

South Africa: Insurance Industry Update

March 2021



Introduction

So far, there has not been much to be optimistic about in 2021 regarding a resurgence of COVID-19. Court rulings and claims costs have both hit insurers hard and, as always, regulatory change continues. Several entities are still coming to grips with regulatory changes over the last year, with new changes set to become effective in a few months.

In this edition, we discuss these issues, along with the emerging priority risks of cyber and climate change.

Did SARS just leave the window open for cybercriminals?

The South African Revenue Service (SARS) recently launched its own web browser as a quick "fix" to solve the termination of Adobe Flash, which is required for e-filing some SARS forms. SARS says it had anticipated the discontinuance of Adobe Flash at the end of December 2020, but somehow assumed the functionality would remain. While SARS has migrated most of the major high-volume tax forms to an alternative platform (HTML5), the remaining forms are only scheduled to be completed in 2021.

There are many questions about how SARS did not ensure that the migration was completed by the end of 2020. The Adobe Flash discontinuance has been known for over three years. Whatever the truth there, serious cyber risk concerns remain around SARS's choice of stopgap measure.

This situation raises troubling parallels to the 2017 NotPetya cyberattack. With the NotPetya attack, a seemingly innocuous tax software app provided attackers with a backdoor into thousands of computers. The attack rapidly spread and crippled the operations of many corporations with a total estimated cost of over \$10 billion.

The SARS-provided browser is based on a platform that is no longer supported and, therefore, offers no future security updates. It may need to be installed on a range of devices across much of corporate South Africa. Remote working requirements only extend the risk and impact of possible cyber risks.

The Milliman white paper "[The law of unintended consequences](#),"¹ uses the NotPetya attack as a case study and provides a framework for understanding the complexity of cyberattacks.

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COVID-19 deaths increase, but so does the information available to model impact on insured lives

With the peak of the second wave behind South Africa, a clearer picture of the mortality impact of COVID-19 is emerging. The South African Medical Research Council (SAMRC) is reporting more than 135,000 excess deaths since April 2020, significantly higher than some initial pandemic analysis predicted.

There have been 35% more natural deaths than expected, with 17% fewer accidental deaths. For insurers offering double accidental benefits the reduction in accidental deaths is a partial reprieve.

SAMRC has also calculated age-adjusted indicators of excess mortality for different provinces, showing significant variability. Insurers underwriting results could be significantly impacted by these differences.

Relative to the country, age-adjusted excess natural mortality has been approximately 75% higher in the Eastern Cape, and 50% higher in KwaZulu-Natal. Conversely, it has been 50% lower in the North West and 35% lower in Gauteng.

For insurers, there is hope that vaccines could mitigate a third or perhaps even a fourth wave in 2021. But this is complicated by both the rollout of vaccines and the emergence of new

¹ Harner, C., Beck, C., & Fleisher, B. (March 2020). The Law of Unintended Consequences. Milliman White Paper. Retrieved 25 February 2021 from <https://www.milliman.com/-/media/milliman/pdfs/articles/the-law-of-unintended-consequences.ashx>.

strains. More difficult to predict will be the long-term impacts on both mortality and morbidity.

Until now, changes in valuation basis have been the biggest actuarial problem. Insurers are now moving on to renegotiating reinsurance treaties, dealing with increased rates and decreased premium guarantee terms and considering changes to their own product ranges. All of these factors will have long-lasting business impacts.

Missing a required approval for encumbered assets could hurt SCR cover

Financial leases have always created “right of use assets” on the International Financial Reporting Standard (IFRS) balance sheet. These assets are explicitly identified within regulations as being “encumbered,” requiring Prudential Authority (PA) approval to hold and count towards solvency.

A 2019 change in IFRS 16, the accounting standard for leases, means that leases previously classified as “operating leases” also result in encumbered “right of use assets.” This has caught out several insurers when producing 2020 year-end figures.

This isn't the only example of accounting changes impacting solvency. Actuarial teams responsible for Quantitative Reporting Template (QRT) completion and Heads of Actuarial Function signing off on these submissions can easily miss these items, resulting in decreased Solvency Capital Requirement (SCR) cover, triggering risk limits and requiring potentially uncomfortable conversations with the PA.

Recent SAM development may increase capital requirements

Capital requirements for many life insurers are set to increase, according to the latest draft guidance from the PA.

A key change is that life incurred-but-not-reported (IBNR) claims must now be stressed, which can dramatically increase the overall SCR for insurers with short-tailed or zero contract boundary risk business, where the IBNR is a significant part of technical provisions.

The information note from the Actuarial Society of South Africa (ASSA) outlines some important limitations on the extent of loss-absorbing capacity of deferred taxes (LACDT). The likely impact is a possibly significant increase in SCR for some insurers.

A similar note on expenses is expected to follow soon, but the capital impact of adopting the proposed guidelines will vary from entity to entity.

These changes and information notes arise out of the PA's Solvency Assessment and Management (SAM) Phase II project, which is expected to continue for several years. ASSA has set up a subcommittee to engage with the PA on these matters.

If you have any questions on SAM Phase II, how ASSA is assisting or on any of the notes published, please reach out to richard.taylor@milliman.com.

2020: Climate and catastrophes

Tropical Cyclone Eloise wrought devastation on Mozambique's coastline over the weekend of 22 January 2021. From there, the cyclone moved further inland over the African continent, reaching as far as the western parts of Botswana before dissipating. During the storms' progression, Zimbabwe, eSwatini and South Africa experienced flooding caused by heavy rain and strong winds. The cyclone resulted in 21 confirmed fatalities, tens of thousands displaced, more than 20,000 houses either destroyed, damaged or flooded and vast swathes of crops flooded.^{2,3}

Even though Eloise has dispersed, South Africa has still been exposed to severe rain and thunderstorms, with regular flood warnings issued by the South African Weather Service. Most recent is a 12 February 2021 report warning that yet another tropical low pressure was expected to move over Mozambique during the ensuing weekend, albeit significantly weaker than Eloise.

Aside from the continued observance of tropical low-pressure systems, the increased rainfall is explained in part by El Niño–Southern Oscillation (ENSO). ENSO is the natural phenomena in respect of variation in winds and sea surface temperatures over the tropical eastern Pacific Ocean. The colder, wetter phase known as La Niña developed during August and September of 2020 and is expected to continue until April to June 2021.⁴

South Africa has experienced some noteworthy storm events in the past few years. These events and their impacts lead us to consider the broader topic of climate change.

² Grobler, R. (26 January 2021). Cyclone Eloise: 2 children dead, hundreds of homes damaged across three provinces. News24. Retrieved 25 February 2021 from <https://www.news24.com/news24/southafrica/news/cyclone-eloise-2-children-dead-hundreds-of-homes-damaged-across-three-provinces-20210126>.

³ Reliefweb (28 January 2021). Southern Africa – Tropical Cyclone Eloise Flash Update No.11. Retrieved 25 February 2021 from <https://reliefweb.int/report/mozambique/southern-africa-tropical-cyclone-eloise-flash-update-no11-28-january-2021>.

⁴ Crop Monitor (25 January 2021). Special Report: La Niña 2020/2021 Impacts in Argentina and Brazil. Retrieved 25 February 2021 from <https://cropmonitor.org/index.php/cmreports/special-reports/>.

Climate change continues to be one of the most frequent topics in scientific communities and political debates. The change in weather patterns and occurrence of severe storms, in conjunction with the ensuing economic impact, are widely considered as some of the top emerging risks in the insurance market. Studies have been conducted to understand upward trends in tropical storms observed over the recent century, the repercussions of which would need to be factored into (re)insurance premiums to manage the increasing claims costs.

The Milliman Climate Resilience Forum, held 2-4 March 2021, hosted more than 50 global leaders discussing the cascading effects of climate change. The virtual summit provided the opportunity to discuss all matters in respect of climate change with some of the most influential and informed experts from industry, government, academia and not-for-profit sectors. To view the presentations from the Forum, [click here](#).

For more from Milliman about our recent thoughts on climate change, see the following articles:

- [Why are regulators talking about climate change and what can you do about it?](#)
- [Climate disasters are inevitable. We need to do more than just wait to clean up the damage](#)
- [EIOPA Consultation Paper: Use of climate change risk scenarios in ORSA](#)

From around the continent

Insurance market penetration is the name of the game and several African countries are playing. From the start of December 2020, conventional Nigerian insurance companies have been permitted to set up microinsurance windows, provided they meet the fairly short list of requirements.

In a similar attempt to increase financial inclusion, Zimbabwean insurers are once again allowed to issue and settle policies in

foreign currencies. This is due to the early November 2020 revision of a mid-2019 regulation limiting insurers to issuing policies in the local currency only.

The Ghanaian government approved a new Insurance Bill in early February 2021. The bill covers subjects ranging from more stringent regulation and governance of insurance companies to the addition of three compulsory covers nationwide.

POPIA is finally upon us

On 1 July 2020, several additional sections of South Africa's Protection of Personal Information Act (POPIA) commenced, with a *compliance deadline of 1 July 2021*. They include Sections 2 to 38; Sections 55 to 109; Section 111; and Section 114 (1), (2) and (3). Sections 110 and 114(4) will commence on 30 June 2021.

POPIA, the South African equivalent of Europe's General Data Protection Regulation (GDPR) sets out a number of rules and conditions for the processing, use and storage of personal information by institutions and other responsible parties.

Large financial services businesses are at the end of multiyear projects to ensure compliance, but many insurers have been focused on other regulatory matters and may have further work to do in the coming months.

The Milliman briefing note "[Data protection in a GDPR world](#)" provides an overview of the GDPR rules, discusses some aspects firms should consider in light of the regulations and explores the implications for risk management frameworks.⁵ Many of these concepts will also be applicable in the South African context.

⁵ Milliman Briefing Note (September 2018). Data Protection in a GDPR World. Retrieved 25 February 2021 from <https://www.milliman.com/-/media/milliman/importedfiles/uploadedfiles/insight/2018/dataprotectiongdpworld.ashx>.

How can Milliman help

If you would like to discuss any of the above, or anything else with us, then please contact us.

Milliman can provide a range of services including:

- Dealing with regulatory change and approvals
- Product performance reviews and changes in light of COVID-19 lessons
- Solo and Group Head of Actuarial Function
- Independent review of actuarial and risk functions
- Own risk and solvency assessment (ORSA) and risk management maturity reviews
- Licence conversion and application assistance
- Cyber risk assessment and modelling
- IFRS 17 implementation and advice



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