largest contributor to GDP in Tanzania. The EIU has forecasted Tanzania's population and urbanization to grow at a rate of 2% and 30% respectively. This is expected to fuel consumer demand for various financial services including insurance.

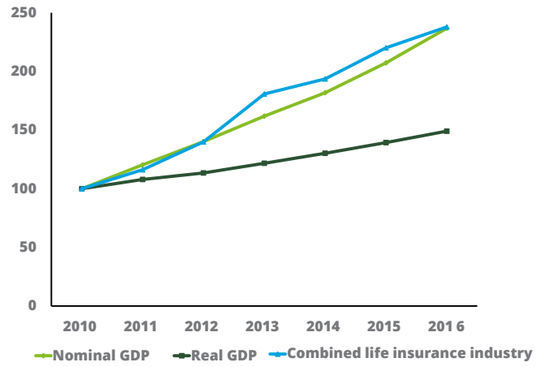
The rise of mobile penetration in the country is expected to play a role in the distribution channels that will be utilised to meet increased consumer demand for financial services.

Performance over the past 7 years is as illustrated below.

Life Insurance- Tanzania

GDP growth versus Premium growth

Index of GDP and total life insurance industry direct premiums 2010 - 2016[6]



CAGR

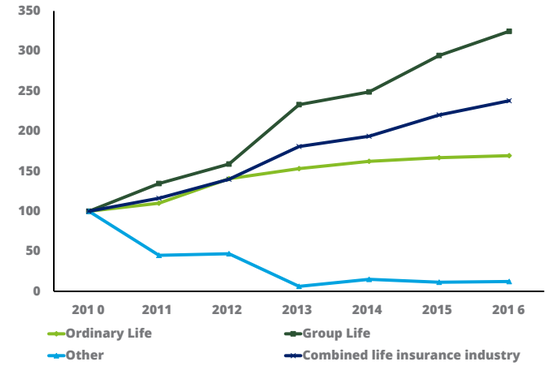
Real GDP 7% | Nominal GDP 15% | Combined 16%

Source: IRA Tanzania Industry reports 2010 - 2016, BMI Report data

The growth of the life insurance market has roughly been in line with the growth in the GDP.

Constituents of industry life insurance premiums

Index of total L&A direct premiums 2010 - 2016[6]



CAGR

Other -30% | GL 21% | OL 9% | Combined 16%

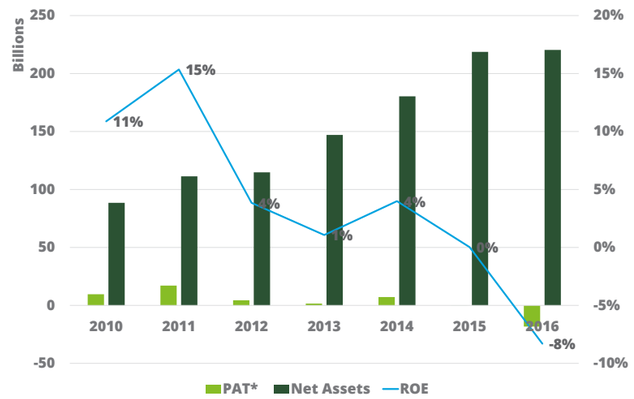
Source: IRA Tanzania Industry reports 2010 - 2016, BMI Report data

Group Life (GL) has contributed the most in driving the growth of the industry.

General Insurance- Tanzania

Insurers are experiencing lowest levels of returns on equity

General Insurance Industry performance, 2010 - 2016 (TZS Billion, %)[6]



6 - year
Net assets CAGR
(2010 - 2017)
16%

Source: IRA Tanzania Industry reports 2010 - 2016, BMI Report data

** PAT refers to change in retained earnings*

The return on equity was at its lowest at -8% in 2016 compared to the previous 7 years.

Life Insurance Sector Outlook

Life insurers face major systemic challenges, creating a need to develop new growth platforms.

Capped interest rate environment: The introduction of interest rate capping regulations in Kenya, heightened insurance regulations, and modest topline growth are putting pressure on insurance companies' profitability.

Dynamic competitive landscape: There is strong interest in new growth opportunities such as the large and underserved middle market. We have seen insurers in the region using mobile and technology to distribute insurance products to the market. This is creating an increasingly dynamic marketplace.

Evolving customer preferences: Experiences with companies outside of financial services and disruptive technologies are making customer expectations rise rapidly.

Amid challenges from regulatory disruption, increasing consumer expectations, and stagnant sales, insurers are increasingly likely to consider technological modernization to drive growth and efficiency.

Growth Opportunities

Innovations are required in product design, segmentation, analytics, distribution options and customer experience.

Why should this be high on insurer agendas?
Historically, high investment performance may have boosted the take-up of endowment and savings products and boosted company profitability. However, macroeconomic factors alone are unlikely to boost penetration rates and substantially without more fundamental business model changes.

As digital capabilities infiltrate nearly every industry, there appears to be a big opportunity for Life Insurance companies to transform their business model. Unless the industry commits to integrating transformative technologies more rapidly into their operations, Life Insurance companies could risk not only continued stagnation, but potential leakage to InsurTech innovators as well.

What is changing?
Globally, several insurers are experimenting with connectivity and advanced analytics reduce the processing time for life insurance cover from weeks to minutes, lowering onboarding costs, and minimizing the consumer dropout rate. Accelerated underwriting metrics, based on digitally available medical data, drug prescription information, and potentially facial analytics technology can be used to estimate an applicant's life expectancy and eliminate traditional medical tests.

Digitalization of life insurance underwriting can also enable online distribution capabilities, allowing insurers to cast their nets wider and embrace younger demographics that often prefer a more virtual experience. Barriers to purchasing insurance would be reduced with the use of digitalized underwriting processes that would make the processes much simpler and convenient for the customers and the back-end insurance operators. Indeed, Deloitte's work on Life Insurance underwriting suggests that the likelihood of prospects buying a policy once they apply increases from about 70 percent to nearly 90 percent as the underwriting and application process gets closer to real time.[7]

Beyond underwriting, distribution also seems ripe for digitalization. In one example, ***Abaris,*** an InsurTech startup, launched a direct-to-consumer online platform for deferred income annuities. This platform eased the process of finding the right annuity solution for one's circumstances and needs, retrieving a quote, comparing the quotes between different options and finally purchasing the annuity.

On the Life Insurance side, ***Ladder,*** another InsurTech startup, is now offering direct-to-consumer term life insurance policies within minutes, particularly targeting younger consumers who may often avoid purchasing such insurance policies, given the time it traditionally takes to do so. Applicants fill out a short questionnaire or have a chat with live personnel. This quickens the documentation and approval process. If a medical test is needed, the medical professional will come to the client. Moreover, ***Ladder*** does not charge annual policy fees or employ commissioned agents, potentially gaining a competitive advantage relative to incumbents.[8] In addition, Swedish InsurTech startup, ***Bima,*** is offering accident and life micro insurance to low-income consumers in developing regions of Africa, Asia, and Latin America via prepaid credit on their mobile devices.[9]

The game-changing potential of such automated lead-generation and direct-sales platforms could challenge Life Insurance providers to modernize their business models to maintain, let alone expand, their client base.

In addition, by connecting with clients via sensor devices, insurers can build more regular and meaningful client engagement. For example, insurers can harness data from devices that monitor vital signs, activity, nutrient consumption, and sleep patterns for more precise underwriting and pricing while offering value-added fitness and lifestyle feedback. John Hancock's Vitality program is one such initiative, offering policyholders premium savings and rewards for completing health and fitness related activities, tracked by smartphone apps and fitness devices.[10]

Innovate to tap underserved segments
Insurers can leverage advanced analytics, telematics, and IoT tech to make products more relevant to buyers on an everyday basis. This could be achieved by offering healthy living incentives, investment tips, and dynamic pricing. Robo-advisers could bolster life and annuities sales for middle-market prospects, especially on retirement, by offering comprehensive options to retirees.

Analyze buyer motivations
Psychological biases inhibit the sales of life and annuities products. Insurers should develop more effective messaging, tools, and products to overcome such behavioral barriers.

Easily understood products by consumers
Many consumers may be shying away from complex Life Insurance products they do not understand. Insurers should develop simpler policies designed to meet clearly defined needs (such as guaranteed income in retirement).

Operational Transformation

Legacy system modernization and process innovation (e.g., block chain, IoT, and robotics) could cut costs while bolstering sales, underwriting, and customer service.

Advanced analytics
Insurers who have leveraged off new data sources have experienced significant improvements in the time efficiencies of their sales and underwriting processes.

Improved leveraging of new data sources should streamline the often burdensome and time-consuming life insurance sales and underwriting process. These new processes should cut the policy acquisition timeline from weeks to days and make the experience more user friendly by eliminating the need for additional medical tests in many cases.

Enhanced automation
Adoption of robotic process automation can eliminate a lot of the keystrokes, clicks, and calculations conducted by administrators, analysts, and auditors. Insurers can move away from this by utilizing virtual assistants that react to verbiage and tone of voice. This can supplement or replace the simpler client services provided by Customer Service Representatives (CSRs), agents, and advisers.

Real-time data
Life insurers should explore how to capitalize on the expanding Internet of Things (IoT) by offering more discounts and additional incentives tied to exercise, diet, and lifestyle choices monitored telematically, while establishing a more interactive, value-added relationship with clients.

InsurTech potential
Life insurance companies should explore use cases for InsurTech, including distributed ledger technology, which may enable greater data access, enhanced security, and improved execution via smart contracts.
Insurers could also use these partnerships to leverage off InsurTech's improved risk-based pricing models and pricing algorithms that could take into account numerous customer points.

Boost cybersecurity
Cyber risk is not just an operational exposure, but a huge reputational risk as well. Insurers are prime targets given the treasure trove of personally identifiable data they keep on file. A major breach could severely undermine confidence in and growth by an impacted carrier.

Potential speedbumps

Life Insurers face a number of challenges including relatively modest economic growth, interest rate capping, and regulatory changes.

Sluggish investment performance
Interest rate capping in Kenya has reduced the investment earnings for insurers. This, along with slowing economies, could make it difficult for insurers to generate the returns they need to attract and retain clients.

The effects of the interest rate cap may be felt for a while. Life Insurers need to find alternative means of managing their bottom line profits through improved operational efficiencies.

Rule changes
Additional compliance rules and costs could be prompted by local and international regulatory standards. These changes include IFRS 9, IFRS 17 and risk based supervision.

Clunky systems
Lingering legacy systems inhibit efforts to boost efficiency, cut costs, and improve customer experience, especially with consumers judging mobile and online performance against noninsurance web-based product and service companies.

Call to Action

Break the mold
Life Insurers should embed digital technology across their organizations — as part of an offensive strategy to expand their market share and a defensive measure to fend off potential competition from nontraditional insurance providers.
Insurers should consider incorporating behavioral economics strategies to drive sales, such as automatic escalation of investment percentage and simulator tools to guide optimal portfolio allocations.

Reposition Sales and Acquisition Processes
Life Insurers need to refine their sales and onboarding processes as part of a wider strategy to improve customer loyalty. A few of the initiatives to be considered are:

- Middle-market prospects with the use of robo-advisers; and
- Customer lifetime value management through effective communication to customers on their changing insurance needs with age and other circumstances.

Operational efficiency with the use of technology
Life insurers need to start thinking of smarter and more operationally efficient ways of remaining connected with their clients. The use of wearables could make a difference for life insurers who are looking to establish an ongoing, interactive, value-added relationship with clients to boost sales. These and other IoT devices can be used to increase customer engagement and retention by:

- Incentivizing healthier lifestyles;
- Leveraging advanced analytics; and
- Rebranding insurance as a product offering with ongoing benefits in both life and death.

Life insurers should consider investing in, collaborating with, and/or acquiring InsurTech startups. Together, they can experiment with robotics, artificial intelligence, block chain, mobile capabilities, telematics, and other new technological frontiers to enhance customer service and automate manual operations.
Life insurers should think about employing more advanced analytics to streamline the life insurance application process. This will lead to improved targeting of customers, enhanced underwriting capabilities, and ultimately increased penetration rates.

Guarding against cyber risks
Insurers need to adopt a holistic approach to defend against cyber-attacks and protect consumer data while also looking to improve security, vigilance, and resiliency by upgrading both systems and talent. Such initiatives could be undertaken in partnership with reinsurers to manage risks to new exposures with little historical experiential data.

Serving underinsured segments
Macro and micro conditions may be challenging, but the Life Insurance industry has plenty of room to grow in an underinsured segment, particularly in the retirement space. However, insurers may need to up their game to make a more compelling case to buyers, and to make their solutions more easily and conveniently accessible.

General Insurance (GI) Sector Outlook

Challenging markets for organic growth should prompt more insurers to transform outdated legacy systems, while adding InsurTech capabilities. The goal is to cut costs and modernize operations in line with changing consumer needs and expectations for 24/7 service, amid heightening competition and emerging disruptors.

Growth Opportunities

To spur growth in a highly competitive market, insurers will likely look to develop new coverages for emerging exposures and added capabilities for the evolving digital, connected, and sharing economy.

Usage-based motor insurance nears a critical stage
While the existential threat of autonomous vehicles looms for auto insurers in the long term, for the next couple of years the battle for market share and profitability may depend on the expanding use of telematics.

Widespread consumer acceptance and regulatory support remain uncertain as carriers collect and leverage a critical mass of data to improve their underwriting, pricing, and claims operations. This will create opportunities to differentiate through risk management and real-time incentives for good driving performance.

Why should this be high on Insurer's agendas?
The conventional wisdom among stakeholders in the emerging mobility ecosystem is that universal deployment of autonomous vehicles could reduce the likelihood of auto accidents to near zero. In the meantime, a variety of factors—including record numbers of miles driven in growing economies, and a proliferation of expensive, embedded technology in vehicles—seem to have created a perfect storm for higher frequency and severity of motor insurance claims.

Motor claim costs on the rise
Many general insurers could continue to struggle to avoid red ink in the coming year, as loss costs mount from a rise in accident-generated expenses, escalating repair charges (with damage for technology in sensor equipped vehicles five times higher than traditional vehicles), technology-related driver distraction, and catastrophe losses.

What is changing?
In an increasingly crowded and commoditized market undermined by minimal customer loyalty, many general insurers are looking to differentiate their value beyond price to maintain or raise customer satisfaction. Otherwise, they could risk declining retention. The real-time data furnished by telematics offers a way for insurers to become an integral daily influence for connected policyholders through offers of frequent, mutually beneficial value-added services to establish brand stickiness. This does not seem to be a pipe dream, as price satisfaction scores are higher among customers who participate in vehicle telematics programs, even when they have experienced premium rate increases.[11]

In addition to telematics and driving monitors, a variety of safety sensors are slowly but surely being introduced to consumers via new car sales, with the eventual goal of full vehicle autonomy. Intuitively, this safety technology should reduce crashes despite the recent increase in miles driven. However, estimates by some insurers are that 25-to-50 percent of vehicles would have to be equipped with forward-collision prevention systems before crash rates decline sufficiently to offset higher repair costs associated with damaged sensors and computer systems.

SME business offers new prospects
Although 98% of all businesses in Kenya are SMEs[12], the existing insurance products do not offer unique solutions that would attract entrepreneurs. Insurers can take advantage of this space by offering flexible pricing and provide unique insurance packages beyond the traditional corporate packages.

New horizons
Insurers are expected to capitalize on the use of sensors in homes and businesses to facilitate new forms of usage-based coverages and loss-mitigation services in personal and commercial lines. Product liability writers in particular may see an exponential growth opportunity if, as expected, liability shifts from property operators and owners to their manufacturers, as well as those writing the software and providing the sensors monitoring and controlling connected properties.

Cyber insurance is the next frontier
Nearly all businesses (including insurers) face escalating cyber exposures with the growing sophistication of threat actors, creating opportunities to develop new coverages and loss control services for what could be the industry's biggest potential growth market over the next few years. Opportunities for expansion go beyond data breaches to protection for those running their operating systems on web-enabled platforms.

Insurers are not only faced with the challenge of managing their cyber risk exposures, but there is also an opportunity to offer solutions to companies who are looking to minimize this risk, more especially companies with sensitive customer data, e.g. banks.

Operational Transformation

Tech innovation can enhance efficiency, precision, and data security to bolster underwriting, pricing, claims, regulatory compliance, and the customer experience while strengthening client relationships.

Keep raising the bar on advanced analytics
Enhanced leveraging and modeling of data can empower risk selection, segmentation, and claims management with more precision and personalization.

Explore InsurTech potential as buyers and investors
Insurers are likely to accelerate their purchase of InsurTech and investment in startup providers. One intriguing possibility is to examine how distributed ledger technology might improve the way data is stored and protected and how policies might be more efficiently executed via smart contracts. Carriers are also likely to look to import innovation through strategic investments and acquisitions.

Automate the work force
More insurers will look to save time and money by transitioning routine data collection, analysis, and compliance tasks to robotic process automation, as well as supplement, if not replace, lower level policyholder interaction with virtual service agents, adjusters, and customer service representatives.

Potential speedbumps

Insurers face a number of challenges that could undermine their ability to bolster market share, profitability, and innovation efforts.

Disruption looming
General insurers need to start planning for a future in which safety technology, the sharing economy, and eventually autonomous vehicles may severely depress volume.

The cyber insurance paradox
The rise in connectivity via proliferating IoT-driven devices and operating systems creates vast new cyber exposures for insurers to cover. Insurers can only profit from these new developments if they can keep up with evolving threats and get a better handle on risk assessment, accumulation, and loss mitigation, while protecting the privacy of their own policyholder information against hackers.

Excess capital as new players enter the game
Insurers should expect more non-traditional competitors to emerge and fight for market share. Web aggregators, direct online sellers, P2P mutual entities, and insurance-linked securities are looking to challenge traditional insurer business models and put pressure on pricing in what is already considered an overcapitalized market.

Mistrust by current and potential future customers
Unless insurers introduce simpler products, faster on- boarding processes and quicker claims settlements, they will remain at risk of stunted organic growth.

Rising fraud costs
General Insurers will have to contend with the risks of increasing fraud and its impact on their existing business model. The rising costs of fraud presents insurers with the challenge of being unable to adequately price risks, leading to deteriorated returns to equity.

Call to Action

Reengineering product designs
General Insurers should consider reengineering or developing new products to align with changing consumer needs while pricing insurance covers dynamically, based on real-time data.

They should also rethink strategies to account for new types of competition, such as peer-to-peer insurers or risk securitization.These insurers can also leverage IoT to create an ongoing, interactive relationship with policyholders, based on real-time data and needs. This will in turn enhance their brand and deepen customer ties.

Moreover, general insurers can consider creation of in-house innovation and product development labs.

Reinvestment
Insurers should consider financing/buying InsurTech startups for:

- Mobile technology to reduce claim adjudication time;
- Drones to improve claim and risk evaluation;
- Interactive websites making real-time digital sales;
- IoT technology (wearables; home, car, and commercial sensors) to improve pricing, underwriting, and claims management;
- Blockchain; and
- Artificial intelligence.

Realignment
Insurers could look to leverage existing/emerging insurer infrastructure through:

- Collaborating with new distribution platforms, such as online exchanges, to maintain market share and reach new prospects; and
- Renting support services from emerging facilities such as peer-to-peer insurers, to generate revenue and learn more about new operating models.

Reinvention
Insurers will need to abandon their status quo by emulating the non-insurance industry mobile/online service capabilities to meet rising customer expectations.

Insurers at risk of disruption due to tech-driven shifts should consider expanding into new product lines to ease the transition (e.g., from motor insurance to product liability, personal auto to ride sharing).

Cyber risk – an opportunity and a threat
Insurers that hesitate to capitalize on the growth potential of the burgeoning cyber market run the risk of seeing the exposure transferred to self-insured funds or securitized via cyber bonds.
Insurers need to adopt a holistic approach to defend against cyber-attacks through:

- Proactively probing for and raising awareness of weaknesses in their operating environment;
- Improving cyber talent development and recruitment; and
- Monitoring stakeholder risk management efforts across the supply chain.

Capital management
Insurers will need to consider bridging internal silos, taking a portfolio approach to managing capital allocations and more closely conferring with distributors to be better positioned to move quickly into growing and more profitable lines, and away from those showing signs of decline.

Emerging Insurance Trends

Mergers and Acquisitions (M&A) Outlook

Various factors have set the stage for increased M&As.

Organic growth remains exceptionally difficult to generate as evidenced by stagnant insurance penetration.

Interest rates continue to decline, making investment income problematic. Therefore, increasing scale is essential to enable the investments needed to remain competitive.

The East African insurance market offers a lot of growth potential, although there are inefficiencies in the value chain that significantly affect shareholder returns. Despite these inefficiencies, the economic growth potential of the region makes insurers, amongst other financial services providers, attractive to foreign investors.

The industry continues to adopt financial reporting, capital management and governance standards that are more aligned to global industry practice.

There is intensifying interest in divesting noncore assets for both regulatory and competitive reasons.

InsurTech firms could have a disruptive impact by compounding the forces of change already reshaping the industry, while also being potential M&A targets for insurers.

Customer Centricity

Deepening client engagement beyond renewals and claims while differentiating with ancillary services is necessary to achieve customer centricity.

There are some principles that insurers would have to follow in order to achieve a customer centric culture. These include:

- The words "sales, revenue, margin and cost" being replaced with "usage, number of orders per minute and return on feature";
- Organization goals should be defined in terms of customer needs;
- Engagement of the customer with the organization's offerings should be measured religiously and by all levels of the organization;
- Insurers need to be more nimble in designing products that are flexible, readily refined with the ability to be turned off, dismantled and rebuilt in the shortest amount of time possible; and
- Customer experience should be monitored with changes being made to insurers' processes as often as daily, with A/B testing being a natural course of business.

New accounting standards

What's next

IFRS 17: Insurance Contracts

IFRS 17 aims to standardize insurance accounting where IFRS is adopted, to ensure that users of Financial Statements are able to compare companies (even between insurers and other companies), past performance and their current financial position.

The key objectives of IFRS 17 are to:

- Introduce for the first time a single IFRS accounting model for all types of insurance contracts;
- Make the new accounting model highly transparent; and
- Align as much as possible insurance accounting with the general IFRS accounting of other industries.

Changes introduced in IFRS17

Under IFRS 17, estimates and assumptions on future cash flows will based on current observable values.

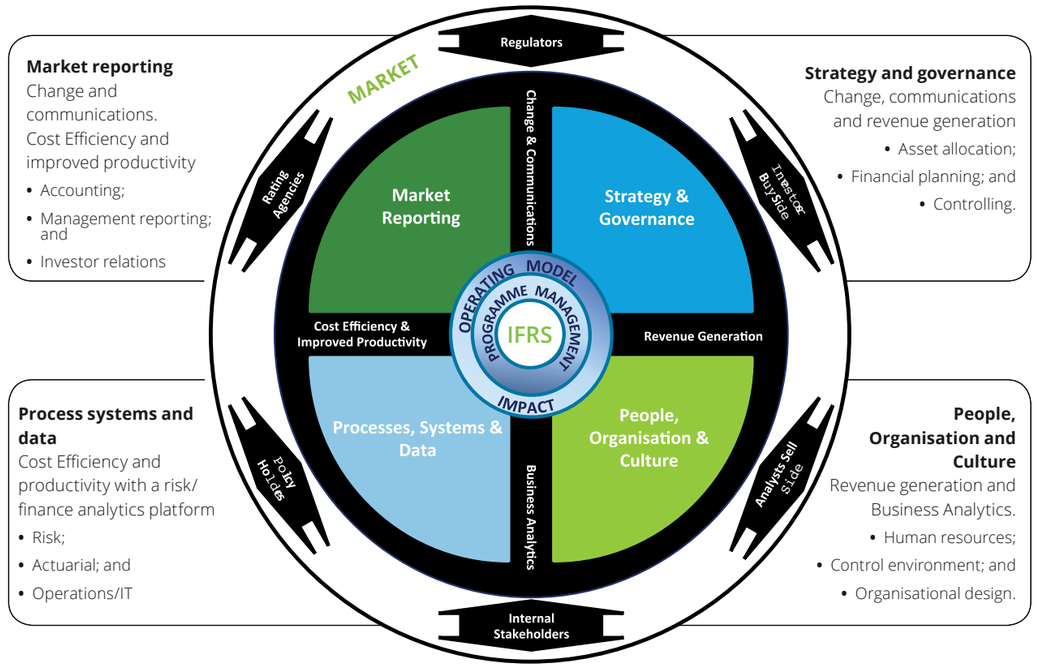
There will also be a requirement to take into account the time value of money in the future estimates.

Insurers will have to explicitly measure and disclose the risks borne from the insurance contracts they have issued.

The standard requires insurers to aggregate insurance contracts in groups at initial recognition and defer expected profit.

The expected profit will be recognized over the coverage period of each contract.

How will IFRS 17 affect insurers?



IFRS 9: Financial Instruments

In a nutshell

Phase 1 Classification and Measurement

- The classification of a financial instrument determines how it is measured.
  - How can financial instruments be classified?
  - When are financial instruments measured at amortised cost or fair value?
- Major driver for classification: **Business Model** and **Cash Flow Characteristics**

Major impacts on results, definition of business models, processes and IT

Phase 2 Impairment

- Impairment rules only apply to financial assets measured at amortised cost or Fair Value through OCI (= equity)
  - What types of losses imply an impairment?
  - What happens if loss expectations change over time?
- Move from incurred loss model to **expected loss model** (12 months or lifetime – depending on the credit risk)

Major impacts on results, processes and IT

Phase 3 Hedge Accounting

- How can a company represent its internal risk management in the financial statements?
  - How are hedging relationships reported in the financial statements?
  - What are the requirements for the designation of hedging relationships?
- Major uncertainties, parts ("Macro Hedge Accounting") taken out of first IFRS 9 version

Impacts on business, processes and IT probably limited

High level impact of IFRS 9 to Financial Institutions

IFRS 9 was brought about following the financial crisis that was mostly because of poor credit and risk management systems in the banking sector. The new standard aims to

- Improve comparability of financials;
- Improve transparency and understanding of complex impairment approach; and
- Recognise credit losses earlier than the IAS39 standard requirements.

Changes to accounting policies: The Standard introduces new guidelines for Classification & Measurement, Impairment, and Hedge Accounting. This will potentially trigger new guidelines for Management Accounting depending on the insurer's decision on implementing IFRS 9.

Business model: The new standard will compel insurers to consider their business models especially on the impact of IFRS 9 impacts on the pricing of their products.

Operational processes and procedures: Insurers will have to assess and enhance the link between their Risks and Finance processes, especially regarding impairment. Further developments in the Standard could lead to further adjustments in the processes for Classification and Hedge Accounting.

Governance: Insurers will need to clarify further the responsibilities of Finance, Risk and Control. This could necessitate setting up of IFRS 9 project delivery teams.

IT Systems: IFRS 9 will have impacts on all IT layers e.g. new attributes, new evaluation functions, adjusted booking rules, and adjusted reporting.

Finance, Risk and IT Staff: IFRS 9 will require significant internal support during project time. Dedicated staff may have to be released from regular tasks. It will also be of importance to involve external support in order to grow internal knowledge on an ongoing basis.

Budgets: IFRS 9 will have impacts at least on 2018 budgets; Gap analysis for enabling reliable budget estimation should be ongoing.

Options for IFRS 9 to sync up with your IFRS 17 implementation

To address the concerns that effective date of IFRS 17 can no longer be aligned with the effective date of IFRS 9 *Financial Instruments*, the IASB amended in *Applying IFRS 9 'Financial Instruments' with IFRS 17 'Insurance Contracts'* to provide two options for entities that issue insurance contracts within the scope of IFRS 17 as follows:

Approaches for Implementation

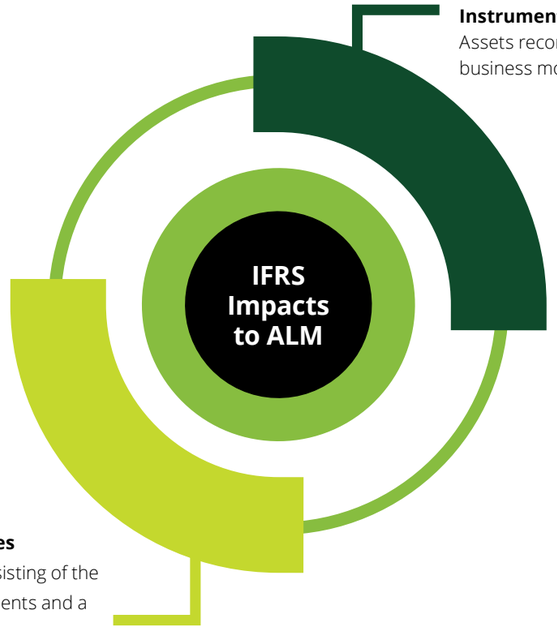
Overlay Approach

- With the overlay approach IFRS 9 applied by all entities, including insurers from 2018
- Insurers permitted to include in profit or loss a transfer to OCI of:
  - Difference between amounts recognized under IFRS 9 and amounts that would have been recognized under IAS 39
  - Financial assets measured at FVPL under IFRS 9 that were not or would not have been measured at FVPL under IAS 39
- The objective of the adjustment is to remove from profit or loss any increased volatility in a transparent and consistent manner

Deferral Approach

- If predominant activity of the conglomerate is insurance deferral of IFRS 9 can be elected
- Predominance will be proposed as the proportion of the IFRS 17 liabilities over the total liabilities of the reporting entity. It will have to be greater than 90% (safe harbor) or 80% (conditional)
- Predominance is assessed at the reporting entity level at the annual reporting date that immediately precedes 1 April 2016
- Entity has option to continue to apply IAS 39 to all financial assets in consolidated financial statements
- Reassessment is required following major corporate restructuring

Both IFRS 17 and IFRS 9 will have an impact on the operating model of the insurers across business areas. Insurers however have the option of deferring IFRS 9 implementation until they implement IFRS 17, subject to certain conditions that are indicated in the standard.



Assets and Financial Instruments

Assets recorded at FVTPL, FVOCI based on the business model and SPPI test

Insurance Contract Liabilities

New measurement model consisting of the PV of cash flows, a risk adjustments and a contractual service margin

End Notes

This report has been adapted from the Deloitte Center for Financial Services 2018 Insurance Outlook Report.

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Contacts

Rebecca Kariru- Muriuki
Insurance Industry leader
Deloitte East Africa
rmuriuki@deloitte.co.ke
+254 (20) 423 0000

Bernadette Wahogo
Consulting Leader
Deloitte East Africa
bwahogo@deloitte.co.ke
+254 (20) 423 0000

Fred Okwiri
Audit partner (Insurance specialty)
Deloitte East Africa
fowkiri@deloitte.co.ke
+254 (20) 423 0000

Freda Muchena-Mitambo
Audit partner (Insurance specialty)
Deloitte East Africa
fmuchena@deloitte.co.ke
+254 (20) 423 0000

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