COVID-19: Financial reporting and Business Implications for Insurers in Nigeria

KPMG in Nigeria

May 2020

Introduction

The COVID-19 pandemic has created new challenges for most businesses globally at unprecedented levels. From supply chain and production disruptions, workforce restrictions, travel restrictions to reduced consumer spending among other factors, businesses have experienced and are still experiencing negative impact of the pandemic which are being seen in their financial performance, revenue projections and may ultimately be expected to result in capital erosion. In addition, volatile global markets due to COVID-19 have resulted in stock markets declining in value, treasury bills and bond yields being at record lows.

Insurance companies in Nigeria are not insulated from these negative impacts of the pandemic, the effects are being seen on their operations from sales and processing of insurance policies through claims processing and payment to financial reporting. These could impact insurers' financial positions, capital and solvency ratios significantly.

Measures adopted by the government, insurance regulators and insurers to support the insurance business during the COVID 19 pandemic and lockdown

In a number of countries, regulators and governments are taking specific actions to support the insurance industry. For instance, providing the grace periods for premium collection, non-cancellation of insurance coverage during the pandemic and waiving co-pays (an insurance policy which is paid for by an insured person each time a medical service is accessed). In Nigeria, some insurance companies have announced premium refund to policy holders for auto policies for the lockdown period. The refund is a credit which can be utilized against future premium payments. The Government has also facilitated the increase of life insurance coverage for health workers who are at the frontline in the fight against COVID-19.

The National Insurance Commission (NAICOM) has also released circulars aimed at easing the operational challenges that insurers face and shielding policy holders from the negative impact of the COVID-19 pandemic. In the circular issued on 1 April 2020, NAICOM stated that *"where Approval-In-Principle for the preceding insurance period had been granted, all renewals or extensions of the foreign reinsurance proportions that become due during the COVID-19 movement restriction are permitted for renewal on the existing basis".* *It was also highlighted that "all insurance/ reinsurance placements shall be done in accordance with other relevant extant insurance laws, regulations and guidelines while all submissions to NAICOM including hard-copies sequel to the forbearance shall be done not later than seven days from the end of COVID-19 Movement Restrictions".* This was, however, subject to further guidelines prescribed by NAICOM. This reduces the stress that insurance companies would have had to face in renewing or incepting policies in this category.

What business impact should insurers expect?

Policyholders' behaviour may change because of COVID-19. For instance, increases in surrender claims and instances of insurance fraud may be experienced. This may also impact the recoverability of deferred acquisition costs (DAC) and reinsurance assets. Measures taken by the government and regulators to slow down the spread of the pandemic may limit sales activity and could impact premium income. The impact may however be reduced for insurers who had already started the journey towards a digital transformation and are able to quickly adjust to changes in doing business brought about by COVID-19 relative to others.

Non life insurance

In non-life or general insurance, some policies have exclusion clauses for pandemic risks, which were strengthened for products such as business interruption and travel insurance after the SARS coronavirus outbreak experience in 2003. In addition, event cancellation coverage may cause greater losses for insurers because some policies cover pandemic risks. Insurers' losses however may be reduced, in this instance, if the event planners are able to postpone already scheduled events rather than a total cancellation. An example is the 2020 Tokyo, Japan Olympics, which according to Sportspromedia.com, could result in about $3billion losses to insurance companies if the event is cancelled. Even if insurance policies totally cover the main event cancellation, there are still losses associated with ancillary services relating to the event. A type of insurance that specifically covers these services is the event contingency insurance policy or clause which reimburses irrecoverable costs and expenses incurred, or loss of profit as a result of the unforeseeable abandonment, postponement, interruption or cancellation of an event.

The following types of insurance businesses may also be specifically affected.

- Trade credit insurance – covering businesses against defaults in their debts or loan obligations. As businesses are faced with the challenges posed by COVID-19 pandemic, it might become difficult for them to meet up with loan repayment obligations and this may expose insurers to claims under the trade credit insurance cover.
- Workers' compensation insurance – covering instances where workers claim they were not adequately protected by their employers against exposure to the virus. As there may be job losses as a result of the COVID-19 pandemic, there may be claims by employees that they have not been properly protected against the impacts of the pandemic. This may expose the insurance companies to more claims.
- Marine insurance (marine hull or cargo)- covering the losses of cargo or damages to ships, cargo vessels and terminals. It is expected that there would be minimal underwriting activities relating to marine insurance during the pandemic period. Furthermore, the premium already written with respect to this class of business may not been earned until restrictions are lifted and major economies opened for the vessels and cargoes to berth.

Life Business

An example of a life insurance product that may be affected is credit life insurance which covers a borrower's debt in the event that the borrower dies or loses his job. As businesses restructure for operations post-COVID-19, job losses may be imminent. In situations where employees with loans outstanding with banks become unemployed due to the COVID-19 pandemic, insurers would need to settle the unpaid balances under the credit life insurance policy.

Increases in mortality or morbidity rates particularly due to COVID-19 could also affect the insurance liabilities for life insurers. Insurers should monitor the developments and assess whether they need to revise their assumptions at the reporting date especially in Nigeria where limited data exist for developing mortality and morbidity rate tables.

The further decline in interest rates and the downturn in financial markets could lead to impairment and decrease in fair value of financial assets. Undoubtedly, the net returns to the insurer on investment-linked products with guaranteed interest would be affected. The measurement of the insurance liabilities arising from the investment linked products could be affected directly or indirectly, if a deficit arises in the liability adequacy test that should be recognised in profit or loss.

Legacy businesses or products that are highly sensitive to market variables are likely to experience the effects more deeply. Such products include regulated and deferred annuities, term life and endowment insurance products.

Reinsurance Business

For reinsurance businesses, there may be increased losses especially relating to those ceded by direct insurers. This could also have a major impact for some specialized reinsurers and insurers with facultative and co-insurance businesses.

What accounting impact should insurers expect?

i. Underwriting

When assessing the impact of COVID-19 on insurance liabilities, insurers should consider the coverage provided under the terms and conditions of issued insurance contracts. The implications for insurance liabilities will be mixed depending on the specific types of coverage provided and the nature of insurance policies underwriting. For instance, the impact on an insurance company with industrial all risk (IAR) and construction all risks (CAR) policies would be different from an insurance company with a comprehensive auto policy.

Insurance companies' financial performance may be impacted considering the expected changes in their assumptions about the timing of premium cash flows, the frequency or severity of claims or the continued use of historical trends to estimate future claims. Also, stay-at-home regulations and resulting operational challenges may affect the claim settlement process and patterns. For example, claims payments may take more time and could result in a change in the paid-claim patterns used in some actuarial methods for calculating insurance liabilities. However, claims could be paid more quickly in the near term because insurers may face regulatory pressure to 'take care of the policyholder' during and after the pandemic; they may also forego regular claim adjudication procedures and question fewer claims before paying. There is also the likelihood of increased reported claims after lockdown is ended given that the insurers provide coverage for death claims, health and other adverse contingencies.

When determining their obligations, insurers need to evaluate the extent of coverage and the impact of exclusions and limitations on coverage. This includes an assessment of new directives, laws and regulations that may require insurers to provide coverage or incur claims for events related to COVID-19 in addition to those required by the existing terms and conditions in the insurance contract.

Current demographic and market estimates as well as discount rates that are reflected under existing accounting practices would have been impacted by COVID-19. Consequently, an insurer may have to update the demographic and market assumptions used when measuring its insurance liabilities. This is especially important for some group life policies where complete details of assured persons may not be available at the point of policy inception.

ii. Investment securities:

Insurers' investment securities can range from quoted and unquoted securities to government and corporate debt securities. These investments, which also generate income for insurers to support their underwriting performance, are subject to volatility in market variables such as foreign exchange rates, prices of underlying instruments, interest and discount rates. These market conditions have been impacted in different ways by the COVID-19 pandemic. Due to the economic downturn brought about by the pandemic, there may be difficulties on the part of borrowers to discharge their obligations under the various loan agreements. The downgrade of sovereign and corporate credit ratings may also impact the default risks and the fair values of investment securities. The investment income derived from these securities would also be affected negatively as yields on government and corporate securities have significantly dropped.

Given the above conditions, whether an insurer has transited to IFRS 9 or adopted the overlay approach of International Financial Reporting Standards (IFRS) 4 -Insurance contracts which permits insurers to still apply the International Accounting Standard (IAS) 39 Financial instruments: recognition and measurement until the adoption of IFRS 17- Insurance contracts, there may be a need to assess the investments securities for impairment. It is therefore important that insurers reassess the entire investment portfolio for impairment and re-evaluate the fair values of the investment securities held.

iii. Insurance and financial risk disclosures

Given the impact COVID-19 will have on the insurance business, disclosures on how the different risks facing an insurer are managed will be very important while ensuring business continuity. These disclosures should include considerations around risk concentrations, major sources of estimation uncertainty, claims development tables, credit, liquidity and market risks. This may involve explaining the impact of COVID-19 risks on the type of insurance business, how experience to date from the COVID-19 outbreak varies from existing assumptions about pandemic risk and how those risks are managed. This may require enhanced disclosures and may also affect sensitivity analysis disclosures. Judgement is therefore required by insurers to determine the specific disclosures that are relevant to their business.

iv. Interim reporting for Insurers

IAS 34 Interim Financial Reporting does not contain specific disclosure requirements for insurance contracts. However, the general principles apply, and the interim financial statements should explain events that are significant to understanding changes in financial position and performance, including changes in estimates, since the last annual financial statements. An insurer should consider whether the interim report needs to include an update to information disclosed in the last annual financial statements because of the pandemic.

Solvency risks and capitalization of insurers

Decreases in asset valuations arising from the COVID-19 pandemic may impact regulatory capital and solvency margin calculations and disclosures about how the entity manages capital. Capital and solvency is particularly important for Nigerian insurers in view of the current recapitalization guidelines issued by the National Insurance Commission (NAICOM). The recapitalization plans require reinsurance companies, composite insurance companies, general insurance and life insurances businesses to increase their minimum paid- up share capital to N20 billion, N18 billion, N10 billion and N8 billion respectively by 31 December 2020. There are however indications, based on the statement by Mr. Sunday Thomas, the Commissioner for Insurance during a recent online conference, that new regulatory guidelines, relating to the new minimum capital requirements, would be issued by NAICOM in view of the challenges posed by COVID-19.

For some insurers, further disclosures around potential going concern issues may be required particularly given the expected impact of COVID-19 on earnings and the ability of the insurers to meet the new minimum capital requirements by 31 December 2020.

Immediate actions for management

In the immediate term, insurers need to take decisive actions to quantity and account for the impact of COVID -19. Some of the proposed action plans are as follows:

a. Evaluate the specific implications for your company based on the accounting policies applied under IFRS 4 and assess the impact on assumptions for measuring liabilities for reported claims, incurred but not reported claims and future claims (including claims handling costs). They should also assess any knock-on effects for assumptions relating t reinsurance recoveries. Insurers may need to review existing special risk policies and exclusion clauses to identify the extent of exposure.

b. Ensure that the liability adequacy test (including recoverability of deferred acquisition cost) is based on current estimates of future cash flows and evaluate whether any deficit should be recognised in profit or loss.

c. Re-evaluate the fair value of investment securities carried at fair value and assess the adequacy of the impairment charges on investment securities held.

d. Consider expanding disclosures about pandemic risk management, sensitivities in the assumptions, major sources of estimation uncertainty, liquidity, market and credit risks.

e. Consider the capital management risks and disclosures, especially where there are concerns about the capital and solvency margin positions relative to regulatory requirements.

f. Re-evaluate strategic plans, scenarios and capital optimization to preserve and protect capital levels. There may be the need for a digital strategy, where this has not been put in place, and a redesign of the agency marketing strategy.

If you need assistance on COVID-19 insurance risks, please contact:

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Below are the links to other KPMG thought leadership materials on COVID-19 relating to Insurance businesses:

- The future comes early: Insurance workforce transformation through COVID-19
- COVID-19 puts insurers on the fast-track to technology adoption
- COVID-19 insurance operations challenges
- Making sense of solvency, capital and COVID-19 for the insurance sector
- COVID-19: the global insurance response
- Do insurers have COVID-19 covered?
- What are the specific accounting implications for insurers?

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