Maxwel Agik

Manager
Audit
Tel: +25 420 280 6000
Email: magik@kpmg.co.ke

The East African insurance industry overview

The outlook for the insurance sector in East Africa is positive, with significant growth potential driven by increasing awareness, regulatory reforms, technology adoption and market diversification. However, the region faces challenges, such as low insurance penetration, economic volatility and regulatory fragmentation across countries within the segment.

Included below are current drivers of growth in the insurance sector:

a. Economic expansion

Rising middle class: economic growth in East Africa, particularly in Kenya, Uganda, Tanzania and Rwanda, is contributing to an uptick in disposable incomes, particularly in respect of the emerging middle class. There has been increased demand observed from this demographic for the purchase of insurance products such as life, health and property insurance.

Infrastructure projects: large-scale infrastructure projects in the region are boosting demand for commercial insurance products, particularly in sectors like construction, transportation and energy.

b. Regulatory reforms

Risk-based supervision: regulators in East Africa are increasingly adopting risk-based supervision models, enhancing transparency and stability within the insurance sector. These reforms are aimed at improving solvency, capital adequacy and governance among insurers.

Harmonisation efforts: there are ongoing efforts to harmonise insurance regulations within the East African Community (EAC), which may contribute to streamlined cross-border operations for insurers and create an integrated regional market.

c. Technology and digital transformation

Insurtech adoption: technology is playing a crucial role in improving access to insurance products in East Africa. Mobile platforms and digital tools are enabling insurers to reach underserved populations, especially in rural areas. Mobile insurance (e.g. M-Bima in Kenya) is growing in popularity, making it easier to distribute and manage insurance products.

Automation and artificial intelligence (AI): insurers are adopting AI, machine learning and data analytics to enhance underwriting, improve operational efficiency and accuracy, and for risk assessment and customer service.

d. Microinsurance and inclusivity

Microinsurance: there is growing focus on microinsurance to target low-income individuals and small and medium enterprises (SMEs). These products are tailored to provide affordable coverage for health, agriculture, life and asset insurance, especially for people in rural areas who are vulnerable to risks such as drought and illness.

Inclusive insurance: efforts to develop products catering for informal sectors and low-income households are expanding, driven by partnerships between insurers, non-governmental organisations (NGOs) and mobile network operators.

Key performance metrics

Gross written premium (GWP): the region witnessed an increase in GWP, with Kenya leading the pack, followed by Tanzania and Uganda. However, the GWP growth rate varies by country, driven by economic performance, regulatory changes and increased awareness.

Insurance penetration: despite the growth, insurance penetration remains relatively low across East Africa. In Kenya, penetration is approximately 2% to 3%, while in other countries like Uganda, Tanzania and Rwanda, it hovers around 1%. This is significantly lower compared to global averages.

Claims ratios: there has been an uptick in claims due to increased awareness and a rise in natural disasters such as floods, which have impacted insurers' profitability. However, insurers are investing in improving claims processing and fraud detection.

Growth opportunities

a. Untapped market potential

Low penetration rates: as noted above, insurance penetration rates in East Africa remain relatively low compared to global standards. This suggests an opportunity for insurers to expand and deepen market coverage.

There is growing demand for life and health insurance products due to increasing awareness of health risks, urbanisation and improvements in healthcare services.

b. Agricultural insurance

Agriculture is a vital part of East Africa's economy, yet it faces significant risks from climate change and natural disasters. Insurers are increasingly providing agricultural insurance products, such as index-based insurance, to protect farmers from drought, floods and other climate-related risks.

c. Regional integration

The EAC and African Continental Free Trade Area (AfCFTA) agreements offer insurers the chance to expand operations across borders, benefiting from a larger and more integrated market. This could lead to more cross-border mergers and acquisitions, as well as the introduction of regional insurance products.

The sector is, however, faced with significant challenges that will require collaboration with various stakeholders such as the regulators, legislators, partners and various economic players for policy interventions to be addressed. Some of these challenges include:

- **Regulatory fragmentation**

  While there are efforts to harmonise regulations across the EAC, each country still has distinct regulatory frameworks, making it difficult for insurers to operate seamlessly across the region. Regulatory fragmentation leads to compliance challenges and higher operational costs for multinational insurers.

- **Low consumer awareness and trust**

  Many East Africans still lack awareness of the benefits of insurance or mistrust insurers due to previous negative experiences with claims settlement. This presents a significant barrier to insurance penetration, particularly in rural areas.

  Efforts to increase financial literacy and educate potential customers on the importance of insurance are critical to overcoming this challenge.

- **Economic volatility**

  The region faces periodic economic challenges, such as inflation, currency fluctuations, and political instability, which can affect the purchasing power of potential insurance customers. Economic volatility can also lead to higher default rates on insurance premiums, affecting insurer profitability.

- **High cost of distribution**

  The traditional insurance distribution model, which relies heavily on agents and brokers, can be costly, particularly in regions where population density is low. Insurers need to find innovative and cost-effective ways to reach customers, especially in rural and underserved areas.

d. Sustainability and environmental, social and governance (ESG) focus

As awareness of climate change grows, insurers are increasingly focusing on sustainable insurance products. ESG factors are becoming important considerations for insurers in the region as they aim to develop products that promote sustainability and respond to climate risks.

Insurers are beginning to offer products that protect against climate risks, which are particularly important for the agricultural and tourism sectors in East Africa.

IFRS 17 Insurance Contracts (IFRS 17) implementation reflections

The adoption and implementation of IFRS 17 marked a significant milestone in the global insurance industry, introducing a substantial shift in how insurance contracts are recognised, measured, presented and disclosed. The new standard is designed to increase transparency and comparability of financial statements across the industry. The journey to implementing IFRS 17 has been particularly challenging for the East African insurance industry, given the region's unique regulatory environment, market dynamics and varying levels of preparedness amongst insurers.

Included below are our key observations from the first year of implementation:

1. Level of preparedness and readiness

Initial challenges: the East African insurance sector faced considerable challenges in preparing for IFRS 17. Many insurers struggled with understanding the complexities of the new standard, including its requirements for detailed data, actuarial models and new accounting processes. The lack of local expertise further complicated the implementation process.

Regulatory support: regulators in East Africa provided varying levels of support. In some countries, regulators issued guidelines and timelines to assist insurers, while in others, the guidance was less clear, leading to inconsistencies in implementation across the region.

Technology and systems: a significant challenge for many insurers was upgrading or replacing existing IT systems to handle the new data requirements and reporting processes mandated by IFRS 17. Smaller insurers particularly struggled with the financial burden of these upgrades.

2. Transition and implementation

Approach to transition: insurers in East Africa adopted different approaches to transition to IFRS 17. Some opted for a full retrospective approach, while others chose a modified retrospective or fair value approach, depending on the availability of historical data and the complexity of their suite of insurance contracts and products.

A number of notable challenges were observed across the region related to the selection of transition approaches and measurement models, the application of discounting techniques and the determination of the risk adjustment.

As it relates to insurance finance income or expenses, the decision to recognise these amounts through profit or loss or through other comprehensive income was a tussle. This was particularly relevant to insurers where parent companies are domiciled in other jurisdictions with stable interest rate environments. These insurers were divided between adopting their parent companies' accounting policy positions and obtaining exemptions to consider an approach that would be more reasonable and prudent considering the region's economic uniqueness and realities.

Training and capacity building: the first year saw significant investments in training and capacity building by insurers, regulators and professional bodies. Insurers partnered with consultants, auditors and training institutions to upskill staff on the new standard. However, the pace of training was often slower than required, leading to a steep learning curve during the initial implementation phase.

Operational challenges: several operational challenges, including the integration of actuarial and finance functions, became more prominent, along with the need for more robust internal controls and the requirement for more granular data collection and analysis.

3. Financial reporting and impact

Financial statement changes: the first set of financial statements prepared under IFRS 17 showed significant differences from those prepared under *IFRS 4 Insurance Contracts* (IFRS 4). Insurers reported changes in profit recognition patterns, with some experiencing greater volatility in reported earnings due to the new measurement models.

Investor communication: insurers had to spend considerable effort communicating these changes to investors and stakeholders. The complexity of IFRS 17 made it challenging for investors to understand the true financial position and performance of insurers, leading to the need for enhanced disclosures and communication strategies.

Comparability issues: despite the objective of IFRS 17 to enhance comparability, the first year revealed that differences in implementation approaches across the region led to comparability issues, particularly for multinational insurers operating in multiple East African markets.

Post-implementation review

1. Lessons learnt

Importance of early planning: one of the key lessons learnt from the first year of IFRS 17 implementation is the importance of early and thorough planning. Insurers that started preparations early and invested in robust project management structures were better positioned to meet the challenges of the new standard.

Continuous training: the need for continuous training and education cannot be overstated. Insurers that invested in ongoing training for staff, rather than relying on once-off sessions, found the transition smoother and more manageable with more value gained in translating learnings into day-to-day operations.

Collaboration with stakeholders: effective collaboration with regulators, auditors and industry peers was crucial. Insurers that actively engaged with these stakeholders throughout the implementation process benefited from shared knowledge and experiences.

2. Regulatory and industry feedback

Regulatory adjustments: following the first year of implementation, some regulators in East Africa have indicated the need to refine guidelines and timelines based on the experiences of the industry. There is also a push for more harmonised regulations across the region to address comparability challenges.

Industry collaboration: the insurance industry in East Africa is considering forming more formalised working groups to share best practices and address common challenges in IFRS 17 implementation. This could lead to more standardised approaches and reduced implementation costs for smaller insurers.

3. Where to from here with IFRS 17

Continued evolution: the journey of IFRS 17 implementation is far from over. Insurers in East Africa will continue to refine processes, systems and reporting practices in the coming years as more experience is gained in understanding the standard.

Focus on data quality: improving data quality and granularity will remain a top priority. Insurers are likely to invest further in data management systems and analytics to meet the ongoing demands of IFRS 17 reporting.

Long-term impact: over the long-term, IFRS 17 is expected to bring about more transparency and comparability in the East African insurance industry, ultimately leading to greater investor confidence and a more robust insurance market.

The first year of implementation in the East African insurance sector has been a challenging but necessary journey. The experiences and lessons learned during this period will shape the future of financial reporting in the region and globally, paving the way for a more transparent and resilient insurance industry. Continued collaboration, investment in training, and focus on data quality will be essential as the sector moves forward with IFRS 17.

Future outlook for the East African region

a. Moderate to strong growth

The East African insurance market is expected to experience moderate to strong growth in the coming years, driven by increasing demand for life, health and agricultural insurance. Microinsurance and the expansion of digital distribution channels will be key growth areas.

b. Increased competition

With the entry of multinational insurance companies and the rise of local players, competition in the East African insurance sector is intensifying. Insurers will need to innovate and offer more tailored products to meet the diverse needs of consumers.

c. Continued regulatory evolution

Regulatory reforms aimed at improving solvency, transparency and consumer protection will continue to shape the landscape of the insurance sector. Insurers will need to stay agile and adaptable to these regulatory changes.

Overall, the outlook for the insurance sector in East Africa is promising, with significant opportunities for growth through innovation, technology adoption and regulatory harmonisation. However, insurers must navigate challenges related to low penetration, regulatory fragmentation and economic volatility. Those insurers that are able to leverage digital platforms and expand into underserved markets, while offering sustainable products, will be well-positioned to thrive in this ever-evolving market.