Assessing the COVID-19 impact on the Ugandan insurance market

Applying the IAA-IAIS proportionate risk assessment tool

February 2021

Introduction

This note considers the impact that COVID-19 has had on the Ugandan insurance market as a cross-cutting risk experienced by the sector. This involved adapting and using the proportionate risk assessment tool developed by the International Actuarial Association (IAA) in collaboration with the International Association of Insurance Supervisors (IAIS). The Insurance Regulatory Authority of Uganda (IRA) and Ugandan insurance market players have received in-depth training on the original tool outside of this assessment – with the IRA going so far as to incorporate the tool into its formal product approval process[1]. Given the established applicability of the tool to risk assessment within the Ugandan market, the process of adapting the tool and assessing the impact of COVID-19 was undertaken. The goals of this exercise were (i) to test the ability of the IAA-IAIS tool to consider the impact of cross-cutting risks and (ii) to identify the broader impact of COVID-19 on the insurance sector in Uganda.

The assessments show that COVID-19 has resulted in large increases in risk from both prudential and operational sources, even as the industry has continued to experience premium growth. The prudential sources of risk relate to, and highlight, the economic impact of COVID-19, while the operational sources show the impact of needing to rapidly digitalise with little warning. The economic impacts of COVID-19 are expected to continue to affect the sector in the medium term, which may ultimately weaken solvency and result in consolidation in the market.

Context

COVID-19 relatively under control

Stringent containment measures have limited COVID-19 infections in Uganda. The Ugandan Government has acted strongly in reaction to COVID-19. Uganda closed schools and banned large gatherings three days before confirming its first case. By the end of March 2020, most businesses were shut, and public transport was banned. The Ugandan Government was already on alert due to an Ebola outbreak in the Democratic Republic of the Congo, which meant that teams were already in place to screen passengers at airports, and isolation wards were ready.

1 The initial training was focused on training the regulator and industry to use a common tool to consider the risks arising from the development and/or introduction of new insurance products.

Testing rates have been relatively high, with over 250,000 tests done by August 2020 (Biryabarema, 2020). This response from the Government has meant that, while active cases increased to nearly 25,000 in December 2020, the trend on daily new cases has reduced since then, suggesting that the peak of first-wave infections may have been reached (Worldometer, 2021). Also, fewer than 300 deaths had been attributed to COVID-19 by January 2021. In contrast, South Africa experienced its second peak in January 2021 with over 230,000 active cases after peaking at over 170,000 active cases in July 2020. The risk assessments considered in this note were completed in November and December 2020, when the active cases of COVID-19 in Uganda were relatively low.

Uganda still at risk of a significant rise in COVID-19 infections. As mutations of COVID-19 are coming to the fore, uncertainty on how to combat the virus has increased. In addition, Uganda held general elections on 14 January 2021, which had the potential to be a super-spreader event, as 57% of the 18 million registered voters cast their votes in person. These uncertainties regarding the risk of COVID-19 decrease the accuracy of future risk estimates and may mean that the identified risks are underestimated in future assessments (the prospective assessments in the study).

Insurance sector growth amid a global pandemic

Ugandan insurance sector experienced growth despite COVID-19. Although COVID-19 has slowed overall economic activity in Uganda, the insurance sector experienced 9% growth in gross written premiums in the third quarter (Q3) of 2020 relative to the same time in 2019. The increase in gross written premiums was driven by a growth in life insurance premiums (19%) and in non-life insurance premiums (7%).

Non-life premium growth driven by compulsory insurance. A key driver of the overall premium growth has been stronger enforcement of compulsory lines, in particular third-party motor. The online third-party motor platform was launched and declared compulsory for insurers to use from 1 July 2020. The result was that over 116,000 policies and UGX8.8 billion of policies were paid on the platform by the end of the year. The IRA also has an MOU with the Ministry of Works and Transport, which will strengthen the enforcement of compulsory insurance. Greater enforcement is expected to increase uptake as the repercussions for not having insurance increase (Insurance Regulatory Authority of Uganda, 2020). At the same time, insurance for marine cargo/goods-in-transit also became compulsory from 1 July 2020 (Insurance Regulatory Authority of Uganda, 2019)[2].

Life premiums supported by continued bancassurance growth. Bancassurance has shown strong growth since its introduction in Uganda in 2018, suggesting that banks are better able to reach customers than insurers. Bancassurance premiums grew by 58% in Q3 of 2020, relative to Q3 in 2019. Bancassurance includes premiums for all lines of insurance business, but the majority (71%) was life insurance.

2 The online platform to help enforce the uptake of local insurance is expected to be launched in March 2021.

Insurers have supported the resilience of Ugandans in the face of COVID-19. Insurers have used the rise in overall premium earnings to foster their clients' resilience in several ways. For example, Prudential has expanded its clients' cover to include a cash payment, should they test positive for COVID-19 – a benefit which Prudential also extended to new customers who enrolled up to 13 May 2020 (Ugandan Daily Monitor, 2020). Prudential and Goldstar have also partnered to extend the cover provided under workman's compensation and group personal accident insurance to include deaths due to COVID-19 (East African Business Week, 2020). In a similar manner, Sanlam Uganda provided "cashback" payments to individual life customers amounting to UGX475 million (approximately USD129,000) and donated UGX285 million (approximately USD75,000) to the Government of Uganda's National COVID-19 Response Fund (PC Tech, 2020).

Reductions in some product lines suggest clients are under financial pressure. While overall premiums have shown growth, the gross written premiums of some product lines have shown significant reductions. These include bond insurance (-28%), fire insurance (-15%) and workman's compensation (-8%) for non-life insurers. Similarly, life insurers have seen a 16% reduction in gross written premiums of group life. These reductions, particularly group life and workmen's compensation, suggest that many clients are experiencing economic pressure, as they would decrease when there are staff layoffs. Reductions in insurance cover may also reflect clients prioritising other expenses and reducing their non-compulsory insurance cover.

Risk tool assessment methodology

The Ugandan insurance sector seems to have avoided the worst impacts of COVID-19, with high-level trends showcasing premium growth. However, some insurance product lines have seen large premium reductions. Moreover, the extent to which COVID-19 continues to disrupt global economic activity remains a threat to the health of the insurance sector going forward, which means that top line statistics could be creating a false sense of security, particularly if the changes in risks are not considered.
The proportionate risk assessment framework and tool were used to unpack the impact of COVID-19 on the Ugandan insurance sector and develop a better understanding of the effect that the pandemic is currently having, and could have, on risks faced by the market. It also showcases the ability of the tool to assess the impact of similar cross-cutting risks, such as climate-related risks, in the future. This nuanced view should empower insurers and the regulator alike to prioritise their resource allocation towards addressing their most vulnerable areas – a true risk-based approach to managing and supervising risks.

Risks considered across two dimensions: product and provider. As the starting point of the assessment, users need to consider the risk appetite within their organisation. The risk appetite informs how much risk the insurer is willing to take on. The proportionate risk assessment tool is then utilised to consider risk in two categories:

1. **Product:** This category captures the key risks relating to the features of an insurance product. Examples include: i) data: availability, quality and suitability, and ii) sum insured: amount and predictability, etc. Product risks generally relate to prudential aspects of insurance companies.

2. **Provider:** This category captures the risks arising across the full supply chain that delivers the insurance product to the customer. As the total service is only as strong as the weakest link in the chain, it is important to consider all of the components – even those that insurers do not undertake themselves. Examples include: i) Operations: institutional assessment and internal audit, finance and administration, technology, management of partnerships and regulatory compliance, and ii) product design capability: market research, prototype design, testing and rollout, full product design, testing and rollout, disclosure and documentation. Provider risks generally relate to the operational aspects of insurance companies.

The results of the risk assessments along these two dimensions are combined into an overall level of risk (ranging from "low" to "high") via a heat map matrix, as shown in Figure 1. The combined risk assessment is then compared with the risk appetite to establish whether the result is within the organisation's risk appetite (the blue line in Figure 1). If the overall risk is above, or to the right of, the blue line, it indicates overall risks beyond the risk appetite of the insurer.

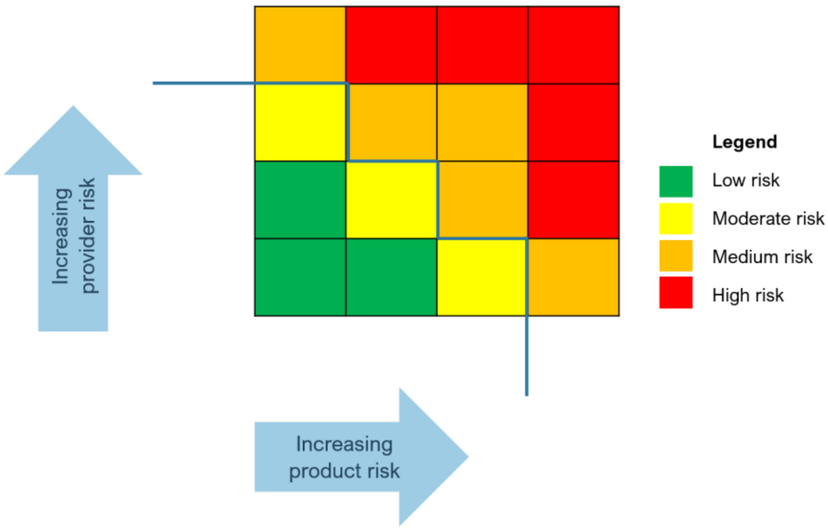

Figure 1: Risk assessments results matrix

Source: Author's visualisation based on proportionate risk assessment framework tool

Three assessments per organisation to consider how COVID-19 changed insurers' risks. To analyse how COVID-19 changed insurers' risk exposure, respondents were asked to complete three assessments:

1. **Pre-COVID-19 assessment:** This assessment considers the risk exposure of the organisation prior to COVID-19.
2. **Retrospective assessment:** This assessment considers how COVID-19 and the related national lockdown changed the risks insurers were exposed to from the onset of the pandemic up to the time of performing the assessment.
3. **Prospective assessment:** This assessment gauges how insurers anticipate risks to change over the 12 months following the assessment.

Limited responses restrict the insights that can be drawn from the results. Six insurers and the IRA were requested to complete the assessment. Three insurers responded, and the IRA responded from the perspective of a non-life insurer focused on the provision of health insurance. The four assessments examined include two non-life insurers (one completed by the IRA with a focus on health insurance) and two life insurers. The insurers that responded were relatively large, limiting the comparability to smaller insurers in the market. In addition, all responses utilised the default risk appetite, suggesting that the risk appetites may not be accurately reflected and limiting the extent to which conclusions can be drawn where the shift of risks beyond insurers' risk appetites is concerned.
In addition, due to the limitations, trends between insurers are only discussed when substantiated by additional response sources.

Findings from risk assessments

Risks increased across the board. All insurers that completed the assessments showed increases in both product and provider risks as a result of COVID-19 (i.e. relative to the pre-COVID-19 status quo). The summary results are shown in Figure 2. The prospective assessments also indicate that all respondents expected these risks to continue above pre-COVID-19 levels for the coming year, though the provider risks show some reductions relative to the retrospective assessments. This suggests that there has been some evidence of possible permanent changes in the future risk profile. Though, the reductions suggest that the worst is believed to be over.

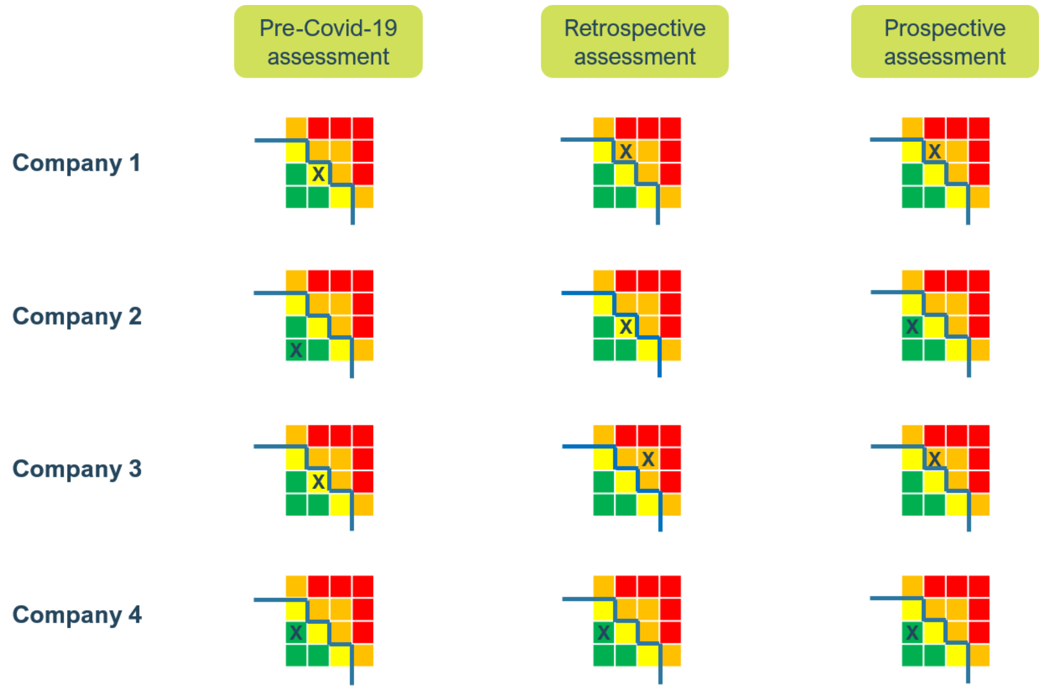

Figure 2: Summary results from risk assessments

Source: Authors' own, based on results of proportionate risk assessment

COVID-19 impact on product risks

Product risks relate to economic impact of COVID-19. All respondents indicated increased risks from reduced business volumes as a result of COVID-19. The increased risk stems from actual premiums being lower than insurers budgeted and the expectation that this situation will continue over the coming year. That is, premiums increased for the assessed insurers, but not to the extent expected. However, the drivers of increased risks differed between respondents. The life insurers emphasised increased risks due to lapses, while non-life insurers emphasised lower sales and renewals. These effects were also expected to mostly remain in the year ahead (prospective assessment) at a similar level to what was experienced so far from COVID-19 (retrospective assessment). The increase in business-volume-related risks suggests that clients are financially constrained as a result of COVID-19 slowing economic activity, and in response are rationalising insurance expenses.

Economic impact may have larger repercussions. The assessment results show that, in addition to lower business volumes (premium income), investment returns were also under pressure. Some prospective assessments (considering future impact) showed higher-than-expected capital and solvency risk levels. The risk on investment returns that an individual insurer faces may depend, to a large extent, on the portion of government securities within its investment portfolio. Insurers in the Ugandan market (like their counterparts across sub-Saharan Africa) hold a large proportion of their assets in this asset class (53% of life insurers' assets and 17% of non-life insurers' assets). If government expenditure in response to COVID-19 results in unsustainable lending and government defaults, this will have significant impacts on the insurance sector. The latest rating by Fitch (June 2020) mentions this risk as part of its rationale for revising its outlook on Uganda to negative, but having not seen significant changes yet, keeping the country's rating at B+ (Fitch Ratings, 2020).

These pressures may be especially marked for some insurers in the market, as results from the IRA's 2019 Annual report show that some insurers had combined ratios over 100% in 2019, suggesting a reliance on investment returns to remain profitable.

Furthermore, the economic uncertainty resulting from COVID-19 has led to most of the assessed insurers expecting increased risk from expected lower asset values or greater uncertainty about whether asset values will recover over the next year. Insurer solvency will be reduced if this risk becomes a reality.

Non-life insurers may face liquidity risks. The nature of non-life insurance is naturally shorter-term focused (hence it is also known as short-term insurance in some jurisdictions). The shorter-term focus of non-life insurers means that they need to hold more liquid assets to pay claims on a regular basis. Most insurers rely on premium income to help provide some of this liquidity. The result is that the disruption to business volumes may have liquidity implications and ultimately increase solvency risk, as evidenced by the non-life risk assessments.

Differing risk experiences, including claims, demonstrate the need for tailored regulatory responses. Motor and accident claims were reduced as the national lockdown restricted movement. At the same time, business interruption insurance has seen significant increases in claims for the same reason. These differences were observed by respondents that offered these different lines of insurance. Health risk claims have seen a reduction, as customers have delayed treatment during the national lockdown, but are expected to increase during the next year (prospective assessment) as customers who have delayed treatment seek the required treatment. Added to this is the uncertainty of claims from new COVID-19 risk cover, and one can see why there is potentially a significant future risk for health-related products.

The assessments also show that different insurers experience very different drivers of risk besides the different claims experience. Each assessed insurer had at least one risk driver in its top three that was unique to that insurer. Unique drivers of risk ranged from uncertainty relating to assumption setting, the potential for investment guarantees to require large payments as investments underperform, and liquidity risks. These differing claims experiences and other drivers of risk provide an example of the need for tailored regulatory responses. Products like motor vehicle insurance, which have seen fewer claims, require supervision to focus on customer value, while higher claims (like business interruption) require regulators to focus on ensuring insurers remain solvent. More broadly, as COVID-19 second waves are emerging across the globe, health and life insurers face a risk of large claims in the future. Supervisors need to keep these differences in mind, monitor the health of individual insurers and the evolution of the risks that they experience – a task for which the IAA-IAIS proportionate risk assessment tool is especially well suited.

COVID-19 impact on provider risks

National lockdown fast-tracked digitisation and increased risks. Respondents mentioned risks arising from the need to shift to more digital sales and distribution, which they had not planned on doing. The forced move to more digital processes and operations resulted in slowdowns – if not due to internal IT issues, then due to constraints and partners' inability to function in the more digital environment.

After initial surge in risk from forced digitalisation, risks relating to digitisation decrease. As insurers work through the changes of having to adjust to the more digital way of working, risks are expected to decrease. Risks decrease as customers, staff and distribution channels become familiar with working digitally. Most prospective assessments (considering risks within a year) see the risks still above pre-COVID-19 levels, but some show risks below pre-COVID-19 levels. These lowered risks suggest that longer-term benefits from digitisation may already be realised within a year. The discussion at the recent innovation workshop of the IRA also mentioned that COVID-19 had forced both the IRA and industry members to rethink some of their operations and that the forced digitalisation provides the foundation for future innovations (Cenfri, 2020).

Limited concerns about cybersecurity risk. Risks from digitalisation were expected to increase, but only one of the four assessments (specifically, the one completed by the IRA) mentioned concerns about cybersecurity risks increasing. The low level of concern regarding cybersecurity suggests that the full impacts of digitalisation may not be considered yet. The relatively low levels of digitalisation may mean that insurers have limited experience with digital processes and the risks entailed.

Staff risks in the year ahead remain significant. The assessments show that one of the longest-lasting provider risks is the risk to staff, including difficulties in being able to adequately train staff during the national lockdown. There is also the risk of COVID-19 incapacitating key personnel within insurers or even a large share of staff as the COVID-19 outlook in Uganda (and the world) remains uncertain.

Learnings

Tool application to better understand risks

The IAA-IAIS proportionate risk assessment tool shown to be applicable to consider cross-cutting risks. The exercise has shown the viability of utilising the tool to consider the cross-cutting impact of COVID-19. Using a similar approach, the consideration of other cross-cutting risks, such as natural disasters and climate change, is possible. The IAA-IAIS proportionate risk assessment tool required minimal adjustment to account for the nature of the risk being assessed, showcasing the tool's versatility and ability to enable a deeper understanding of the nuances and risk factors underlying and potentially threatening overarching trends such as the overall growth in gross written premiums.

It is also worth noting that while the tool supports the understanding of risks without the need for advanced actuarial skills, it cannot replace specialist actuarial skills entirely. However, these assessments facilitate greater targeting to ensure the efficient use of these scarce skills (in many emerging markets), even when considering cross-cutting risks.

The proportionate risk assessments highlight the need for risk-based supervision. Even the small sample in this study shows diverging impacts on risk levels and drivers of risk between insurers. Some of the differences relate to the insurance products offered by insurers. These varying impacts from the same event (COVID-19) emphasise the need for supervision and regulation to consider proportionate and risk-based responses and to monitor the health of individual insurers (in addition to the overall health of the market).

Risk needs to be considered temporally. The main adjustment to the tool has been the consideration of different periods. Simply changing the period under consideration for the different assessments resulted in insurers reporting and highlighting significant differences in the risks that they experience. The large differences in the risks that insurers face over time demonstrate the importance of undertaking assessments regularly, as a static/one-dimensional view could leave insurers/the regulator vulnerable to unforeseen risks. The reduced risk in the prospective assessments also needs to be monitored with more risk assessments in the future. This is particularly relevant due to the large uncertainties regarding future COVID-19 risks.

COVID-19 impact on risks

Forced digitalisation expected to have longer-term benefits while creating new risks. Insurers are optimistic that the shift to more digital processes may allow them to reap efficiency rewards, which will ultimately decrease the risks that they face. Some insurers expect these benefits to already lower risks to pre-COVID-19 levels within a year. However, at the same time, more digitalisation may also bring about new risks, such as cybersecurity, which insurers may not explicitly be considering yet.

COVID-19 impact to continue in the year ahead, due to economic impact.
The prospective risk assessments (considering the risks one year ahead) reported risk levels across all dimensions as high or higher along both the product and provider categories. For product risks, the economic impacts of COVID-19 drive these longer-lasting effects.

Continued risks from COVID-19 may place industry under pressure to consolidate.
Some insurers were already under pressure pre-COVID-19, with combined ratios of over 100. The assessments show some concern for increasing solvency risk in the coming year, which is confirmed by the IRA's circular (2020). The circular notes that most insurers do not meet the minimum capital adequacy ratio (CAR) of 200% and restricts dividend payments by insurers until they do. The note also states that six non-life insurers and one life insurer do not meet the minimum capital requirements and have a year to comply. These pressures suggest that consolidation within the insurance sector may be in the offing. The impact on the sector depends on how these risks are managed. Key priorities – for the regulator and insurers alike – are to limit unpaid claims and reputational damage to the sector.

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