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The Nigerian Insurance Industry: Will it cross the crossroads?

Half Full or Half Empty?

The recent surge of foreign direct investment (FDI) in the Nigerian insurance market by some of the reputable global names in insurance has led sceptics to rightly ask, *"Can anything good come out of the Nigerian Insurance Industry?"*

The paradox of the Nigerian insurance market is such that both pessimists and optimists have valid arguments. The pessimists view the Insurance Industry as one with a long history of underperformance, an Industry relegated to the background in a financial services sector that has produced more prosperous industries such as banking and pensions. Optimists on the other hand argue that Nigeria remains a largely underdeveloped insurance market that can become a new frontier for growth.

Interestingly both sides of the divide will often refer to Nigeria's meagre 1% insurance penetration rate, which indicates that only about 3 million Nigerians have any form of insurance whatsoever. At the root of these failings are age-old challenges of poor regulatory enforcement, weak corporate governance & risk management framework and general inefficiencies within the Industry. The greatest of these inefficiencies would possibly be the dearth of innovation. The level of product innovation in the insurance industry pales in comparison to the banking industry which has adopted several simple technological driven solutions that are being replicated across the globe today, such as SMS based and online transaction notifications as well as USSD based funds transfer mechanisms.

Narrow Product Focus

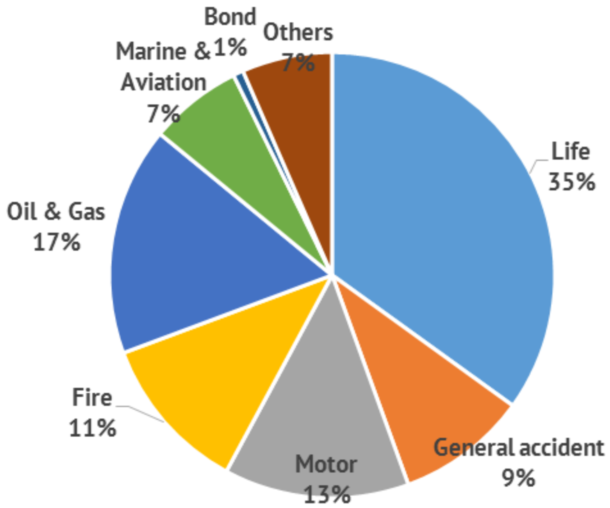
In 2016, the Nigerian Insurance Industry is estimated to have generated gross premium income (GPI) of over ₦356 billion through its various insurance products & services. Historically GPI growth has been driven by the six compulsory insurance policies:

- third party motor insurance,
- employer's liability insurance
- group life insurance,
- builders' liability insurance,
- healthcare professional indemnity insurance
- occupiers liability insurance.

These products and services are not only concentrated in statutory insurance policies but also within the formal sector. The insurance industry continues to pursue a strategy of selling compulsory insurance policies to the formal segment of the economy, particularly corporate clients. With the formal market representing about 40% of the economy and the informal segment being 60%, there is a strong raison d'être for concentrating within the informal segment of the market.

Significant opportunities abound within the informal sector which can be harnessed through micro-insurance. However, this will require technologically driven strategies to reach the large Nigerian population while reducing the cost of acquiring new policies in the long term. In our view, to be profitable, the "low margin/high volume" philosophy should be adopted in micro-insurance.

Figure 1: GPI by Business Lines



Source: Agusto & Co.

> ***"The need to engage customers cannot be overemphasized as this not only builds trust, but also puts the insurer in the face of the customer".***

Getting it Right in Nigeria

With more than half of the population living below the poverty line, the idea of insurance is unthinkable to a significant number of Nigerians. In addition, consumer purchasing power continues to be negatively impacted by high inflation. Thus there is a need for insurers to offer specific products that cover just the right amount of insurance that is desired at various income and demographic levels.

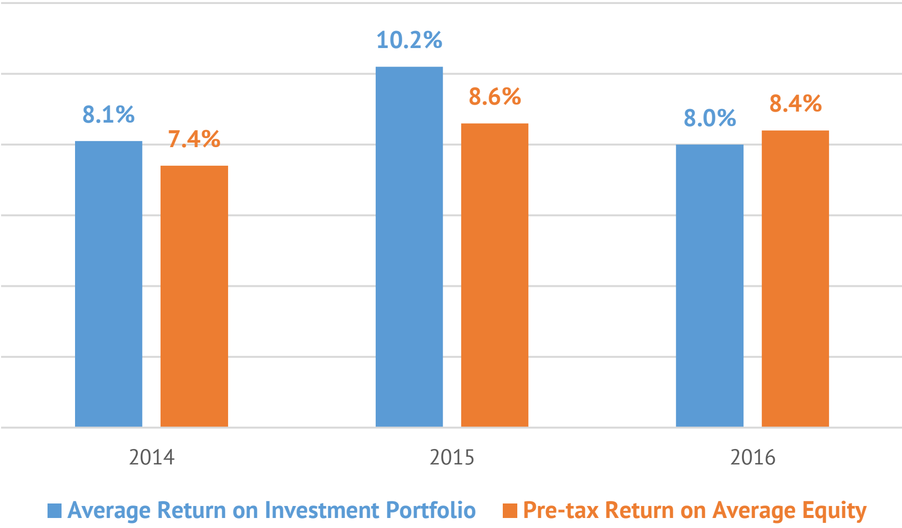
Nonetheless, the underlying issue blighting the perception of insurance in Nigeria needs to be addressed, especially from a systemic level. The fiduciary relationship between insurers and consumers is usually broken due to a number of factors. One of these factors is poor consumer education on insurance practise. Insurance operators have under-invested in consumer education thus creating a vacuum that leaves consumers and operators as losers in the game. Investing in consumer education could help to restore confidence in the Industry and align expectations appropriately.

A good starting point will be the provision of basic knowledge on insurance and its *modus operandi*. Secondly, insurers need to be more transparent in educating consumers on the fine prints in insurance contracts. These fine prints have become a sore point in the business, leading to negative perceptions and adverse referrals from clients who feel short changed.

The need to engage customers cannot be overemphasized as this not only builds trust, but puts the insurer in the face of the customer. Typically, insurance products and services do not require constant engagements with clients except at major events such as customer acquisition, claims registration and policy termination. It is vital to make these moments rancour free.

The Industry must also consider its preparedness for the next generation, termed "millennials" which accounts for about 28% of the Nigerian populace. This segment of the retail market is inclined to a digital dominated world and are characterised as being technologically savvy, highly informed and captivated by instant gratification. The spending power of these individuals is expected to increase as they mature and there is need to engage them as they evolve.

Figure 2: Key Profitability Ratios



Source: Agusto & Co.

> *"With inflation in double digits of about 15% and one-year Treasury Bill rates at about 18%, investors are losing in real returns and can earn higher returns on alternative risk-free assets."*

The Financial Costs of Not Reforming

The Insurance Industry controlled an investment portfolio of about ₦723 billion as at FYE2016, with about 60% of total investments in money market placements (bank placements and government securities).

Despite the bullish returns on government securities which impacted other money market investments positively, the Industry's estimated investment yield was single digit of about 8% which shows inefficient asset allocation and weak balance sheet management. Furthermore, 16% of the Industry's investments are in real estates that continue to record poor rental yields on account of poor location, poor state of the infrastructure and significant exposure to undeveloped land. Unlocking the income potentials of these real estate investments alone could significantly impact the bottom line of the Nigerian Insurance Industry in the near term.

The net effect of the financial condition of the industry is its poor Return on Equity (ROE) of about 8.4%. With inflation averaging 15% and one-year Treasury Bill rates at about 18%, investors are losing in real returns and can earn higher returns on alternative risk-free assets.

Recapitalisation through Consolidation and FDI

The full implementation of the risk based capital framework which simply measures capital adequacy in view of underwriting risks, should spur recapitalisation in the near term. This could be positive for the Industry by strengthening underwriting capacity while fringe players may capitulate. The Industry has undergone two major rounds of capitalisation in the last 15 years leading to a drop in number of operators to 49 from 103. Currently, the minimum capital requirement for life, non-life, composite and reinsurers are ₦2 billion, ₦3 billion, ₦5 billion and ₦10 billion respectively. At this level, it is clear that capitalization remains inadequate and a significant amount of risks are insured overseas as the capital base of most insurers cannot carry the risks of insuring assets in key sectors such as oil & gas and aviation. This has led to the consortia of insurance companies pooling funds together to underwrite significantly large risks.

In our view, there could be major consolidations within the Nigerian Insurance Industry, driven by recapitalisation which would separate the wheat from the chaff. However, this will only be fast tracked by stronger regulatory oversight leading to an effective corporate governance framework. Without these reforms, the Industry may continue to falter at the cross roads.

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UBA House (5th Floor),
57 Marina Lagos
P.O. Box 56136, Ikoyi
Tel: (234) 270 7222—3
E-mail: info@agusto.com
Website: www.agusto.com