INSURANCE INDUSTRY STABILITY IN A TURBULENT ECONOMY

BY J.F. WILCOX

INTRODUCTION

I thank the Chartered Insurance Institute of Nigeria for the invitation extended to me to address this session of the 2017 Professional forum; it is indeed a privilege to be able to share from my personal and professional experience of over 40years of involvement with the Nigerian insurance industry with you all this morning.

In the course of my involvement with the industry, I had seen a bit of it all, as an insurer and a broker, my views this morning have been shaped by the Good, the Bad and the Ugly; the totality of my experiences and permit me state upfront that the commentary this morning will be hard hitting as we will be focusing on our professional conduct as industry persons, I appeal for your introspection and discernment.

THE NIGERIAN INSURANCE INDUSTRY

The insurance industry in Nigeria has in the past few years been through a difficult time similar to that which all other sectors of the national economy have experienced. The challenges of the insurance industry have been made more acute by the combined effects of inflation; slow down in the growth of Gross Premiums Underwritten and sharp drop in investment returns alongside the historical and cultural perception issues which have bedeviled the industry in Nigeria.

The response of the industry practitioners to these challenges has been varied but the underlying theme has been “survival at all costs”. However an industry in “survival mode” is an unstable one which is prone to failure.

Our discussion this morning, will focus on the roles of the market players in the industry's response to the economic turbulence that we are currently experiencing in Nigeria, the effects of same on the stability of the insurance industry and the possible strategies that we can adopt to ensure the stability of the market, guaranty long term growth and profitability of the industry.

The repercussions of the last global economic recession which rather interestingly Nigeria did not suffer from as dramatically as other emerging economies did has continue to reverberate across many parts of the world, creating significant impediments to the growth and prosperity of global insurance business.

Investors have become nervous about the reduced “headroom” occasioned by the low ratios and relatively high target surpluses (in some cases in excess of 60%) based on regulators capital requirements and the impact of this on the operational model and dividend policies of insurance companies

Access to cheap underwriting capital has considerably dried up and any capital available for accessing is now constrained by restrictions and impositions by investors who have become more specific on their return margins and corporate governance models.

The global insurance market has also been affected by the coming into effect of the Solvency II Regulations, which were designed to help ensure that companies have strong financial buffers so that they can meet claims effectively leading to the need for more liquidity to cover their operational position and acceptances in the light of the regulators guidelines.

The lingering effects of the foregoing coupled with the local recession experienced in Nigeria in the period from Q2 2015 until Q1 2017 has thrown up many challenges for the insurance organizations in Nigeria, for whilst the international insurance market has had to contend with a cycle of protracted low-interest-rate environment, intensifying regulatory risk and capital pressures, eroding top lines and a desperate need to streamline costs, the local insurance industry has to deal with similar challenges and the stark reality of low insurance penetration, diminishing per capita income, disposable income and consumer discretionary spending constraint in Nigeria.

The insurance sector is an underdeveloped part of the Nigerian financial sector with less than 2 percent of GDP in assets. Assets of the life business are about half of the assets of the non-life sector reflecting a low level of savings and investment insurance products.

The Nigerian insurance industry in the last five years has grown at a compound annual growth rate (CAGR) of 11%, buoyed by increased capitalization as well as the Nigerian Content Drive of the Government and the MDRI Initiative of NAICOM to some extent.

The industry growth potentials has also been affected by the move by NAICOM to implement new capital adequacy requirements based on a risk based framework and the enforcement of the ***No Premium No Cover Provisions*** of the Nigerian Insurance Act of 2003 which has had the effect of reducing the high outstanding receivables position of many insurers as cover is now on “a cash before cover basis”, whilst making the purchasing public more discerning in their insurance purchase practices.

THE NIGERIA ECONOMY

2014 – 2016 Nigeria has been experiencing economic turbulence since late 2014. The country's annual gross domestic product (GDP) growth rate dropped from 6.22 percent in 2014 to 2.79 percent in 2015, before plunging into recession in 2016, ending the year at about negative 2 percent growth. Inflation, unemployment, underemployment and exchange rates also rose significantly in 2016.

The economic downturn can be traced to a myriad of factors – the fall in global crude oil prices being, perhaps, the most prominent. The vandalisation of oil and gas facilities by militants in the Niger Delta also contributed in no small measure to the economic upheaval, as crude oil production and power generation witnessed lows of 1.468 million bpd and 1.4 MGW in 2016. The delay in the passage of the National Budget annually in this period, the hike in electricity tariffs and the prices of petroleum products, the controversial management of the exchange rate policy by the Central Bank of Nigeria (CBN), and the insurgency in the North East are some of the other factors that pushed Nigeria into an economic recession.

It is this therefore against this backdrop, that we will be examining the theme of this session – **Insurance Industry Stability in a Turbulent Economy**.

MARKET STABILITY

In dealing with the topic of our discussion, it is important to address the concept of market stability and relate same to the context of our conversation.

Market stability refers to the absence of or the minimization of volatility in the market predicated on the observance of prudent underwriting practices and management of investment activities to ensure the continuance of the overall ability of the insurance industry to meet its contractual obligations to the insuring public.

It is the minimization of systemic risks within the industry and enhancing its ability to support the national economy in its roles as a major component of the financial services industry.

Arising from the foregoing it is clear that the stability of the insurance market is directly tied to the management practices, operational models of the industry players and the regulatory framework/outlook of the industry

The key players in the industry that are central to the discuss on market stability are:

- **Insurance companies**
- **Reinsurance companies**
- **Intermediaries**
- **Industry Regulators & Associations**

Each of the identified stakeholders above has a role to play in the maintenance of the stability of the market and this will be addressed in greater detail, further in our discussions this morning.

MARKET INSTABILITY – ISSUES TO PONDER

Without market instability, there would be no conversation on market stability; it is a fact that it exists now in the industry here Nigeria, it is therefore important that we discuss the root causes of market instability to be able to address the theme of this session’s conversation adequately.

The Underlying Causes Of Market Instability In Nigeria Are

- **Inflation** – This has a considerable effect of Returns on Investments and the ability of insurers to build up reserves
- **Shareholder Pressure** – especially with the current state of the economy which has made shareholder demand for greater profit margins and dividend payout greater in the absence of other sources of income
- **Risk Appraisal Failures and Disruption of the pool** - It is very interesting to note that in the Nigerian economy with an annual inflation rate of close to 19% YoY, sums insureds are not reviewed upwards adequately and whilst premium has been reducing. Essentially the trend has been that most insurers in the market have been underwriting greater risks with lesser sum insured as adjusted on a YoY basis.

- **Liquidity or Cashflow Underwriting** – We are poor students of history; we have not taken full cognizance of happened in America with "**Cashflow underwriting**", its impact on the long term stability & viability of the insurance industry.

  Insurance is a science with underlying principles and practices. Insurers are supposed to be risk averse but what we have seen in the market today is contrary to this, we see people say that insurance is not a "technical", that probability and the law of large numbers does not apply; that technical rates don't apply and commercial concerns should be the overriding consideration in determining acceptances and retentions.

  The pressure to increase the top line has been very acute and synonymous with the operations of many insurers in Nigeria today. The failure of the insurers to have a clear differentiation strategy has meant that many companies have resulted to liquidity underwriting without adequate attention being paid to the core principles of insurance management and business ethics.

I have watched over the years in non recession time's people running their insurance businesses with rampant abandonment of the core principles of the science of Insurance with emphasis on ratemaking.

Results in the property portfolio have historically been very poor for the Nigerian market and most insurers have remained reckless in rates charged for risks. Ironically insurers in Nigeria grant huge discounts to companies and entities that can buy them over many times over with a care for what the appropriate technical rates should be.

The underwriting and acceptances of most insurers of risks that are "domesticated" deserve scrutiny in this regard, underwriting lines as Motor, General Accident, Marine and Liabilities covers which form a large percentage of the business which fall into this category of risks show that prudent underwriting practices are not observed in the rating and pricing of these risks.

When view critically, these classes of insurance also constitute the most widely patronized by the insuring public and any default by market players in the discharge of their obligations towards the insuring public will have a disproportionate negative impact of the public perception of the industry with the concomitant effect on the drive to increase insurance penetration in the country ***(one of the identified solutions to the maintenance of industry stability***

The motor portfolio of most insurers also shows a glaring disregard for prudent underwriting with some insurers charging rates of less than 1% on some large motor fleet programmes with free extensions of cover added on as “sweeteners” and it appears that most insurers are afraid of brokers and consequently cede the ***“underwriting pen”*** to them, forgetting that the brokers always work for the interest of their clients hence we are seeing sums insured and liabilities going up with premiums comparatively decreasing in Nigeria.

In the rush to “grow the business” the focus of many companies have shifted from the need to underwrite risks on a sustainable basis to acceptance of risk placements on a largely “caviler” basis to get the cash in and keep the business afloat.

Due cognizance is not paid to risk appraisals and survey reports with regard to pure risk premium determination, consequently many placements or acceptances by insurers are without adequate security. The import of same on the overall ability of the market to fulfill its obligations to the insuring public is clear and this is a fact that market observers are keening aware of.

- **Human Resources Challenges**

The last point discussed above has been discovered to be a result of a dearth of "full blooded" professionals in the Nigerian Insurance industry. It does appear more glaring by the day that the shortage of qualified and skilled technical resources in the industry is having a great effect on the ability of insurance institutions to uphold the tenets of the practice of the trade. I dare say that the influx of ***"charlatans"*** into management positions in our insurance industry is one of the more considerable risks to the overall stability of the industry and future viability of the Nigerian insurance industry.

This assessment cuts across all segments of the market; Carriers and Intermediaries alike.

On the intermediary side of the business, the focus obviously is on ***"trying not to be broke'***so in most instances, it comes across that the brokers are more concerned on getting the lowest rates, premiums outlay and securing their appointments than on the security of their client placements and service delivery of the selected carriers. Even more disturbing is the lack of proper evaluation of client risks and the determination of the best "fit for purpose" solutions in proposals to clients as these are sacrificed on the altar of expediency. ***Brokers need to realize that a collective loss of credibility in the market by external players does not benefit the market and the reaction of the international reinsurers will remain negative to this trend.***

The insurers who traditionally as the risk carriers are expected to harp on the need for proper evaluation of risks and technical underwriting of risks, have also not been coming to the table in this regard. As I see it, the insurance companies are suffering from a lack of proper mentorship programmes and technical training of underwriting staff and in cases where there is technical competence seems have to bowed to "***other commercial considerations'***.

It is clear that the short term outlook of most market players in the current turbulent economy is **survival first** however this comes at a cost with the long term viability of the industry at risk, reinsurers have over time had to bear the brunt of the lack of prudence of local insurers and the reinsurance markets have recently been more stringent in term proposed to the Nigerian market.

We see this at the treaty renewal sessions with the reinsurance market imposing even more stringent terms for renewal of existing treaties and declinature of proposals for new lines for new emerging risk areas which should naturally been areas of growth for the industry especially with the maturity of the "traditional lines" and diversification of portfolio which are essential ingredients to the overall stability of the insurance industry.

The 2015 -2016 reinsurance renewal approaches to the international markets were difficult with terms such as punitive rates, increased loss participation, sliding commission rate and refusal of automatic cession of fac acceptances on to treaties being imposed on the local market.

The process is not going to get easier going into the 2018 renewal treaty sessions

Let me state for emphasis that poor risk evaluation, pricing and selection of acceptances by insurers poses a greater risk to the stability of the market than any other risk hitherto identified or discussed above. WE ARE, WHAT WE UNDERWRITE!!!!!

ACHIEVING AND SUSTAINING INSURANCE INDUSTRY STABILITY

An industry-wide basis, we will need to reappraise the technical underpinnings of the practice of our profession and our reinsurance arrangements to reduce the risks of accumulation / risk concentration within the reinsurance markets patronized by the market.

We also need to reappraise our professional technical training framework and institute a more comprehensive "hands-on" mentoring strategy coupled with succession planning within our various organizations.

- The competition between insurers should rightly be on the basis of product differentiation and service delivery and not necessarily on price as price based competition results in cash flow underwriting even a soft market where the broker seeks to have the benefit of better pricing felt the client.
- Redefinition of the competition strategy of insurance companies to focus more on differentiation in terms of products and service delivery standards including ease of accessing each company's products and services and likewise payments for same despite shareholder pressures is a must going forward.
- When we take a comprehensive look at the emerging risks frontier, we find a great deal of opportunities waiting to be explored, Kidnap and Ransom, Cyber liabilities, Bespoke Financial institutions cover, Political Risks & Terrorism cover and Personal Insurance covers but for the market is able to take advantage of these opportunities, a fundamental change in the management approach and attitude of the leadership of the industry must happen because international reinsurance market will not support any venture into these emerging risk areas based on the less than satisfactory outcomes of the current "traditional market" structure.

More compelling perhaps to consider, in this discussion, is the issue of how structure of industry and the basis of the regulatory framework and capital requirements for insurance companies in Nigeria.

- Do we need to proceed faster towards the adoption of a risk based operational framework alia Basel 1 or 2 type framework and free up more capital for investment and growth from the Insurers statutory deposits which are currently under utilized and to all intents and purposes idling away with the Central Bank of Nigeria ?
- Do we need to consider global emerging trends in the areas of alternative risk transfer mechanisms and securitization of risks, the introduction of CAT Bonds and partnering with other players in the financial services industry including the role of emerging digital currencies such Bitcoin in our investment and service delivery space?
- What will be required to enable us take advantage of the over USD $80 Billion currently under management within the international captive market with the introduction of rules for local captives and managed cell captives and what will be overall impact of same on stability of the Nigerian Insurance market?
- Do we need now require competence testing and confirmation for our company leadership to ensure more prudent management of insurance assets or
- Do we jettison the current regime of self regulation for a strict imposition of prudential guidelines and underwriting standards as we see emerging on the West African Coast in places like Ghana e.t.c?
- Do we need to consider the introduction of risk modeling tools to guide our rating and risk pricing as is obtainable in the reinsurance market?

I remain convinced that self regulation is still the best alternative for us as an industry but perhaps it is time for a limited regulatory intervention in our industry with the regulator determining minimum rates and maximum discounts regimes for wide application in the market in the short term to help curb some of the problems identified above.

This issues, I assume will be addressing further in the next segment of this session and again, I appeal for your candid opinions and thoughts on these posers.

CONCLUSION

Conducting business in Nigeria is tough and very competitive at the best of times. With the economic difficulties currently being experienced, it is unlikely to get any easier.

The penalty for acting slowly is unforgiving and hits very quickly as many businesses would have experienced It is critical that insurance industry executives take decisive and proactive steps early to stay ahead of the curve.

Adapting some of the measures outlined above, will stand your business in good stead to overcome some of these challenges, and emerge from it stronger and better positioned for the future whilst ensuring greater stability in the Nigerian Industry.

It is self evident from our discussion so far that there are many issues which need resolution before we can achieve real stability in the Insurance industry, most importantly however is that we will need to reexamine our professional conduct as industry professionals and leaders.