# Sri Lanka Insurance Report

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KPMG in Sri Lanka

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# Foreword

The COVID-19 outbreak that began in Wuhan, China by the end of 2019, established its status as a global pandemic by March 2020. Although it does not appear to be slowing down across the globe nor is a complete eradication of the virus in sight, governments are reacting in even more dramatic ways, closing borders, imposing lockdowns and travel restrictions, shutting schools and colleges, and banning mass gatherings such as sporting events. At the same time Sri Lanka was successful initially, in the fight against COVID-19 when compared to other countries with minimal number of deaths and positive cases until recently when the new wave caused an increasing number of new patients infected by the virus.

Many developments took place within the industry during the first half of 2020, where insurers needed to re-engineer operating models to stay efficient in the post COVID-19 era while having an eye on competitive edge. A crisis such as COVID-19 affects all business sectors - it also put a spotlight on insurers who can expect to be inundated with general inquiries and claims across multiple different lines, whether that be for health, life or non-life cover. Balancing the need for responding to this influx of activity in the contact centers with a quickly shifting remote workforce is an area that insurers are working to address.

This edition of Sri Lanka Insurance Report brings about many segments on how long-term and general insurers are progressing towards covering COVID-19 as part of the insurance contract, liquidity challenges that may arise and how to respond prudently and also a refocus towards IFRS 17. A focus on digitalization is presented in this report reflecting the insurtech trends that need to be leveraged in a time period of which a global pandemic has promoted and is continuing to demand acceleration in digital transformation. Insurers will be required to push products through innovative and more digitally aligned channels to stay relevant in this particular period of recovery.

For our readers to get a clearer view of the country's insurance industry, we share the unique perspectives of two key figures of the industry; Iftikar Ahamed (Managing Director – Softlogic Life Insurance PLC) and Sanjeev Jha (Managing Director – Fairfirst Insurance Limited). Their views on the threats faced by the industry and response to the unfolding crisis caused by COVID-19 gives hope to look past the clouds- at the silver lining! Despite such challenging times, we expect insurers to innovate and thrive with more opportunities due to high mobile penetration that can offer products for low- and middle-income segments at relatively low costs.

So, how is the insurance industry likely to shape up to the unfolding crisis? What are the implications across the different segments of the industry? And what longer-term trends might the outbreak serve to usher in for the future? These are areas we will continue to discuss, if this virus crisis is not eliminated, soon!

"The impact of COVID-19 will affect the short as well as the long-term financial outlook of insurers. The pandemic will not only reduce global growth but have an impact on equity and debt instrument pricing and also reduce insurable exposures due to negative impact on businesses."

**Suren Rajakarier**
Partner, Head of Audit
KPMG in Sri Lanka

# Thought Leadership

# Do insurers have COVID-19 covered?


## Limited exposure for General Insurers?

Starting with non-life or general insurance first, we expect the impact on claims to be relatively manageable. Most insurers learned lessons from the SARS outbreak of 2003 and introduced exclusion clauses for communicable diseases and epidemics/pandemics into most non-life products such as business interruption and travel insurance.

Business interruption policies usually pay out only if physical damage occurs to an organization's assets or operations - so coronavirus related claims may not be covered, but there is potential for future disputes on this issue. Travel insurance, meanwhile, may offer cover if a customer is diagnosed with the virus before or during their trip - but not for travel that is cancelled because of the pandemic, unless a customer has taken out premium `any cause' cover, which very few have. Of course, interest in `premium' policies could change in a world after COVID-19.

Event cancellations may cause greater losses to insurers as some large events (but certainly not all) have policies that may cover them even for epidemics or pandemics. The largest event taking place this year is the Tokyo Olympics where analysts estimate approximately $2bn of coverage. It is likely that the reinsurance sector will bear some of the brunt here, as insurers claim back the costs of cover from reinsurance over a certain threshold.

However, there are two potentially big areas to watch for non-life insurers. Firstly, trade credit insurance, covering businesses against debts that cannot be paid by their customers or suppliers. This is an $11bn global market - and if increasing numbers of companies go out of business due to coronavirus impacts, insurers could face rapidly spiraling claims.

There are particular concerns that, alongside some big corporates in acutely affected sectors, SMEs in many markets could be hit hard due to supply chain disruption and a crunch in business levels.

The cost of this may very much depend on just how bad the pandemic becomes, the extent to which containment measures affect different kinds of businesses, and how long it lasts.

The second area is workers' compensation claims. We could see spikes in workers claiming they were not adequately protected by their employers against exposure to the virus brought about by their normal working duties. It is impossible to know at this stage how significant such claims could become. But insurers offering this type of cover to employers may need to brace themselves, depending on how things develop.

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Finally, the volatility and falling interest rates within the financial markets will likely impact general insurers from an earnings and solvency perspective. The impact is likely to be greater for life insurers and therefore is addressed in more detail below.

## A mixed diagnosis for Health Insurers

The impact on health insurance is hard to determine at a global level because the impacts will be very different country by country. This is both because the number of actual cases and deaths could vary greatly between countries/regions, and because of the varied make-up of health coverage itself.

The key issue currently in most countries is to enable rapid testing of individuals, particularly people in vulnerable populations such as the elderly or those with underlying health conditions, especially compromised immune systems. In most countries, this testing is free (provided by governments) or the costs are being waived by healthcare providers and/or health insurers. Free treatment, however, is not universal and these costs can be substantial.

Additionally, this has forced insurance companies to take multiple steps to stay relevant in these challenging times. With that insurance companies have also taken initiatives to prevent the spread of the Coronavirus by extending benefits to their policyholders.

Sri Lanka Insurance Corporation Limited has covered all health and insurance policyholders with COVID 19 tests, loss of life claim benefits, daily hospitalization cash benefits and Surgical & hospitalization due to COVID 19, Allianz Life Insurance Lanka Limited has introduced hospitalization expenses benefit, and Hospital daily cash for better protection against COVID 19, AIA Insurance Lanka Limited has given free COVID 19 cover for all policyholders, Union Assurance introduced free COVID 19 life cover and hospital cash benefits for quarantine treatments and Softlogic life Insurance PLC also extended their benefits to pay all medical and life claims that relate to COVID 19.

As of now, we simply do not know what the ongoing treatment requirements and eventual mortality or morbidity rates from the coronavirus will be and therefore what the cost might be for health insurers. However, the crisis may have a number of long-term (positive) effects on the sector. Firstly, as the pressure on health services rises due to the sheer number of patients, we are likely to see a rise in telehealth services, offering consultancy to patients via phone or online video services.

This could have constructive long-term effects, helping healthcare reach more remote and less affluent populations including the under- or un-insured. Making healthcare more available and accessible means that, in some small way, societies may benefit from learnings and actions taken during COVID-19

Secondly, the very pandemic itself may cause more people to reconsider their individual health insurance needs. In the wake of the SARS epidemic, for example, we saw a temporary spike in critical illness policy sales in Asia. We may see a similar phenomenon post-coronavirus, with rising sales of health insurance, critical illness and even life cover across the provinces in Sri Lanka as well.

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# Market volatility creating more difficulties for Life & Retirement Insurers

Of all insurance segments, it is life insurers who are facing the most difficult challenges. The industry is closely monitoring the potential impacts on mortality rates, however, we expect that life insurers may also feel significant impacts due to what is happening in the financial markets.

Because of the long-term assets and liabilities that life insurers hold, market volatility is always challenging for the sector - and we have seen extreme volatility in recent weeks.

Movements in equities, interest rates and credit spreads create tremendous asset liability management risks for life insurers as yield curves flatten. Globally, life insurers manage more than $20 trillion in assets and as much as half of this is estimated to be in government bonds. But the yields from these have fallen dramatically - US 10 year bond yields have more than halved since the end of 2019 for example. The crisis also puts pressure on non-government bonds which may cause credit concerns and may lead to an increase in bond downgrades.

All of these factors can result in solvency ratio challenges. Prior to the COVID-19 outbreak, much has been said about the industry being well-capitalized and so insurers may be starting from a position of strength as it relates to capital. However, risk-based capital approaches vary widely by country which impacts how reactive the ratios are to current market conditions. Other capital approaches could be sensitive to bond downgrades. As a result, insurers will need to closely monitor solvency ratios in order to meet economic, regulatory and rating agency capital requirements.

The sector will be hoping that the pandemic blows itself out before long. Otherwise, if market volatility continues and fluctuations persist, they may need to reassess their investment portfolios and exposures to potentially reduced investment earnings as well as protecting capital/security for policyholders and key stakeholders. Speaking of technology, the crisis could also be the spur to look at moving more systems and applications to the cloud - an area that insurers have lagged other sectors in. With more people working remotely, having systems in the cloud offers much greater bandwidth and capacity than if staff are accessing on-premise servers remotely.

This is an opportunity for the insurance industry and could be the catalyst for this movement. Actuarial modelling software, for example, often sits on individuals' computers, as there are deemed to be security issues with putting it in the cloud. But with today's cloud services offering enhanced security protocols, perhaps the time has come for more of the industry to make the move.

More broadly, insurance businesses - as well as other sectors need to embark on the digital transformation of their organizations, to become more agile, responsive and connected enterprises. Perhaps one legacy of the coronavirus crisis could be that it actually propels more insurers to do that.

These are extremely challenging times for individuals, families, businesses and indeed whole societies and economies. The insurance industry has a key role to play in supporting customers and societies through the crisis and the recovery.

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# COVID-19: the global insurance response

Broadly speaking, the COVID-19 virus has swept westwards across the world - beginning in China at the end of 2019, reaching Europe from February/March 2020, and taking increasing hold in North America. When we look at the response of insurers in different jurisdictions around the world, the stage they are at corresponds to where they are geographically and how far they are through the timeline of the virus' spread.

In Asia, where the virus struck first, insurers took rapid action to respond to the rapidly unfolding situation and are now, one hopes, on the verge of moving into a period of assessment to gauge where the market heads from here and what the long-term impact may be. Further, the total premium volumes in life and non-life insurance markets will shrink by 4% this year and is expected to reinstate positive growth of more than 2% in 2021.

In the emerging markets, premium growth will hold out positive in both years, up 1% in 2020 and 7% in 2021. In Europe and North America, however, insurers are still very much in the eye of the storm - configuring their operations to cope and trying to establish what business as usual looks like in extraordinary times. COVID-19 will continue to present challenges to the insurance industry profitability leading to pandemic related losses, toned down investments and losses on invested assets. However, certain common themes are already becoming clear for insurers around the globe to overcome these uncertainties.

## Insurers stepping up

In China, some insurers have extended coverage on existing health policies to cover treatment costs or provide Covid-19 specific death cover. One of the major life insurers, for example, launched a special pre-compensation program for existing policies and provided agents 10 million free policies totaling 1 trillion RMB (about US$10,000 per policy) to be distributed to customers. Other health insurers have initiated 'Emergency Response Plans' to ensure fast claim settlement for policyholders. Additional coverage has also been provided to millions of healthcare workers and reporters working in the worst-affected areas.

In Italy, healthcare costs are largely covered by the public health system. Some major insurers have already developed policies designed specifically to protect policyholders from the risk of Covid-19 as a standalone product or extensions on existing products. These policies are primarily aimed at businesses and families and are contingent on being diagnosed with coronavirus.

For families, they may be provided with a hospitalization allowance in the event this is required and the provision of additional funds in the case of intensive care.

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For companies, they may be given an insurance coverage solution that can be offered to all company employees regardless of the existence of health insurance plans (daily allowance for hospitalization, convalescence and an Assistance Guarantees package). More than six months into this pandemic, Sri Lanka had made huge progress in controlling the spread of COVID-19 until running into another wave of infection recently. However, insurers have taken multiple action to deal with this new circumstances by providing free insurance covers to hospital's staff members, offering free COVID cover to all customers, extending benefits for hospitalization expenses and etc.

In other countries, governments have committed or are considering to cover the wages of workers laid off for a period of two months - but there is ongoing discussion about what insurance payments, if any, might be made to compliment social security support for those who are sick or need to care for relatives. Finally, we are starting to hear of insurers from a social purpose perspective donating monies or other assistance in support of healthcare workers, hospitals or others in need. Insurance companies, like many other industries, are looking at meaningful ways to contribute to society.

## Agent networks interrupted

In many countries around the world, there is a prevalence of tied agents as part of insurance companies' sales and distribution networks. A widespread impact of the virus has been the implications posed for agent networks, who still usually rely on face-to-face meetings with their clients in order to sell new business.

Technology is used more and more by these agents, but this is mostly from an enablement standpoint. Longer term, the crisis is sure to accelerate the digitization of sales channels, to better enable agents to do more business digitally rather than face-to-face and of course, will likely open up new lines of direct sales.

Customers will vary on how they would like to transact business, and there are wide variations by geography and by product, so we don't see face-to-face disappearing.

## Non-life story of ups and downs

This concern about future sales is not only confined to those with large agent networks. It is an issue for non-life insurers generally. More broadly, if the pandemic provokes recessionary conditions in economies around the world, commercial premiums can be expected to drop. SMEs, for example, have been a strong growth area for many insurers internationally, but many small businesses will be looking for ways to cut costs or some may not even exist if this pandemic is sustained for a long period - insurance covers may suffer for a more extended period.

Balanced against this, however, is the widespread sense across jurisdictions that the direct impact on non-life business from a claims perspective will likely be limited. The pandemic exclusions built into products such as business interruption and travel insurance means that insurers' exposure is limited. Meanwhile, other areas such as motor have seen a significant drop-off in claims already as people are travelling much less. However, we also have to consider the possibility that policyholders (and, perhaps, regulators or governments) might expect or call for some form of concessions on active policies now or when life has returned to normal.

## Health uncertain, Life looking clouded

Health insurance varies widely by country as to how much is covered by the government versus through private insurers. In many ways, health insurers have been on the front lines in terms of concessions like free testing or removing other barriers to access with the goal of helping to reduce the spread of this virus.

On the Life insurance front, however, there is already a consistent pattern around the world: the sector faces a difficult path ahead. Extreme stock market volatility and in some countries - like Italy - Government Bonds volatility, zero or near-zero interest rates, and the potential for a prolonged economic downturn or recession are all combining to put increasing pressure on solvency ratios and liquidity. The industry is generally well-capitalized but nevertheless headroom is narrowing. This may be compounded by lower levels of new investments from customers and an increase in withdrawals to access cash. Currently there are restrictions, in many countries,

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on the policyholder's ability to access retirement funds, but under the circumstances, some of these restrictions may be lifted to allow immediate access to cash without the same penalties.

In Germany, for example, there are hundreds of life insurance companies many of whom were already challenged by the low interest rate environment even before the Covid-19 situation began. The smaller or medium-sized life insurers are the ones that are most likely to have difficulty sustaining the impacts.

The circumstances could also spread a cold through the M&A market. Current large deals could now be in doubt - or, at least the price may be up for renegotiation. Other deals in process could be disrupted. Future deals could then spike after things settle down, especially if there are companies whose valuations have suffered, making them attractive targets.

## Where will we go from here?

What does all of this mean in terms of the future impact on insurance companies? Much depends on the nature of the intersection in each country between insurers, customers/distribution and regulators/governments. There are complex interplays in each national market between what insurers have traditionally offered, what customers expect, and the stance of regulators and authorities take. However, we believe that a number of trends and issues are already becoming crystallized by the challenging environment.

Firstly, there is no doubt that Covid-19 will propel insurers to increase the digitization of their operations and interactions with clients. Agent networks need to be more digitally-enabled. We may also see insurers scaling back on their physical office networks and moving more people to remote working. This could have significant impacts on the real estate industry as insurance might not be the only industry thinking in this way. At the same time, more focus will fall on the automation of processes for greater cost efficiencies and resilience.

Another impact of the pandemic may be that insurers - and regulators - take an in-depth look at their business continuity planning. No one could have predicted the size and scale of this situation, but nevertheless the scramble to keep operations running will have focused minds. Operational resilience has been on many regulators' radars for some time: now it will be right in the center of their field of vision. And everyone will have gone through a live stress test from which many lessons can be drawn.

More widely, the Covid-19 situation will reignite the debate about what exactly the role of insurance should be in our rapidly evolving and volatile world.

The insurance sector is providing huge support to customers and businesses throughout this challenging time. But the business interruption issue brings back into focus the question of how best to mitigate major structural and societal risks.

A pandemic may be unpriceable too. But too expensive to insure against at all? The insurance industry has shown itself to be innovative and responsive in the past, and there is no doubt that it will do so again. Cyber insurance was also seen to be too expensive when it first emerged, but the response was to bring in limitations to make it more affordable.

Perhaps we will see a similar pattern here - insurers building pandemic cover or rider into new products, but with certain parameters, and priced appropriately. Ultimately, it will be up to clients whether or not to purchase it, in whatever form it is offered.

Making sure to understand customers how to manage their business risks and assessing their risk appetites in the context of insurance coverage or otherwise will be critical for businesses in the future, large or small.

This is one area of many that the Covid-19 is bringing into focus. But mostly, this is for the future. Right now, in an increasing number of countries, insurers are working around the clock to support their own people, customers, distribution networks and partners as they deal with the immediate issues at hand.

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# COVID-19: could liquidity challenges be on the way for insurers?

In a difficult time, they say, cash is king. COVID-19 has certainly brought an immediate cash and liquidity crunch to many business sectors, who have seen their income streams dramatically dry up. But could this, over time, apply to insurers too?

Historically, liquidity is a problem the sector has never seriously had to deal with. The very basis of the insurance business model - take in premiums upfront, invest and grow the proceeds, pay out later if needed - means that cash is nearly always on hand. Within the financial services industry, it is insurers' banking cousins who need to worry most about liquidity given customers' ability to withdraw funds en masse and create a proverbial 'run on the bank.'

This is certainly true in normal times. But one thing we know for sure right now is that we are not living in normal times. The COVID-19 situation has been throwing up unprecedented challenges to societies, economies and businesses, with the exit strategy to stabilization and recovery still unclear.

Perhaps, therefore, at a time when the norms have been so overthrown, it shouldn't be a surprise if the view put forward is that the COVID-19 situation could begin to create liquidity strains even for insurers. As a result, cash management will likely be an issue that the sector should start thinking hard about and acting upon right away.

## Simultaneous pressure on three fronts

Standing back a little and surveying the landscape, it's likely that insurers are experiencing a number of asset, liability and investment pressures. It's that these are all happening together at the same time that makes this period extraordinary - and potentially increasingly difficult - for the sector.

**On the asset or inflow side:** New business is trending downward in most products and markets, with both retail and commercial customers looking to cut back on spend. Meanwhile many brokers are struggling to operate in these disrupted times and are bringing through considerably fewer new business proposals.

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On existing policies, some customers (both commercial and retail) have cancelled them or just not paid their premiums. Commercial renewals in particular may have been delayed. At the same time, insurers have given payment holidays and rebates for some products (notably motor) in some markets, leading to significantly impactful liquidity complications.

**On the liability or outflow side:** Payouts are undoubtedly set to rise, and perhaps significantly. In many ways, we are sitting in the calm before the storm at present. It is still unclear how much the situation could eventually cost.

But payouts for the tragic deaths that have occurred, as well as for health claims, mental health and many kinds of non-life cover will grow. This is before we even mention the elephant in the room which is business interruption cover.

In the wake of COVID-19, we can also expect to see not only increasing claims but also increasing litigation over payout disputes. These could be long, drawn out and costly. Even where an insurer wins a dispute, the loss adjustment expenses could be considerable.

Meanwhile, insurers continue to have significant fixed outlays in terms of staff compensation and payroll costs. To date, the sector has not made any large-scale redundancies and some have publicly stated their intention to avoid layoffs at this time.

**On the investment side:** the ultra-low interest rate environment that we now find ourselves in will dampen investment returns, which may also be hit by the ongoing volatility in the financial markets. At the same time, there are potentially dramatic increases in derivative collateral requirements which could decrease cash flow. Insurers may also experience dividend income reduction for some of the assets in their portfolios.

Clearly, the combined effects of these pressures could be significant and are likely to grow over time. It is certainly true that the insurance industry is well-capitalized and well-diversified - but no one should be taking anything for granted. In most industries, there are early warning indicators about possible liquidity difficulties which are usually debt covenant related. But in the insurance sector, early warnings will be harder to see - making it all the more important to introduce the right cash management and forecasting tools.

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# IFRS17 – Final amendments are out

# IFRS17 - Final amendments

| TOPIC | KEY FACTS AND IMPACT |
|---|---|
| 1. Effective Date | • 1 January 2023 effective date for application of IFRS 17 and exemption from applying IFRS 9<br>• Companies have just 15 months until the transition date of 1 January 2022, from now. |

## Scope of IFRS17

| | |
|---|---|
| 1. Credit cards and similar products that provide insurance coverage | • Most companies that issue these products will be able to continue with their existing accounting, unless the insurance coverage is a contractual feature, easing implementation for non-insurers |
| 2. Credit cards and similar products that provide insurance coverage | • Companies that issue such loans – e.g. a loan with waiver on death – have an option to apply IFRS 9 or IFRS 17, reducing the impact of IFRS 17 for non-insurers |

## Measuring the contractual service margin (CSM)

| | |
|---|---|
| 1. Accounting policy choice for interim reporting | • Companies will choose to apply either a 'period-to-period' or 'year-to-date' approach, allowing greater opportunity for consistency with current practice and for subsidiaries to align reporting with their parent |
| 2. Insurance contract services now include both insurance and investment services | • Revenue and profit emergence will better reflect performance of the wide range of insurance products and the services they provide to customers |
| 3. Accounting for assets and liabilities before the related group of contracts is recognised | • Allocating insurance acquisition cash flows to future renewal groups reduces the risk of groups becoming onerous solely from acquisition expenses paid relating to future renewals.<br>• The allocation is revised at each reporting period to reflect any changes in assumptions that determine the inputs to the method of allocation used, until all contracts have been added to the group.<br>• Companies now need to assess each period the recoverability of insurance acquisition cash flow assets usually on a more granular level than applied today. |

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## Transitioning to IFRS 17

| | |
|---|---|
| 1. Contracts acquired in their settlement period | • Companies may be able to account for acquired contracts before the transition date as liabilities for incurred claims |
| 2. Assets for insurance acquisition cash flows | • In many cases, companies will be required to identify and recognise an asset for insurance acquisition cash flows incurred prior to transition.<br>• Companies are not required to perform a recoverability assessment for periods prior to transition |

## Accounting for direct participating contracts

| | |
|---|---|
| 1. Risk mitigation option expanded to non-derivative assets at FVTPL and reinsurance contracts held and extended to provide relief prospectively from the transition date | • Broader application of the risk mitigation option will lead to fewer accounting mismatches.<br>• If a company meets the risk mitigation option criteria before transition, it can now apply the fair value approach to the related contracts at transition |
| 2. Applying the OCI option and risk mitigation option together | • Companies applying both options together will be able to achieve better matching in the income statement |
| 3. Eligibility criteria for VFA | • Assessed on a contract level instead of group level as some companies had interpreted |

## Accounting for reinsurance contracts held

| | |
|---|---|
| 1. Accounting for recovery of losses on initial recognition | • Companies will be able to offset losses on initial recognition of direct insurance contracts based on a prescribed formula if they are covered by reinsurance contracts held, reducing accounting mismatches |

## Presentation and disclosure requirements

| | |
|---|---|
| 1. Presentation in the statement of financial position | • Relief for companies to present (re)insurance contract assets and liabilities at a portfolio level, instead of group level |
| 2. Income tax chargeable to the policyholder | • Income taxes specifically charged to policyholders may now be included in fulfilment cash flows, better reflecting local practice in certain jurisdictions |

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# Future of the Sri Lankan Insurance industry in a post COVID-19 era

# A Discussion with the Industry Leaders

Taking a peek at the Sri Lankan insurance industry, life insurers were impacted by the deteriorated economic activity and employment levels caused by the Coronavirus. The reduced consumer spending led to policyholder's being unable to pay premiums whereas for general insurers, the pandemic took a toll on the premiums of business lines such as travel, tourism and casualty.

To get a clear view of how the insurance industry in Sri Lanka responded to the pandemic, we gathered valuable insights from leading companies in the general insurance and life insurance space in Sri Lanka. We appreciate the ideas from Sanjeev Jha (Managing Director – Fairfirst Insurance Limited) and Iftikar Ahamed (Managing Director – Softlogic Life Insurance PLC) who shared their perspective on the future of the industry in a post COVID-19 era, how the pandemic impacted operations and the response to each of the challenges that arose during lock-down in this issue.

## Digitalization is not the future; it is here and now

Iftikar was very firm about Digitalization paving the way for the future of Softlogic Life and the Industry. The idea behind digitalization does not mean the automation of an existing paper process. He mentioned that automation of a manual process would not make sense in terms transforming the industry's landscape to be futureproof.

**"In this new norm of business, smart digitalization is what matters and not just digitalizing existing processes"**

Ifthikar Ahamed
Managing Director
Softlogic Life Insurance PLC

As to life insurance, Iftikar states that digitalization at Softlogic Life Insurance PLC is transforming all aspects of the Life Insurance Lifecycle, for instance not just the digitalization of the point at which a policyholder purchases a contract but right through the whole process.

Focusing on the life insurance lifecycle, he said digitalization begins at the point where potential customers are identified. Therefore, Softlogic Life has set up a Data Science team to stay ahead in the life insurance lifecycle's stage of identifying prospects by profiling numerous key attributes. The use of data analytics is at the core of identifying opportunities where Softlogic's sales teams could leverage. Furthermore, digitalization is leveraged at the underwriting stage where certain crosschecks take place against existing databases to profile similar risks. This enables a seamless process of capturing the risks that need to be underwritten and priced.

The process of proposals that come through agent channels is completely paperless as it is done via an Application contained in the Tab or Device with the agent. The data is crosschecked and the policy is underwritten thereby producing a policy to a customer within a short period of time.

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Claims are taking a seemingly easier process facilitated via WhatsApp with tools available to read claims via images sent by policyholders or hospitals. Digitalization helps to crosscheck claims with profiles and integrate the settlement of claims with minimum waiting times.
Looking at today's state, technology and talent are readily available compared to how it was two decades ago. Insurers need to invest wisely on whatever brings the most effective outcome and customer convenience.

Sanjeev commenting from the point of general insurance, was equally positive about how technology has changed the way in which physical documentation has reduced and how it has helped Fairfirst in underwriting business faster based on data gathered on behavioral aspects.

By leveraging digitalization, Sanjeev stated that pricing the risk is completely based on the availability of the data picked without any interaction with the policyholder. Innovation at Fairfirst takes high priority and it is proven by Fairfirst's track record. Fairfirst Insurance Limited was awarded the most innovative entity amongst the Fairfax global group for the year 2019.

## Uncertainty in the road ahead

These are challenging times for whole swathes of the global economy. For insurers, this means a tighter approach to cash management is most likely needed. How badly they may be squeezed over the coming months remains to be seen, but the combination of the pressures outlined could place some strain on more thinly capitalized players or those heavily concentrated in certain lines of business. The business interruption situation is a real wild card at the moment. Regulatory or legislative action to enforce cover that simply has not been priced in could create a real risk of insurance insolvencies. This remains an important topic being hotly debated and discussed in several countries around the world.

The outbreak of the Novel Coronavirus has had major impact on the behavioral aspects of human life. The enforcement of social distancing is a habit that humans will need to get used to in the coming years. At a moment of time when social distancing is mandatory, insurers will need to pay attention to their distribution channels.

Sanjeev and Iftikar both agreed on the fact that in this new normal, insurers will have to remodel their distribution strategies to be more effective in this post COVID-19 era.

In Sri Lanka's insurance industry, a higher amount of distribution for both life and general products is through Agency channels. During a period of social distancing, distribution through agents is deemed to reduce for safety reasons. Insurers need to realign distribution strategies to abide by social distancing and penetrate the market via digital channels.

Insurers need to leverage technology to create distribution channels in a digital platform. Integration of IT infrastructure and collaboration with other service providers is a way in which insurers can distribute their products.

Sanjeev further stated that revenues may take a dip due to the decreasing usage of traditionally insured assets such as buildings, factories and hotels resulting from new working arrangements. Nevertheless, new types of businesses and risk taking by entrepreneurs will need insurance and therefore revenue for general insurers will flow in from these new types of businesses.

In response to the new norm, general insurers will need to identify new techniques to underwrite risks that could emerge in this post COVID-19 era. Sanjeev thinks cyber risk, medical insurance for tourists, Work from Home insurance are some of the areas that general insurers can focus on.

**"We have been affected by the Black Swan theory, and the fear of the next pandemic will drive change"**

Sanjeev Jha
Managing Director
Fairfirst Insurance Limited

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## Are Insurers taking prudent steps?

The findings of KPMG's CEO Outlook Survey in 2020 found that CEOs chose talent risk to top the list of risks that could pose the highest threat to businesses. Nevertheless, Sanjeev had a different view on what risk would pose the highest risk to the insurance industry. His view was 'Culture' and not talent that poses the highest threat to the industry in today's context. There is adequate talent in Sri Lanka which needs to be nurtured is his view.

COVID-19 is forcing change in all directions. Companies that are agile will be the ones that thrive in a post COVID-19 era. Change will be enabled where the culture is open minded.

Sanjeev stated that strict hierarchical cultures with highly structured decision-making processes will not thrive in such unprecedented times as what is required is a focus in the core activity and making timely decisions with customer convenience in mind. He further commented,
to mitigate such risks, wherever the process needs change, it should be initiated by the decision makers quickly. It is the leader who should enable an agile and open culture.

From the life insurer's perspective, significant threat is posed to the investment side of operations.

Iftikar mentioned the volatility in interest rates and equity markets that led to an increase in the insurance liability held by insurers. During the outbreak of COVID-19, life insurers found it rather tough to hedge their liability.

In addition, there are more tactical areas that insurers should be examining closely. One of these is the better management of receivables. Now is surely a good time to ensure greater efficiency around collections. There should be a review of service level agreements with the insurer's intermediaries, monitoring compliance to ensure that cash held is paid over within agreed terms

Further, the dependence of a single distribution channel such as Agents could have posed a significant threat due to lock-down and social distancing that is taking place in today's context. While Softlogic Life was able to take advantage of their digital platform as a response to mitigate financial risk, Iftikar said it is critical to lobby the issuance of long-term instruments for insurers due to its nature of business.

Furthermore, for the growth of the industry such instruments could be reserved or given higher priority for insurers.  In terms of premium collection, Insurers need to focus on liquidity and cash management in a way they have never needed to do before; making cash a top priority now and into the future will be critical. Accordingly insurers need to provide platforms for policyholders to pay premiums at their convenience. Payment platforms could be part of a digitalization cycle to add value to the industry and the policyholder. Retaining a much stronger grip on liquidity will enable insurers to respond more quickly to the ever-changing conditions.

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A suggestion from Iftikar in terms of the industry growth was to create a consolidated pool of funds with the collaboration of insurers to benefit the public at any stage of their workday commencing with travel to work, starting with your bus fare. A percentage of the bus ticket could be charged as a premium for the risk of travelling and thus a tailormade cover to be applicable for instance, with hospital cover for the individual. Such creative initiatives could take insurance to reach the community and make insurance relevant for health or other related risk.

These are all prudent and sensible measures - but there is much more that carriers could be doing. The real challenge here is that, for the reasons already outlined, cash management has never been a specific area of concern within the insurance sector. Therefore  players in the Sri Lankan sector simply lack the processes and indeed the cash-conscious culture in such a way that they can respond quickly to changing circumstances

## Future of insurance business

The pandemic has made everyone aware of health risks and this has brought in a sense of security and more awareness about loss of income of self employed and also others. Iftikar stated that insurers spend significant amounts of resources to spread awareness and the pandemic has uplifted the level of awareness of risk that can be mitigated through life insurance. Life and health insurance businesses have improved due to this increased awareness resulting from the outbreak of COVID-19.

Operational efficiency is one of the key aspects that insurers need to rethink especially with regard to the Work from Home condition. Being agile and flexible is what enables adaptability to various conditions that emerge through pandemics such as COVID-19.

Iftikar mentioned the fact that the sudden lockdown did not cause any disruption to Softlogic as the landscape was already built with the enhancement of IT. In response to maintaining efficiency while working remotely, Softlogic Life leveraged the existing IT infrastructure immediately to enable operationality while maintaining social distancing. When the lockdown was ordered by the government, the flexibility of IT infrastructure was what made the operations  maintain its efficiency while working from home.

Therefore it is understood that taking a cross functional structured approach is required. Managing liquidity and cash flow is something that the Treasury function in an insurer should take a central role in - but bringing in all parts of the organization that are involved in cash inflows or outflows such as claims, reinsurance, sales, and operations . It is only by creating a cross-organizational approach that liquidity can be effectively managed. Cultural factors within an organization play a large part in creating and reinforcing a more cash consciousness culture. To be really effective, awareness of the importance of managing cash needs to emanate from the top; buy-in at a senior level is key.

Both Ifthikar and Sanjeev mentioned the strategy to provide autonomy to individual departments to base their level of flexibility was key to creating a seamless environment during lockdown. The number of claims, policy loan requests and surrenders were definitely low during lockdown nevertheless the operations proceeded with high efficiency maintaining a quality service.

Sharing another point of view, Sanjeev spoke of the importance of focusing on the core business element in such unprecedented times; Focus on Underwriting and Pricing Risk properly are examples given by him. As a matter of fact, Reinsurers may dictate terms of underwriting such risks and thereby treating the insurer as an agent. Insurers need to grasp their own original thinking to underwrite risk and price it to add value to the policyholder.

With respect to the aging population of Sri Lanka, general insurers may need to innovate universal medical products as a response to trends in a post COVID-19 era.

Sanjeev further stated that the regulator needs to increase the national recognition of insurance business in order to reach the potential of the Sri Lankan insurance industry. Introducing systematic measures like these are not something that can happen overnight. It takes time and, with time of the essence right now, insurers should be acting immediately where appropriate.

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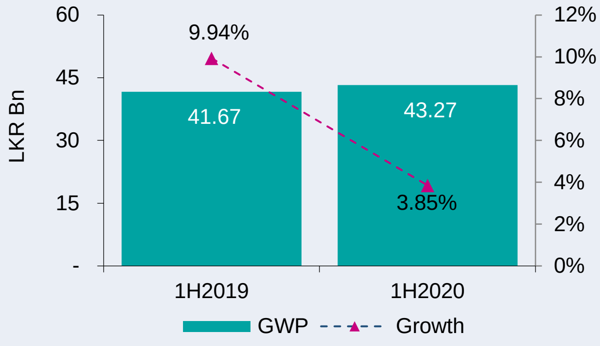
# Sector Outlook

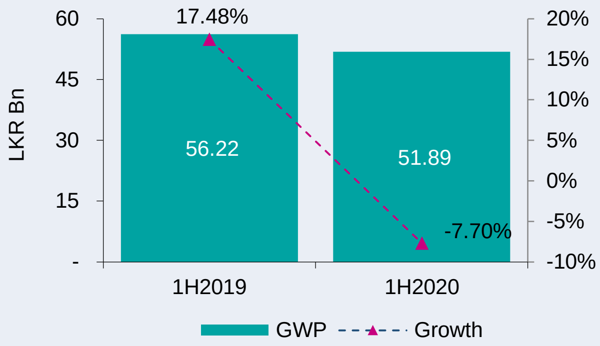
# Gross written premiums (GWP)

**Gross Written Premiums – Life Insurance**




Source: IRCSL – Industry Performance Q2 - 2020

**Gross Written Premiums – General Insurance**




Source: IRCSL – Industry Performance Q2 - 2020

The first half of 2020 was reflective of a contracted growth of Sri Lanka's insurance industry. The industry's total recorded premium was LKR 95.16 Bn, a scale down of 2.79% in respect of the corresponding first half of 2019.

As accustomed, general insurance contributed the higher proportion of the industry's premiums recorded at LKR 51.89 Bn. Meanwhile premiums for long term insurance stood at LKR 43.27 Bn.

Life insurers grew their gross written premium by a mere 3.85% a significant decrease from the corresponding period's 9.94% (1H2019).

The declining trend of written premiums during the first half of the year was in fact driven by the outbreak of the Coronavirus with many policyholders being unable to pay out monthly premiums due to lockdowns and economic uncertainties.

Amidst such unprecedented times, there were reflections of a stand out performance by Softlogic Life Insurance PLC that recorded premium growth of 10.33% for the period.

On the non-life business side, gross written premium of General Insurers significantly reduced by 7.70% in contrast to the growth of 17.48% in the first half of 2019.

A significant contributor to the gross written premium of the general insurance business was Motor Insurance which recorded LKR 30.78 Bn GWP.

Despite Motor Insurance being an important class of the general insurance sector, motor premiums decreased by 3.83% during the first half of 2020 compared to first half of 2019.

The outbreak of coronavirus severely impacted the travel and tourism industry since December 2019. This led to a significant proportion of hiring vehicles being unused for tourism purposes. The dip in the usage of hiring vehicles may have negatively affected the motor premiums of the general insurance industry.

A significant decrease of 10.68% was noted in written premiums of health insurance during the first half of 2020 compared to the corresponding period of last year. Despite the increasing health concerns arising from the pandemic, the dominant unfavorable economic conditions were a barrier for health insurance premium growth. The contribution from health insurance premiums were recorded at LKR 8.40 Bn.

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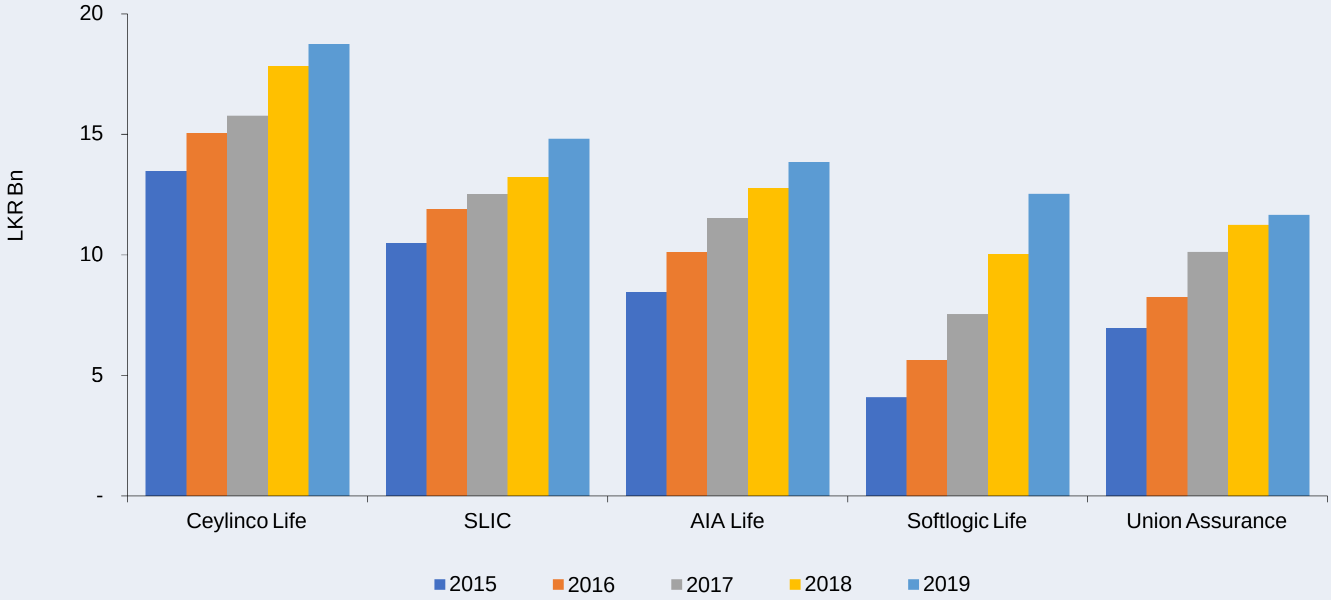
GWP share for life business shows a growth for the following 5 companies over the last 5 years. Which supports the potential for this line of business in Sri Lanka and an increased penetration.

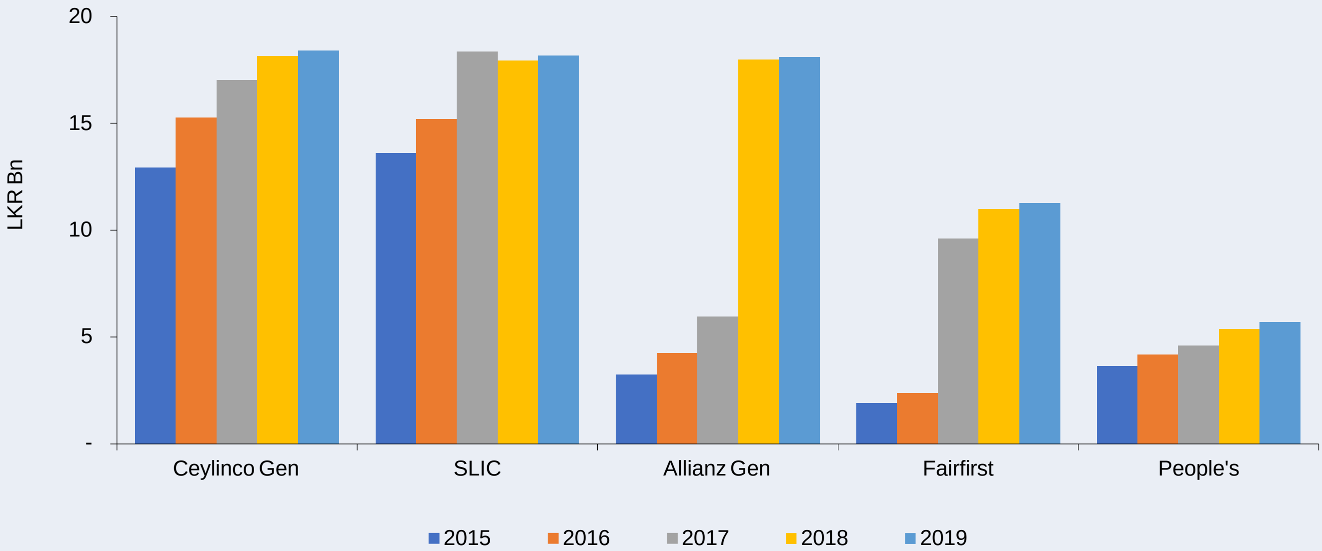
## Gross Written Premiums – Life Insurance (Absolute Growth)




Source: IRCSL – Statistical Review - 2019

On the general side the largest 5 companies have the following trend with a significant share of the business with the top 3 in the industry:

## Gross Written Premiums – General Insurance (Absolute Growth)




Source: IRCSL – Statistical Review - 2019

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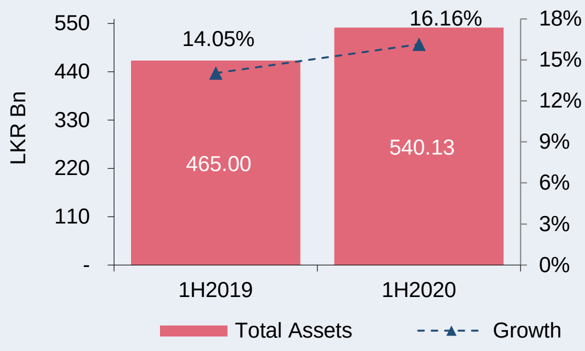
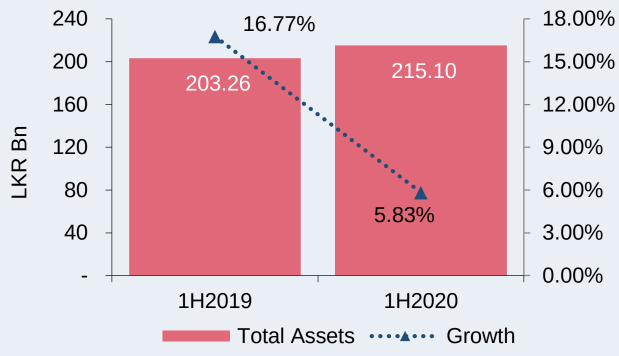
# Assets

## Life Insurance



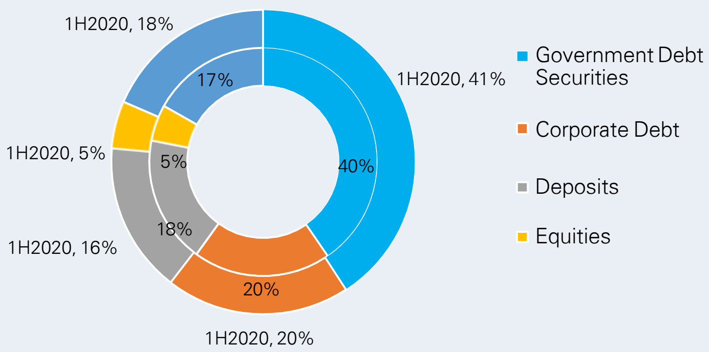

Source: IRCSL – Industry Performance Q2 - 2020

## General Insurance



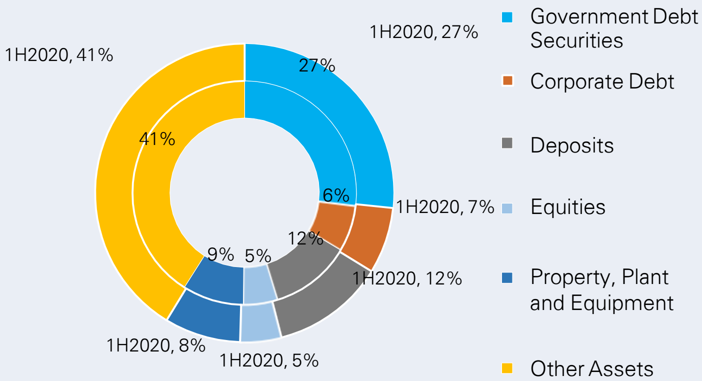

Source: IRCSL – Industry Performance Q2 - 2020

## Concentration of Assets – Life Insurance




Source: IRCSL – Industry Performance Q2 - 2020

## Concentration of Assets – General Insurance




Source: IRCSL – Industry Performance Q2 - 2020

A comparison of the asset spread between the two comparative periods of 2019 & 2020 for both types of businesses does not display a significant change.

Total assets of life insurance companies were at LKR 540.12 Bn as of 30th June 2020, unveiling a growth rate of 16.16% in the first 6 months of the year. Further, in comparison with the first half of 2019, life insurers showed an improved growth rate of their balance sheet to ensure stability in unprecedented times.

Similar to previous year, life insurers have the highest proportion of their investment in government debt securities that amounted to LKR 220.53 Bn due to its associated low risk and regulatory requirements.

Corporate debt was the second most significant portion of total assets standing at LKR 105.81 Bn.

In addition, deposits as at 30th June 2020 amounted to LKR 86Bn giving a slight growth of 3% compared to last year. Total assets of the general insurance sector as of end of June 2020 amounted to LKR 215.10 Bn. The assets have marginally increased at a rate of 5.83% during the first six months of 2020.

Similar to the Life Insurance sector, higher composition of the asset portfolio was invested in government debt securities due to similar regulatory and risk factors. Investments in deposits were also comparatively higher than 2019 amounting to LKR 26.29 Bn, an increase of 10.82%.

On the flip side, Investments in Equities reduced to LKR 9 Bn from LKR 10.10 Bn in June 2020 as a result of the economic downturn caused by the pandemic and also in response to the current macroeconomic conditions.

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# Claims incurred

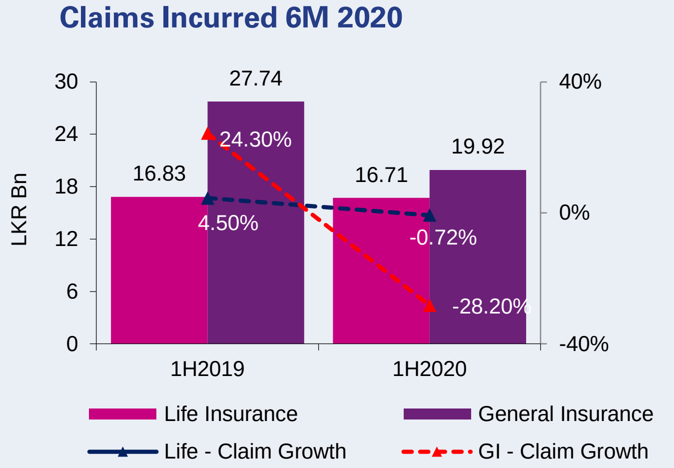
Overall claims incurred by the insurance sector as at 30th June 2020 was LKR 36.6 Bn, exhibiting a significant drop of 18% in comparison with the claims incurred in the corresponding period of 2019.

The figures illustrate a slight downturn of the total claims of life insurers for the six months ended in June 2020 totaling to LKR 16.71 Bn compared to LKR 16.83 Bn in the corresponding period of 2019.

On the contrary, general insurance claims reflect a decline during the year to June 2020 which amounted to LKR 19.92 Bn compared to LKR 27.74 Bn in the first six months of 2019.

Motor insurance has continued to be the largest sub sector of claims over this period which amounted to LKR 12.8 Bn but it indicates a significant drop at a rate of 25.39% compared to the corresponding period of 2019. It is noteworthy, in the initial lockdown period, many people were not able to travel using owned vehicles which resulted in reduction of number of motor insurance claims.

The health insurance sector has remained the second highest contributor towards total claims of LKR 5.36 Bn. Claims incurred for fire amounted to LKR 0.99 Bn a decrease from LKR 1.10 Bn as reported in June 2019. Further, the marine sector has recorded a pronounced decline from LKR 0.35 Bn in June 2019 to LKR 0.16 Bn in June 2020 mainly driven by supply chain disruptions due to COVID-19 that resulted in cancellation of sale and shipping contracts, companies seeking to renegotiate supply contracts, shifting supply chain demands, delayed payments and more.




Source: IRCSL – Industry Performance Q2 - 2020

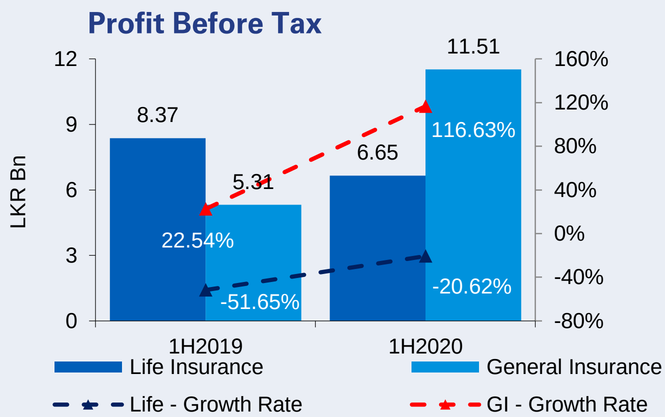
# Profitability - 6M 2020

The overall insurance sector reported a significant growth of 32.7% in profit before tax amounting of LKR 18.16 Bn compared to LKR 13.69 Bn reported in the six months ended in June 2019.

Similar to previous years, the life insurance sector profit has declined by 20.6% from LKR 8.3 Bn in June 2019 to LKR 6.6 Bn in June 2020. This downturn can be predominately driven by the global pandemic which delayed premium collections from policyholders due to negative impact on individuals.

On the flip side, general insurers grew profits significantly totaling up to LKR 11.51 Bn in June 2020, more than doubling the profits earned back in June 2019.

The shock of COVID-19 has had an impact on motor insurance, with lengthy lockdown and closure of workplaces during early 2020 that resulted in decreased usage of vehicles. Knock-on effect of this is that there has been a significant reduction in the number of motor insurance claims and thereby a higher profit.




Source: IRCSL – Industry Performance Q2 - 2020

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# About KPMG

## KPMG Global

KPMG is one of the world's top global networks of professional services firms. We provide, audit, tax and advisory services with quality, integrity and excellence as fundamental pillars that have marked our work over our more than 140 years of history.

Global Revenue

**29,750 million USD**

| 9,110 | 20,040 |
| --- | --- |
| Financial sector services | Rest of services |

*Revenue figures 2018/2019*

| 147 | 985+ | 219,281 |
| --- | --- | --- |
| Countries | Offices | Professionals |

## KPMG Sri Lanka

KPMG is one of the largest professional services firms in Sri Lanka and is also the oldest Chartered Accountancy firm in the country spanning over a century since inception in 1897.

**6 Offices**
Including one in Maldives

**Over 1,400 Professionals**
Our clients value the breadth of skills and experience KPMG professionals bring to every client engagement

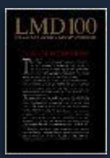
**Audited 38% of Listed Entities in Sri Lanka**
As indicated in the LMD Auditors League 2018/19.

| 842 | 178 | 272 |
| --- | --- | --- |
| Professionals in **Audit** | Professionals in **Tax** | Professionals in **Advisory** |

## Recognition | KPMG in Sri Lanka


Awarded first in the financial services category

Most Respected 2019 - LMD




First in the Auditors League in Sri Lanka

LMD 100 - 2017

Best Deal Advisory Firm in Sri Lanka

Global Banking and Finance Review 2015

Best Advisory Firm in Sri Lanka

The International Finance Magazine 2016

Sri Lanka Tax Firm of the Year

Asia Tax Awards 2018

Highlighting the significance of KPMG's impact in the marketplace, KPMG in Sri Lanka received a number of accolades including being the 'Best Deal Advisory Firm in Sri Lanka' by The Global Banking and Finance Review for its outstanding achievements in Deal Advisory, being ranked among the 'Most Respected' entities in the country for 2016 and being ranked first in the 2015/2016 Auditors League as indicated in the LMD 100. Recently the firm also won the Tax Firm of the Year at the Asia Tax Awards 2018.

# KPMG Service Offerings

## Audit

High quality, independent financial statement audits are essential to maintaining investor confidence.

Our audit professionals are committed to the public interest. They seek to challenge assumptions and unlock valuable insights based on a thorough understanding of an organization's business and industry, and innovative audit methodologies and approaches.

Understanding the financial performance of any business must be placed in the context of strategic priorities, risk appetites and competitive positioning. Our technology-enabled audit approach applies extensive data analytics to provide the necessary evidence confirming that critical controls and disclosures uphold the highest level of integrity.

- Audits of financial statements
- Audit-related services
- Audit data & analytics
- Accounting Advisory

## Management Consulting

Our high capability teams offer deep industry and technical knowledge, and market-leading tools to deliver solutions across every business and industrial sector.

Our consultants assist clients to make better decisions that may reduce costs, enhance organizational effectiveness and develop appropriate technology strategies.

- People & Change
- Customer & Analytics
- Financial Management
- Operations
- Strategy & Economic Advisory
- IT Advisory
- Supply Chain

## Risk Consulting

Our risk consulting practice combines the knowledge and expertise of over 50 partners, directors and professionals. We help organizations transform risk and compliance efforts into competitive advantage by applying a risk lens to corporate strategy. This improves risk intelligence and decision making, protects financial and reputational assets, and enhances business value.

- Forensic
- Business Process Management
- Accounting Advisory Services
- Internal Audit & Risk Compliance

## Deal Advisory

Our experienced investment professionals skilfully assess how opportunities to buy, sell, partner, fund or fix a company can add and preserve value. Our teams combine a global mind-set and local experience with deep sector knowledge and superior analytic tools to support clients. From assisting to plan and implement strategic change to measurably increasing portfolio value, we deliver tangible results.

- Valuations
- Debt Advisory
- Transaction Solutions
- Mergers & Acquisitions
- Corporate Restructuring
- Real Estate Advisory

## Tax

A business's approach to tax is increasingly subject to public scrutiny and is now a major reputation driver. From company set-up to cross-border and transfer pricing solutions, we work with a wide range of national and multi-national organizations to deliver effective tax solutions. Our tax professionals combine international experience with local knowledge to provide leading edge commercial tax strategies tailored to specific client needs.

- Inbound & indirect taxes
- Mergers, acquisitions and restructuring
- International tax services
- Transfer pricing
- Tax management consulting
- Global mobility services
- Automatic exchange of information

# KPMG Leadership - Insurance

## Reyaz Mihular
Managing Partner

### Audit

**Suren Rajakarier**
Partner, Head of Audit

### Tax

**Shamila Jayasekara**
Partner, Head of Tax & Regulatory

### Advisory

**Priyanka Jayatilake**
Partner, Head of Advisory

Markets

## Ranjani Joseph
Partner – Head of Banking Services and Markets

**Yohan Perera**
Partner, Audit
Chief Operating Officer

**Suresh Perera**
Principal - Tax & Regulatory

**Shiluka Goonewardene**
Principal – Deal Advisory

**Thamali Rodrigo**
Partner Audit & Family Business Consulting

**Jagath Perera**
Partner, Internal Audit Risk & Compliance Services & Forensic Services

**Raditha Alahakoon**
Partner – Department of Professional Practice (DPP)

**Dulitha Perera**
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