Kazakhstan’s Insurance Market Grapples with Uncertainties

The Kazakhstan insurance market achieved rapid growth in 2019, driven by further development of the life segment, the introduction of new mandatory products and the roll out of electronic contracts for mandatory motor insurance.

Despite significant development in the past 10 years, the market is yet to reach maturity. The operating environment remains challenging. At the same time, the regulatory environment continues to evolve. The cost of sourcing business remains high and is a drag on earnings, with online insurance still accounting for only a fraction of business. Meanwhile, local insurers face the prospect of higher levels of competition as the market opens up to foreign insurers.

Kazakhstan’s insurance market also faces a new and unprecedented challenge in 2020. As an oil-exporting country, Kazakhstan is dealing not only with the global coronavirus (COVID-19) pandemic, but with the economic fall-out from the resultant reduced demand for energy. Any projected contraction of the country’s gross domestic product (GDP) will have implications for premium volumes, particularly for commercial lines.

Kazakhstan’s Insurance Segment is Once Again Faced With Economic Challenges

While Kazakhstan’s insurance market is small in terms of volume, it has grown rapidly, driven by the country’s economic growth, improvements in the regulatory environment, and a greater demand for personal insurance. In 2019, the market’s total gross written premiums (GWP) increased by 32% to KZT 508.5 billion (approximately USD 1.3 billion). This compares with International Monetary Fund (IMF) estimates of a GDP growth of 4.5%. AM Best expects the insurance penetration rate to continue to rise, supported by increased awareness of insurance and further regulatory developments.

Credit insurance has also been a source of significant premium growth, with a number of insurers working in partnership with banks (some of which are affiliates) to distribute products. The health of the country’s banking system has improved over the past two years, supported by The National Bank of Kazakhstan’s (NBK) Bank Recovery Programme. Several banks have received significant state funds, either through the purchase of bad assets by the Problem Loan Fund, or through subsidised loans. Consequently, there has been a significant increase in bank credit, particularly retail loans.

Following good growth in 2019, the country has had a difficult start to 2020, as despite efforts to diversify its economy, Kazakhstan continues to rely heavily on revenues from the oil and gas sectors. This has meant that the economy has felt the negative impact both of faltering negotiations between members of the Organization of the Petroleum Exporting Countries (OPEC) and Russia, and the COVID-19-related reduced demand for oil from its key trading importers in the first quarter. Oil prices have continued to fall despite an agreement to cut output, and are likely to remain under pressure over the coming months due to inventory build-up and continued lower demand.
The NBK hiked its base interest rate 275 basis points to 12% on 10 March, 2020 in response to economic pressures and concern over its currency and inflation. However, the move did not prevent a sell-off in the tenge and on 3 April, the central bank unexpectedly reduced its base interest rate to 9.50%, while also expanding the base rate corridor to plus or minus two percentage points. Amid the economic uncertainty and the risk of a COVID-19-driven global recession, AM Best expects demand for insurance products in Kazakhstan to be muted. Premium volumes are also likely to be affected by potential delays in government-financed infrastructure projects due to a forecasted decline in economic growth and an increase in the budget deficit. In addition, the tenge’s depreciation is likely to result in increased claims costs, especially for motor insurance business (where spare parts are often imported). At present, the reduction in road traffic due to COVID-19-related restrictions, which results in fewer car accidents, provides a partial buffer against this risk.

AM Best has observed similarities between Kazakhstan’s current situation and that experienced in 2015-2016, when energy prices plummeted and the government had to revise its budget several times to account for lower oil revenues. At the time, a number of insurers reported higher loss ratios on lines of business linked to inflation, and companies writing business denominated in foreign currencies had to significantly increase their technical provisions. Insurance companies also recorded material unrealised losses on their fixed-income portfolios, following a rise of the NBK’s base rate (which peaked at 17% in February 2016). At the time, a number of companies were able to partly offset these losses by significant foreign exchange gains on their US dollar denominated investment positions.

At the time of writing, there is material uncertainty regarding the potential impact of the COVID-19 pandemic on both Kazakhstan and the broader global economy. Following the declaration of the pandemic by the World Health Organization in March 2020, Kazakhstan banned all mass gatherings, and subsequently put the country’s two largest cities in lockdown. Further restrictions have followed. These measures will have a significant negative impact on economic activity and, as a result, insurance purchasing.

AM Best maintains a dialogue with the (re)insurers it rates in Kazakhstan, monitoring how these economic and operational issues are affecting their performance and balance sheet strength metrics, their ability to conduct business, and what risk management steps they are taking to manage the situation. AM Best’s focus is on how companies are managing asset price volatility and ensuring they have sufficient liquidity levels, as well as how they review the adequacy of claims reserves, given the potential for claims inflation in lines such as motor and medical insurance.

From an operational point of view, AM Best expects insurers it rates to put in place safety measures and contingency plans to minimise COVID-19-related disruption to their businesses. While most local insurers have procedures in place to deal with extraordinary situations, pandemic is not always listed, as the focus is typically on an earthquake event (which is a material risk in Kazakhstan). As a result, those insurers that do not have written contingency plans in place for pandemic, have to respond to the situation in a reactive manner and follow the government’s advice.

AM Best does not expect local insurers to have significant direct (re)insurance exposure to COVID-19 claims. Usually, business interruption risks are covered only when they are linked to physical property damage. Other lines of business such as event cancellation and trade credit insurance may be triggered in limited cases, although these lines tend to be significantly reinsured to the international market, and there may be some claims on travel insurance.
AM Best has noted that some companies have begun offering special insurance for COVID-19 that includes the risk of death or medical expenses in case of illness. These companies are expected to model potential losses in an appropriate manner, given that this risk is still evolving.

In January 2020, a new financial regulator was established to provide an appropriate level of supervision of the financial system and to implement state regulations. The Agency for Regulation and Development of the Financial Market of the Republic of Kazakhstan has taken over regulatory responsibilities from the NBK and will focus more on the protection of consumers of financial services.

**Further Market Consolidation Likely As Companies Seek Scale; Foreign Entrants Could Impact Competition**

Kazakhstan’s insurance market is concentrated, with a handful of large market players controlling a significant share of premiums. For example, in 2019, over 70% of compulsory motor third-party liability (MTPL) risks as measured by GWP were underwritten by the top five companies in the market. At the other end of the scale, a large number of small players compete for remaining premium.

Merger and acquisition (M&A) activity in recent years has often been driven by companies aiming to achieve the critical mass needed to operate efficiently. There have also been instances of mergers following the consolidation of banking parents, while a number of small companies, unable to form stable portfolios and satisfy supervisory requirements, have left the market. AM Best also notes that over the past decade, the larger and more established market participants have been most resilient to challenging market conditions, evidenced by consistently good returns on equity, increasing market shares and the benefits of economies of scale.

In AM Best’s opinion, market consolidation is likely to continue as smaller companies struggle to compete due to the relatively high costs of sourcing business in Kazakhstan and the intense competition. In addition, the regulator plans to strengthen the solvency and reporting requirements for insurers, potentially leading to higher expenses, which may be harder to bear for smaller players.

Kazakhstan has been a member of the World Trade Organization (WTO) since 2015 and, following a five-year transition period, foreign insurance companies that meet certain requirements will be able to open branches in Kazakhstan from 2020. These requirements include holding aggregate assets to a value of at least USD 5 billion and having at least ten years’ experience in the sector in classes in which it applies to operate.

The introduction of foreign insurers is expected to further intensify competition and may lead to more M&A activity between local companies as they try to defend their market positions. In addition, if foreign insurers obtain local licences in Kazakhstan, this could trigger a reallocation of insurance premiums relating to the local assets of foreign enterprises. At present, these risks tend to be written by local insurers before being reinsured into the international market. For customers, the introduction of foreign competition could be a positive as it would likely increase access to capital and better services, which in turn could incentivise local players to become more efficient.

In 2019, Kazakhstan’s non-life market demonstrated strong growth of 21%, mainly driven by property and MTPL insurance. The life market expanded by 66%, albeit from a lower base, fuelled by a change to pension regulation allowing policyholders to transfer their
annuities from the country’s state-owned pension fund to private life insurance companies. The development of other life products also spurred market growth, and, as a result life insurance GWP reached KZT 148 billion in 2019 (up from KZT 89 billion in 2018), which translated into a market share of 29% (see Exhibit 1). Kazakhstan’s local life insurance market is also heavily concentrated, with the top three insurers accounting for 83% of the life market’s GWP in 2018.

Within Kazakhstan’s non-life insurance segment, voluntary property insurance is the largest class measured by GWP, due to the strong presence of the oil and gas industry. However, this business is largely reinsured into international markets. On a net basis, compulsory insurance (in particular MTPL) dominates and is the main driver of local market growth.

In 2018, legislation was passed to withdraw compulsory personal injury insurance for travel agents and establish in its place compulsory outbound travel medical insurance for tourists who organise travel via a commercial organisation. The introduction in 2019 of compulsory tourist insurance gave a boost to travel insurance premium figures, which rose to approximately KZT 5.9 billion from a much lower base of KZT 97 million in 2018. A new class of professional liability insurance was adopted through amendments to insurance legislation with effect from 1 January, 2020 which require certain professionals, such as advocates and legal counsels, to obtain coverage. AM Best expects the number of mandatory insurance classes in Kazakhstan to continue to increase as the regulator seeks to deepen insurance penetration.

AM Best notes that the regulatory environment in Kazakhstan is subject to frequent changes. This impacts insurance companies in a number of ways. For example, regulatory changes in 2018 led to Kazakh life insurers being unable to reinsure workers' compensation (WC) business with local non-life companies. The NBK introduced the change due to the high credit risk exposure for life companies associated with fronting WC business for local non-life insurers, as well as concerns regarding the adequacy of non-life companies' reserves for WC due to the long-term nature of this business. For non-life carriers that meant the loss of some GWP and profitable business, prompting some groups to establish life subsidiaries so they could continue to share in the growth of this compulsory insurance segment.

The inability to reinsure with local non-life insurers, as well as concerns about retaining business on their own balance sheets with WC exposure that could be greater than the compulsory minimum sum insured, has led life companies to seek reinsurance cover in the international market. However, this has been challenging as some international reinsurers consider Kazakh WC business too risky, as they have had to bear significant losses in the past.

AM Best notes that further product diversification is taking place in the life sector. In particular, the regulator is working to develop innovative endowment products in the market.
One example of this is unit-linked insurance that is an investment product packaged as an endowment policy. In contrast to other endowment products, the policyholder will be able to choose a strategy and investment tools. However, there is no guaranteed return and the policyholder assumes the risk of investing. From the insurer's prospective, unit-linked products require less regulatory capital, because the associated investment risk falls on the policyholder. However, insurers are exposed to conduct risk, for example if the product is mis-sold due to an incorrect assessment of the customer’s risk appetite. While the introduction of a new insurance product to the market is likely to increase insurance penetration, in order to mitigate conduct risk, it is important that there are transparent policy terms and conditions and advice, so that policyholders understand the financial risks.

**Capitalisation Levels Vary Significantly – More Robust Solvency Requirements Expected**

Insurance companies in Kazakhstan are required to comply with minimum solvency requirements (currently 100% or ratio of 1). The solvency margin is roughly based on European Solvency I principles and is published by the NBK on a monthly basis. Some companies aim to maintain a solvency ratio just above the regulatory margin while others target three or more times the minimum required. AM Best notes that the regulator will usually intervene when a company’s margin approaches minimal levels and may ask for a plan of action as to how a company intends to improve its solvency.

The solvency ratios of the 28 insurers operating in the Kazakh market were volatile in 2018 and 2019, particularly the ratios of those with small capital bases. Solvency ratios are often volatile month by month due to the impact of large claims, changes in their reinsurance cessions, as well as exposure to large single contracts. Changes in asset allocation can also have a significant impact on the solvency capital requirements as investments of low credit quality are heavily penalised.

Many insurance companies in Kazakhstan grew rapidly in 2019. Some were able to support the corresponding increase in underwriting risk through internal capital generation or capital injections from their shareholders. However, those with limited operating earnings or significant dividend requirements from shareholders reported sharp declines in their solvency margins. As a result, a larger number companies reported a ratio of less than 1.5 at 1 January, 2020, compared to the year before (see Exhibit 2).

The regulator is seeking to enhance its solvency model for insurance companies, bringing it more in line with the European Union’s Solvency II regime. While AM Best believes that this is likely to further improve risk management practices in the market, at the same time, more stringent solvency requirements may require insurers to invest in new IT systems. This may be challenging for smaller players that already have a high cost base relative to premium

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**Exhibit 2**

**Kazakhstan – Local Insurers – Solvency Ratios Comparison, January 1, 2019 and January 1, 2020**

<table>
<thead>
<tr>
<th>Range</th>
<th>1/1/2019</th>
<th>1/1/2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>S &gt; 10</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>2 &lt; S ≤ 10</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>1.5 &lt; S ≤ 2</td>
<td>9</td>
<td>7</td>
</tr>
<tr>
<td>1 &lt; S ≤ 1.5</td>
<td>10</td>
<td>6</td>
</tr>
<tr>
<td>S &lt; 1</td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

Note: Number of insurers in each range. Source: The National Bank of Kazakhstan
income. In addition, smaller market players may find it difficult to satisfy the enhanced capital requirements, which could lead to further market consolidation.

So far, regulatory efforts to improve the penetration of insurance in the country have been the main driver behind industry growth. In recent years, regulatory attention on insurers’ risk management standards, including the introduction of regulatory information systems in insurance, has helped the regulator to focus its resources on companies that fit its “high-risk” profile.

**E-Commerce to Drive Down Acquisition Ratios**

In 2018, a number of laws relating to mandatory motor insurance were amended to provide for the issuance of electronic insurance contracts. Since 1 January, 2019, it has been possible to insure the civil liability of a car owner online, without a visit to the office of the insurance company or the mediation of an insurance agent, and to issue an electronic contract. This brought motor in line with other compulsory types of civil liability insurance, which must be processed electronically by insurers. In addition, some law clauses were added to facilitate the integration of insurers’ e-policy systems with a unified insurance database.

AM Best expects demand for online products to grow, supported by improvements in insurance companies’ IT infrastructure, and for online distribution to be expanded to voluntary classes. Insurance companies already offer products that protect a property from minor damage that are “packaged” in so-called boxed products. These products are standardised and sold without individual underwriting, and could be a good candidate for online distribution. A wider roll out of online contracts should reduce expense ratios for local insurance companies and increase penetration of various insurance products across a wider customer base.

A large portion of mandatory business is distributed through insurance agents (in particular MTPL) and the associated commissions and bonuses create a significant expense burden for insurers. Increased use of online policies, as well as the use of a unified insurance database that is available to all insurers, should begin to lighten the burden of agency fees and encourage more direct business. Together, these should drive down acquisition ratios, making this class more profitable.

AM Best expects the distribution capabilities of local insurers to be enhanced by both the development of online channels and the increased use of technology.

### Exhibit 3

**Kazakhstan – AM Best-Rated Companies**

Ratings as of April 21, 2020

<table>
<thead>
<tr>
<th>AMB #</th>
<th>Company Name</th>
<th>Best’s Long-Term ICR</th>
<th>Best’s ICR &amp; FSR Action</th>
<th>Best’s ICR &amp; FSR Outlook</th>
<th>Rating Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>78331</td>
<td>Eurasia Insurance Co. JSC</td>
<td>bbb+</td>
<td>B++</td>
<td>Affirmed</td>
<td>25-Jul-19</td>
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<td>91215</td>
<td>Joint-Stock Company Subsidiary of Halky Bank of Kazakhstan Halky Insurance Co.</td>
<td>bbb</td>
<td>B++</td>
<td>Affirmed</td>
<td>6-Dec-19</td>
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<tr>
<td>91331</td>
<td>Halky-Life, Life Insurance Subsidiary Company of the Halky Bank of Kazakhstan JSC</td>
<td>bbb-</td>
<td>B+</td>
<td>Affirmed</td>
<td>12-Feb-20</td>
</tr>
<tr>
<td>92322</td>
<td>Kommesq-Omir Insurance Co. JSC</td>
<td>bb-</td>
<td>B-</td>
<td>Affirmed</td>
<td>27-Feb-20</td>
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<tr>
<td>92467</td>
<td>Victoria Insurance Co. JSC</td>
<td>bbb-</td>
<td>B+</td>
<td>Affirmed</td>
<td>26-Jul-19</td>
</tr>
</tbody>
</table>

Source: Best’s Financial Suite - Global, AM Best data and research