CORONATION
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From the Lagoon to the Ocean

2019 Nigeria Insurance Industry Report

Nigerian Insurance Industry

From the Lagoon to the Ocean

The industry that got left behind

Nigeria's insurance industry has not shared in the growth experienced by other Nigerian financial services, notably banks, pension funds and mutual funds. In fact, it has hardly grown in real terms over 10 years. Without scale, the industry suffers from poor returns on equity.

Yet its smallness is also its opportunity. If it were to grow to the level reached by countries with similar GDP per capita, it might grow by a factor of 10 times in real terms in eight-to-10 years. The technological infrastructure and data necessary for expansion are largely available.

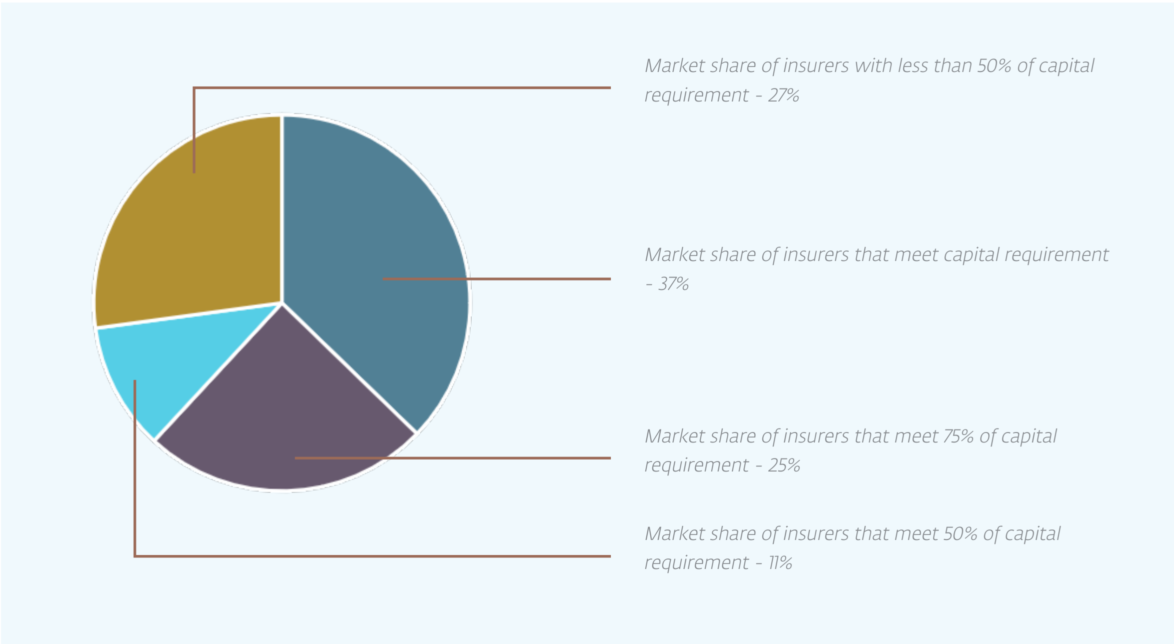
Re-capitalization, mergers & acquisitions

The National Insurance Commission (NAICOM) is imposing steep new capital requirements, due in June 2020. We believe these will reduce the current 59 companies to around 25. There are close parallels with the banking reform of 2004. The banking industry grew rapidly after that, so the question is how the insurance industry can grow after 2020. In the meantime, there will be capital raising and M&A.

The route to growth

Lessons learned in Asian markets, and also in West Africa, show how insurance can be rolled out to tens of millions of customers. Cooperation between regulators is critical, as are distribution partnerships with banks and telecom companies. Fresh capital is necessary for development, but a fresh strategic approach is required to reach the industry's potential.

INSURANCE COMPANIES' INITIAL STANDING RELATIVE TO NAICOM'S NEW CAPITAL REQUIREMENT



Source: Companies, Coronation Research. For constituents and details see Appendix I

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Executive summary

The best investment case in Nigeria?

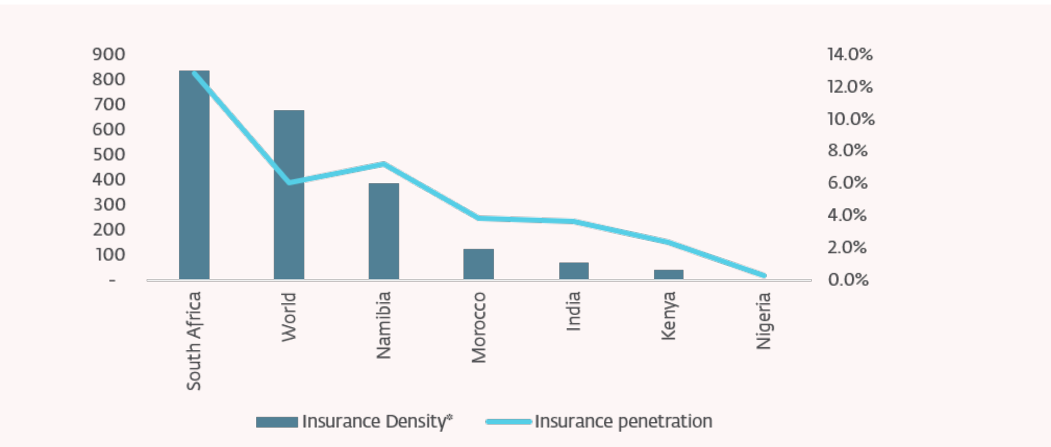
Nigeria's insurance sector presents perhaps the most remarkable investment case of any industry in Nigeria. At one level the business case is very simple. Insurance penetration, at 0.31%, is extremely low, even compared with countries with similar GDP per capita, for example India with insurance penetration at 3.69%. Experience in other countries shows that, in the right conditions, insurance can be rolled out to India's level in eight to 10 years. So Nigeria could go from 0.31% penetration to 3.69% penetration in 10 years.

The banking sector precedent

Is this far-fetched? Note that our investment case does not require Nigeria to become any richer. A 10-fold increase in real terms over 10 years means a real-term compound annual growth rate (CAGR) of 25.9%. Nigeria has seen this happen before. This is the same CAGR achieved in gross customer loans by Nigeria's banks (actually, 27.9%) in the five years after the banking reform of 2004. To take a more modest and recent example, the real-term CAGR for total assets under management in Nigeria's pension funds was 9.8% 2008-18, or 155% growth in real terms over 10 years. Nigeria is no stranger to financial services development.

Insurance reform – new capital requirements

The banking reforms of 2004 imposed steep new capital requirements and reduced the number of banks from 89 to 25. Insurance reforms in 2019, and due for implementation by June 2020, also impose steep new capital requirements. They are likely to reduce, in our view, the number of Nigerian insurance companies from 59 to a figure around 25. Higher capitalisation increases underwriting capacity and the potential exists to roll-out a much bigger industry than currently exists.



Insurance density* (lhs) and insurance penetration** (rhs)

*Source: Swiss Re Global Insurance Report 2018, Coronation Research *Annual US dollar Gross Premiums per capita **Total industry Gross Written Premiums divided by GDP. Nigeria's data point for insurance density is US$6.0 per capital and for insurance penetration is 0.31%.*

Historically a laggard

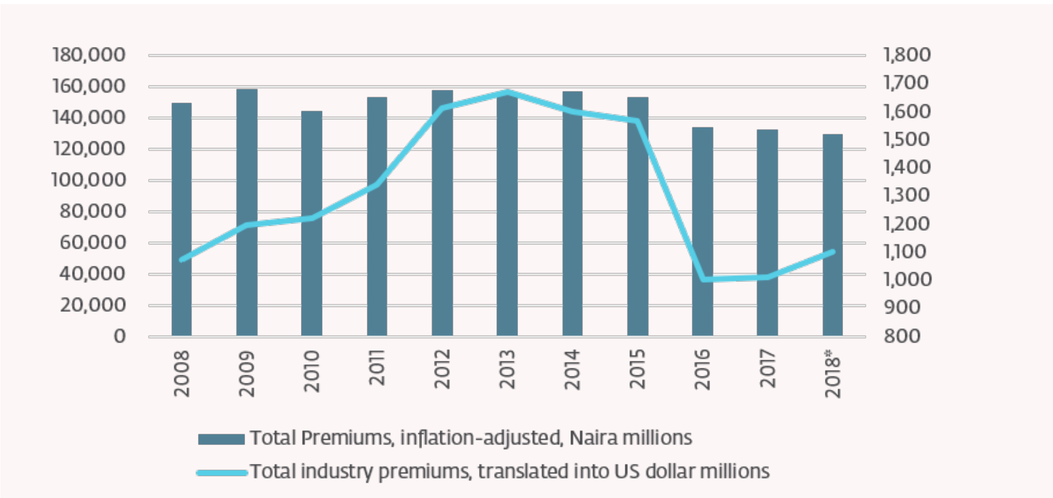
So far Nigeria's insurance industry has lagged its other financial services. Conditions have not been helpful for growth. Experience from other markets, particularly in Asia, suggest three remedies. First, government and regulators – not only insurance regulators but bank and telecom regulators, too – need to cooperate: there are gains for all. Second, the roll-out of micro-insurance with the development aim of financial inclusion, is key to familiarising and educating the market. Third, technology plays a key role in partnerships and distribution.

Knowledge already gathered

How will these experiences be transferred from Asia to Nigeria? The answer is simple. The same companies which have enjoyed success in Asia, and rate the region as their key growth zone, are investors in Nigeria. Axa bought Mansard Insurance in 2014 and Allianz bought Ensure in 2018; they are among six global insurance companies, including Prudential of the UK, present in Nigeria.

The technology already exists

Objectors to our investment case might say that the distribution channels for rolling out insurance in Nigeria are not there. We say they exist but have not been deployed yet. In recent years the issuing of bank verification numbers (BVN) and SIM card registration have created significant levels of personal data. Already, in Lagos, traffic police use number-plate recognition to check motor insurance cover. Whereas some Nigerian insurance companies are set up to process tens of thousands of customers, the technological platforms and the customer data exist to service tens of millions.



Total inflation-adjusted Gross Premiums, Naira millions (lhs) and total Gross Premiums translated into US dollar millions (rhs), 2008-18

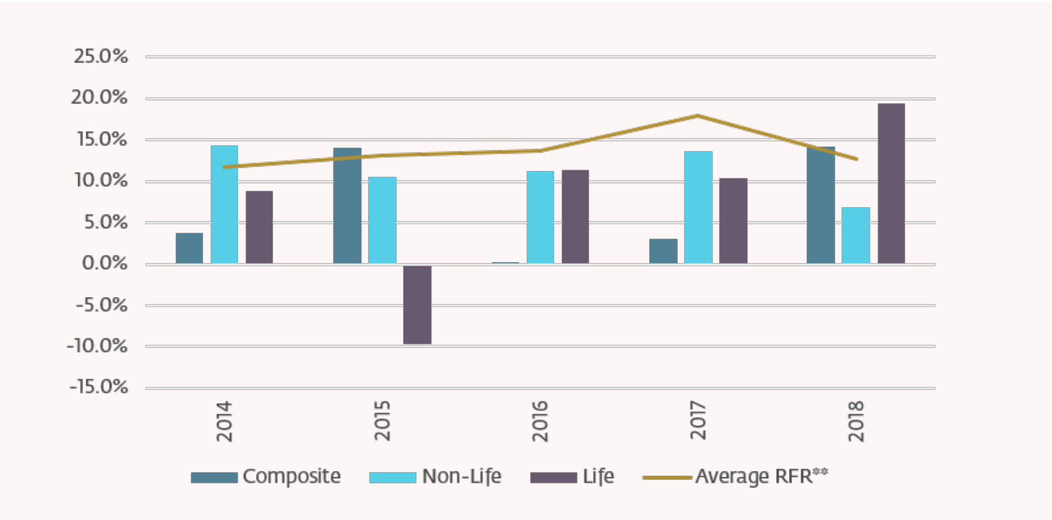
*Source: Nigerian Insurance Digest, National Bureau of Statistics, Bloomberg, Coronation Research. *2018 data is from press sources, and 2018 Gross Premium Written of N400 billion is inflation-adjusted. Naira/US dollar exchange rate at average of interbank market rate in each year*

Capital and the regulator

Nigeria's insurance companies are being asked to put up significant levels of new capital. Given that most of the insurance industry returns less – in terms of return on equity - than the risk-free rate, let alone its cost of capital, extra capital – other things being equal – implies lower returns. However, a recapitalised industry consisting of fewer players might ask more of its regulator, the National Insurance Commission (NAICOM), in terms of industry development and will likely have sufficient capital for growth.

From the stagnant lagoon to the blue ocean

NAICOM's reforms address an industry that today is small, fragmented and not very profitable. In inflation-adjusted terms, and in US dollar terms, it has barely grown over the past ten years. Of course, it could continue to stagnate in the years to come but that would: a) be a waste of the capital being raised to meet the current regulatory initiative; b) frustrate the experience of strategic investors (domestic and foreign); c) leave existing technology unused; and d) allow Nigeria to fall further behind its peers. On the other hand, given fresh capital and renewed regulatory cooperation, the industry can leave the stagnant lagoon and make waves in the blue ocean.



Average* sub-sector RoEs and average risk-free rate**.

*Source: Companies, Coronation Research. *Simple average sub-sector (i.e. Composite, Non-Life and Life) RoEs for 28 companies featured in this report. **Risk-free rate (RFR) is given as the average 1-year T-bill yield at auction in each year. N.B. the data point for Composite companies in 2016 is 0.2% but is not visible in the chart*

NAICOM reform - strategic implications

NAICOM reform - strategic implications

From 59 companies, start to think of around 25 companies

In May this year the National Insurance Commission (NAICOM) issued a circular requiring steep increases in the minimum paid-up capital for insurance and reinsurance companies by 30 June 2020. This circular followed a 2018 circular that attempted to re-define the capital levels of insurance companies in terms of Solvency Capital (SC). For our assessment of 2018's circular see Coronation Research: *Nigeria Insurance Industry, winners, losers & NAICOM reform*, 9 November 2018. To cut a long story short, the 2018 circular was challenged in court and was later withdrawn. It was argued that tiering activities as a way of authorising insurance companies was not founded in statutes.

NAICOM's May 2019 circular: minimum capital levels, Naira billions

Class of Business	Existing Capital Requirement	New Capital Requirement
Composite Insurers	5.0	18.0
Non-Life Insurers	3.0	10.0
Life Insurers	2.0	8.0

Source: National Insurance Commission (NAICOM), Coronation Research. N.B. recent Naira/US dollar exchange rate is N360.00/US$1, so N10.0bn is US$27.8m, for example.

In this section we assess what NAICOM's May 2019 circular implies for insurance company strategy. What follows is, emphatically, not legal advice and in respect of the legal implications of NAICOM's May 2019 circular we recommend readers refer to their own legal counsel. Our assessment is only offered in order to discuss the strategic implications of NAICOM's May 2019 circular for the industry.

It may be that NAICOM can refer to Insurance Act 2003 when demanding that insurance companies adhere to its minimum levels of capital (as opposed to SC). The act stipulates, in Part III, 9, (1), various minimum levels of capital for Life, General (i.e. Non-Life), Composite and Reinsurance businesses and then states (Part III, 9, (4)):

"The Commission may increase from time to time the amount of minimum paid-up share capital stated in subsection (1)."

An important point, in our view, is whether NAICOM's circular of May 2019 refers to just paid-up capital (which is what is says) or whether paid-up capital may include retained earnings. The Insurance Act 2003, in Part III, 9, (1b), states that paid-up share capital:

"may be subscribed to by the capitalization of undistributed profits as approved by the Commission."

Indeed, a NAICOM circular dated 23 July 2019, clarifying the original circular published in May, defined as admissible capital the following: paid-up capital plus share premium account plus undistributed earnings, plus payment-in-kind for new shares. It also stated that any of its requirements for capital may be achieved through mergers and acquisitions. It stopped short of admitting reserves as part of capital, which may be significant as reserves (including revaluation reserves) are sometimes included in total shareholders' funds.

Strategic implications of the circular of May 2019

30 June 2020 sets a challenging deadline for the industry with significant implications for mergers, acquisitions and capital raising. On the other hand, and given the experience of last year's circular on minimum levels of SC, we should not rule out the possibility of the May 2019 circular being modified through consultation, or deferred, and/or amended, or even challenged.

However, insurance companies cannot rest. A further NAICOM circular of 23 July 2019 instructed all insurance companies to submit to NAICOM, by 20 August 2019, details of how they will comply with its new capital requirements. In cases where they fall short of capital requirements, they were obliged to inform NAICOM of:

- Capital-raising plans; and/or
- Merger & acquisition plans.

To give readers an idea of how far-reaching NAICOM's capital requirements are, we examine their potential effects on Composite Insurers, Non-Life (i.e. General) insurers and Life Insurers, below.

Theoretical impact of NAICOM's May 2019 circular on Composite Insurers, Naira millions

Naira (Millions)	Minimum Level in New regulation	Paid up Share Capital + Retained Earnings	Initial Pass/ Fail
Leadway Assurance	18,000	29,969	Pass
AIICO Insurance	18,000	7,768	Fail
AXA Mansard Insurance	18,000	14,956	Fail
Cornerstone Insurance	18,000	9,312	Fail
LASACO Insurance*	18,000	5,792	Fail
NSIA Insurance**	18,000	7,564	Fail
Standard Alliance*	18,000	13,940	Fail
Great Nigerian**	18,000	5,024	Fail
Niger Insurance*	18,000	4,661	Fail

*Source: Companies, NAICOM, Coronation Research. *Based on 9M 2018 financial results, **Based on 2017 financial results N.B. this table includes all the Composite Insurers for which we have information and excludes Industrial and General Insurance and Nicon Insurance. N.B. We asses the capital of insurance companies in terms of Paid-up capital, including share premium, plus retained earnings (i.e. undistributed profits) but excluding other reserves.*

As the above table shows, the potential impact of the May 2019 circular on the Composite Insurers could be drastic. We might see eight companies either seeking to merge or raise a considerable level of fresh capital. We can ameliorate this judgement by pointing out that two companies, Axa Mansard and Standard Alliance are not far from the required threshold, so a moderate level of future retained earnings or fresh capital might see them meet or exceed the capital threshold.

Note that this initial assessment is based on 2018 accounts where we have them, nine-month 2018 accounts or 2017 accounts where 2018 accounts are not available. We are presenting an overall impression of the potential impact of the May 2019 circular, and not an accurate and contemporary company-by-company guide.

In Appendix I we update the information in the above table with the recently-announced capital raising plans of some of the featured companies.

To make an accurate assessment of each company we would need to know: the impact of retained earnings on the companies at the end of 2019, and by Q1 2020; clarifications of and/or amendments to NAICOM's May 2019 circular between now and June 2020; the results of consultations between the industry and NAICOM; the results of possible court action between now and June 2020. We emphasise that our study presents an initial view of the impact of NAICOM's May 2019 circular.

Moving onto the top-ten (by Gross Premiums Written) Non-Life (also know as General) Insurers, the potential impact of the May 2019 circular would be almost as dramatic as on the Composite Insurers. We might see eight of the top 10 companies seeking to merge or raise fresh capital ahead of the June 2020 deadline.

Theoretical impact of NAICOM's May 2019 circular on top-10* Non-Life (General) insurers

Naira (Millions)	Minimum Level in New regulation	Paid up Share Capital + Retained Earnings	Initial Pass/ Fail
Custodian & Allied	10,000	9,803	Fail
NEM	10,000	7,628	Fail
Zenith General	10,000	19,963	Pass
Sovereign Trust	10,000	4,287	Fail
WAPIC	10,000	12,886	Pass
Allianz	10,000	8,599	Fail
Royal Exchange Gen**	10,000	6,214	Fail
Mutual Benefits	10,000	4,000	Fail
Consolidated Hallmark	10,000	3,324	Fail
Regency Alliance	10,000	5,130	Fail

*Source: Companies, NAICOM, Coronation Research. *Top 10 by Gross Premiums Written **Royal Exchange General Insurance, data based in 2017 financial results. N.B. We asses the capital of insurance companies in terms of Paid-up capital, including share premium, plus retained earnings (i.e. undistributed profits) but excluding other reserves.*

However, there are some important qualifications in terms of near-misses, or rather near-qualifications. NEM, Custodian & Allied, and Allianz come quite close to the required threshold and could – quite possibly – make up the difference with retained earnings or small capital increases.

In addition, among the smaller (outside the top-10) Non-Life Insurers, we identify Universal Insurance (with N8.8bn paid-up share capital plus retained earnings as at FY 2018) and Sunu Assurance (with N8.0bn paid-up share capital plus retained earnings as at FY 2018) as being close to the threshold. Retained earnings and/or small capital increases could take them over the threshold.

In Appendix I we update the information in the above table with the recently-announced capital raising plans of some of the featured companies.

Again, when it comes to the potential application of NAICOM's May 2019 circular to Life Insurance companies, the outcome appears to be radical. The table here presents the possible outcome for nine of Nigeria's 14 Life Insurance companies for which we have sufficient information.

Theoretical impact of NAICOM's May 2019 circular on Life Insurers, Naira millions

Naira (Millions)	Minimum Level in New regulation	Paid up Share Capital + Retained Earnings	Initial Pass/ Fail
African Alliance	8,000	24,658	Pass
Custodian Life	8,000	6,690	Fail
FBN Life Assurance	8,000	10,725	Pass
Mutual Benefits	8,000	5,609	Fail
ARM Life	8,000	5,587	Fail
WAPIC Life Assurance	8,000	4,796	Fail
United Met*	8,000	3,813	Fail
Royal Exch Prud**	8,000	3,866	Fail
Prudential Zenith Life	8,000	8,508	Pass

*Source: Companies, NAICOM, Coronation Research. *United Metropolitan Nigeria Life, data based on 2017 results, **Royal Exchange Prudential Life, data based on 2017 results. N.B. We asses the capital of insurance companies in terms of Paid-up capital, including share premium, plus retained earnings (i.e. undistributed profits) but excluding other reserves.*

Here the Life Insurance companies that pass the threshold, based on paid-up share capital plus retained earnings are African Alliance, FBN Life Assurance and Prudential Zenith Life Insurance. Custodian Life Insurance, Mutual Benefits Life Insurance and ARM Life Insurance come close to the thresholds, in our view.

In Appendix I we update the information in the above table with the recently-announced capital raising plans of some of the featured companies.

How this may play out

Consolidation is the obvious lesson to draw from the three tables above. Whereas NAICOM's intent could be to remove a number of small and weak companies from the industry, its May 2019 circular implies the reduction of the total number of companies in the market from 59 to, perhaps, around 25. This would reproduce the effect of 2004's banking reforms which reduced the number of banks from 89 to 25.

If the industry is convinced that these proposals will be implemented, then a wave of mergers and acquisitions (M&A) is set to take place. Because we have been able to access data on just 28 (mostly the stronger ones) of Nigeria's 59 insurance companies we think that the degree of industry re-organization is likely to be more extensive than implied by the data presented here.

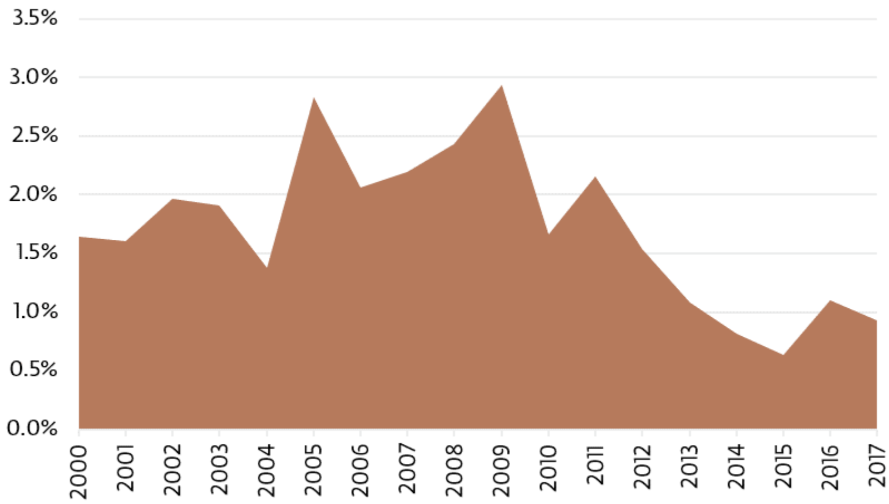
Every capital raising operation and every M&A deal requires an investment thesis. The key point is whether investment at this stage will justify itself in shareholder returns given the recent growth characteristics and shareholder returns of the industry. We argue that the key element – which has been lacking over the past ten years – is growth. Only with significant future growth can the recapitalisation of the industry be justified.

Capital – the banking sector precedent

NAICOM's 2019 circular and Nigeria's 2004 banking reform

NAICOM's current reform of the insurance industry shares essential features with the 2004 reform of the banking industry under Professor Charles Soludo, then Governor of the Central Bank of Nigeria (CBN). Just as NAICOM appears to seek consolidation and an overall reduction in the number of players through stringent capital requirements, so too did the CBN in 2004.

The result of 2004's banking reform was to reduce the number of banks from 89 to 25. As we have already argued, 2020 could see the number of insurance companies fall from 59 to around 25. If some insurance companies are actually eliminated rather than consolidated by this process, then the survivors will enjoy market share gains. The banking sector enjoyed a boom after 2004, so the question is how the insurance industry will grow after 2020. Note that economic conditions between 2005-08 were different from today, with rising oil prices bringing in a very high level of foreign direct investment from which banks benefited, sometimes directly.



Nigeria, Foreign Direct Investment as % of GDP

Source: World Bank, Coronation Research

However, as with banks after 2004, there exists the opportunity for a re-capitalised insurance industry to make enormous gains from 2020 onwards, not only in terms of expanded underwriting capacity but also (as was the case with banks after 2004) by attracting millions of new accounts. As already mentioned, Nigeria's insurance penetration, at 0.31%, is less than one tenth of that of India (with similar GDP per capita) which suggests significant un-tapped potential. The business opportunity exists because of Nigerias's very low bases in insurance penetration and insurance density.

The key challenges to realising the industry's potential, beyond financial recapitalisation, are customer education and customer acquisition, which we discuss in detail later in this report. Whether the insurance industry follows the very steep trajectory of the banks in the post-reform period 2005-09, or the more modest (but still rapid) growth pattern of the pension fund industry 2008-18, investors in the industry can point to precedents where financial services enjoyed rapid growth in Nigeria.

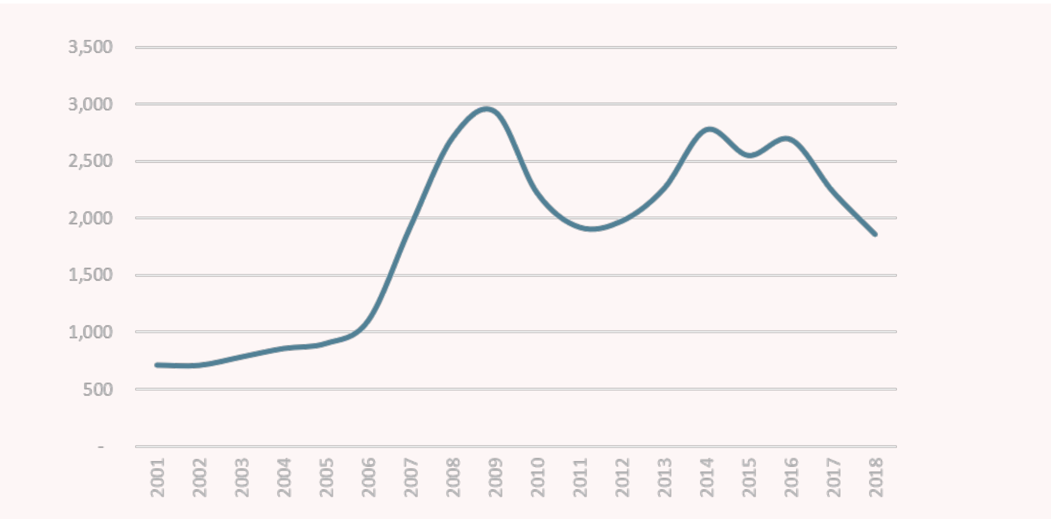
The Soludo Reforms of 2004

On 1 January, 2005, after the CBN's deadline for banks to raise minimum capital from N2bn to N25bn (US$190m at the time) had passed, 25 banks met the recapitalisation level reducing the number of banks from 89. The fate of the 89 banks was as follows:

- 50 banks entered into combinations, ranging from a merger of two banks to a merger of nine banks;
- A small number survived as stand-alone entities;
- 14 banks failed to meet the new capital requirements;
- Of these 14 banks 11 were liquidated while the remaining three were put under the management of the CBN.

Prior to the consolidation exercise confidence in the banking system was very low; assets of all the banks put together were smaller than those of the fourth-largest bank in South Africa; and none of them was in the top 1,000 banks in the world. Before the reforms, if any private-sector entity needed a loan of US$500m, it had to syndicate it from all the banks put together, or go abroad. Barely a year after the consolidation 14 Nigerian banks were ranked among the top 1,000 in the world, and in 2008 two of them were in the top 300. The banks were funding projects worth hundreds of millions of US dollars in oil & gas, manufacturing and infrastructure.

The Nigerian banking system hit the rocks in 2009, as many of the world's banks had done the year before. However, the success of 2004's reforms can be seen, both in 2004-09 data and in a longer series 2004-2018 data.



Total bank sector loans*, Naira billions, in 2001 prices

*Source: Central Bank of Nigeria (CBN), National Bureau of Statistics (NBS), Coronation Research, *Loans and advances excluding public sector loans*

In real terms banks' customer loans grew at a compound average growth rate (CAGR) of 27.9% 2004-09 and 5.7% 2004-18. There is no doubt that the reforms led to a period of rapid growth.

This contrasts with the insurance industry, which has seen hardly any real-term growth over the past 10 years. We examine this next.

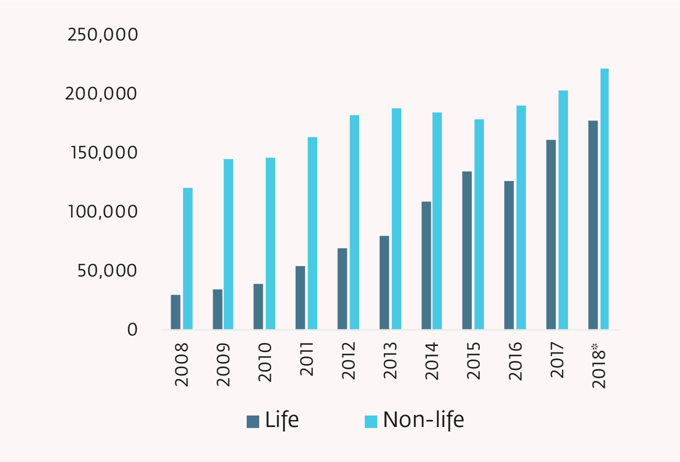
Growth - the industry that got left behind

Growth - the industry that got left behind

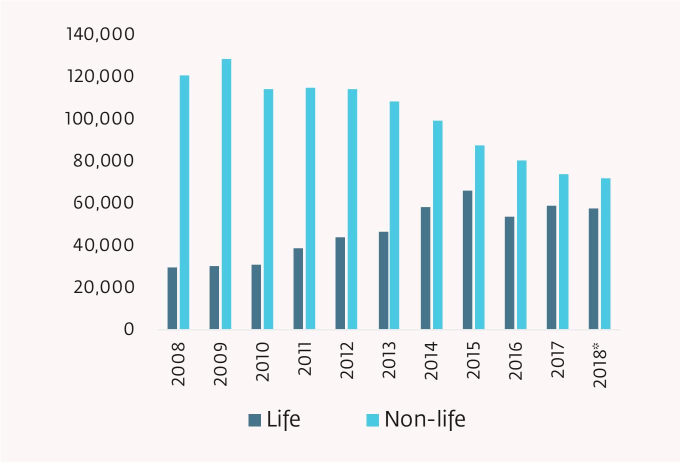
Historically, almost no real-term growth

Is Nigeria's insurance industry growing or contracting? Although the total Gross Premiums of the Nigerian insurance industry appear to be growing this is only true in nominal terms (see chart below, left). When we adjust Gross Premiums for average annual inflation over the past 10 years, a different pattern emerges (right). In real terms total industry Non-Life Gross Premiums declined at a 10-year CAGR of 5.0% 2008-18e, while Life Gross Premiums grew at a 10-year CAGR of 7.0% over the same period.

Industry Life and Non-Life Premiums, nominal Naira millions



Industry Life and Non-Life Premiums, inflation-adjusted Naira millions



*Source: Nigeria Insurance Digest 2017, National Bureau of Statistics (NBS), Coronation Research, *2018 data is from press sources and broken down pro-rata between Life and Non-Life*

Taking the total Gross Premiums of Nigeria's Non-Life and Life insurance industries together, these fell at an inflation-adjusted 10-year CAGR of 1.4% 2008-18e.

In US dollar terms the nominal Non-Life Gross Premiums fell at a 10-year CAGR of 3.4% 2008-18e, while Life Gross Premiums rose at a 10-year CAGR of 8.9% over the same period. Taking the two items together, the total Gross Premiums of the insurance industry in US dollars rose at a 10-year CAGR of just 0.3% 2008-18e.

In other words, it makes sense to talk of the development of the Nigerian insurance industry as essentially flat 2008-18e, whether we look at it in inflation-adjusted or in US dollar terms. This is why insurance penetration in 2018 stood at a lowly 0.31%.

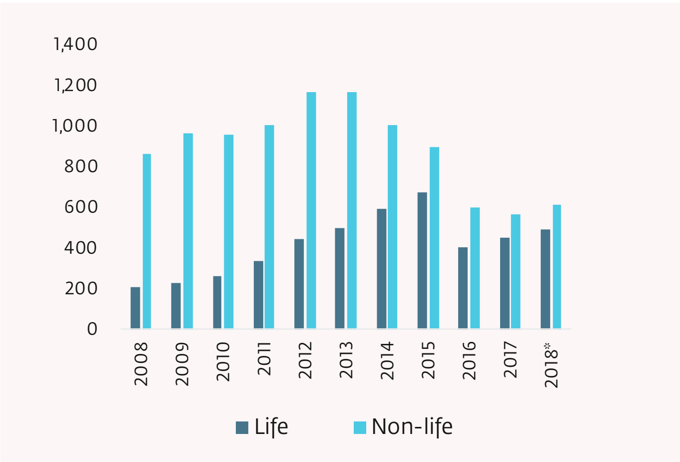
The different development paths of Life and Non-Life premium is of secondary importance, in our view. The rise of Life business has depended on the emergence of mandatory Group Life policies for employers and the regulator's recent (2018) intervention to hike minimum premiums when these were being competed away. Before plumping for Life Insurance as the future of insurance we recommend readers look at what we have to say about its loss ratios and profitability, below.

The result of a 10-year period of flat development means that insurance has missed out on the capacity gains made in commercial banking and pension funds, and even mutual funds management. It is a small industry which is one reason, when combined with its modest shareholder returns and retained earnings, why it requires fresh capital.

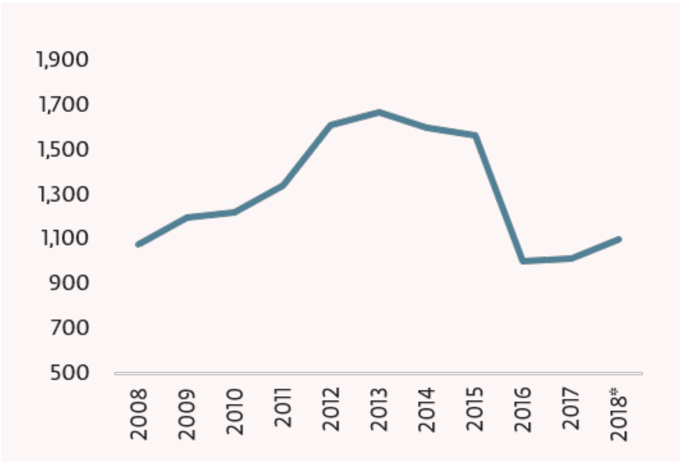
Insurance not yet part of financial inclusion

As we will see later in this report, Nigeria is able to create financial inclusion and thereby enrich people's lives through involvement in financial services. Thus far, insurance has not been included in Nigeria's financial inclusion story.

Industry Life and Non-Life Premiums, translated into US dollar millions

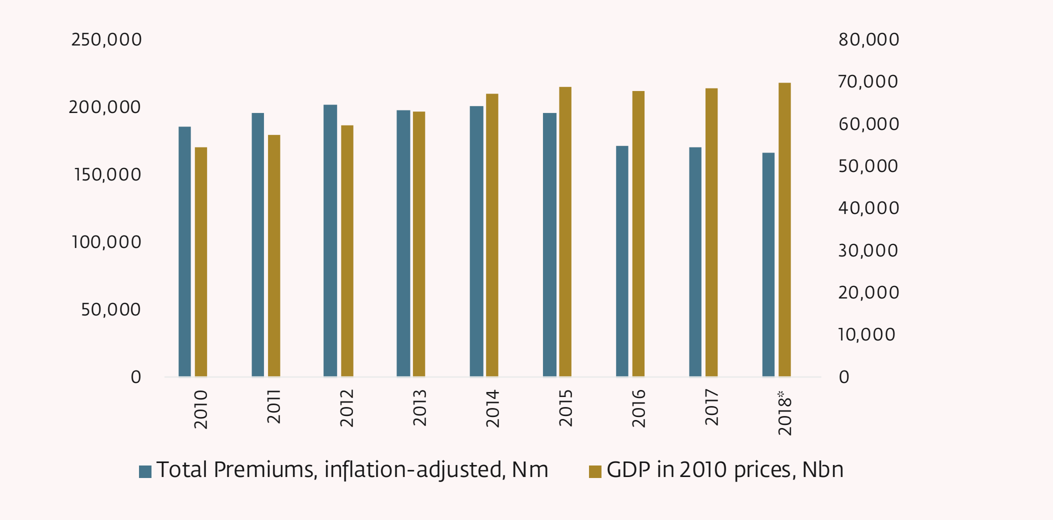


Total industry premiums, translated into US dollar millions



*Source: Nigeria Insurance Digest 2017, Bloomberg, Coronation Research, *2018 data is from press sources and broken down pro-rata between Life and Non-Life. N.B. Naira values have been translated at the average Naira/US dollar rate for each year provided by Bloomberg.*

Nigeria's total 2018 insurance premiums are reported at N400bn (US$1.1bn) compared with nominal GDP of N129.1trn, thus 0.31% of GDP. In comparison, a country like India with similar US dollar GDP per capita to Nigeria has an insurance industry equivalent to 3.69% of its GDP. We examine India's successful drive for insurance later in this report.



Total premiums, Naira millions (lhs) vs Real GDP, Naira billions (rhs)

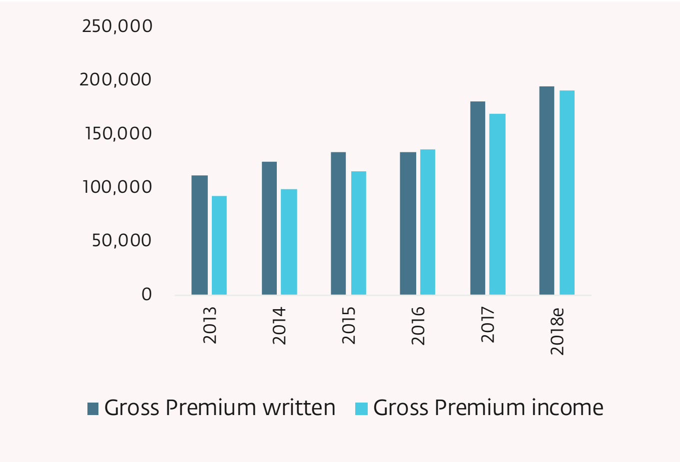
*Source: Nigeria Insurance Digest 2017, Coronation Research, NBS, *2018 data is from press sources and broken down pro-rata between Life and Non-Life*

Recent pockets of growth

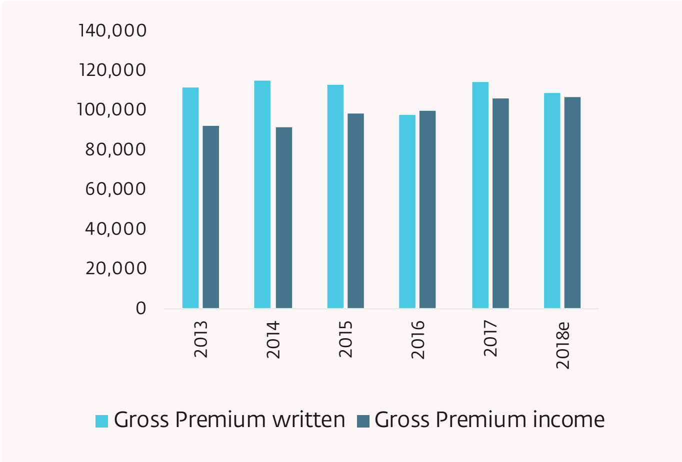
While it is correct to say that the development of the industry has been essentially flat over the past 10 years, this view needs to be refined. First, it is clear that the Life Insurance business was growing in real terms 2008-15 (see beginning of this section). This reflected the take-up of group life policies by companies in the formal sector.

Second, the recent period 2016-18 has seen some growth in real terms, though it came after a significant contraction in business in 2016. Third, the part of the industry which is expanding in real terms likely reflects gains in market share by the leading companies from the less successful companies, some of which have serious issues. In other words, a process of competitive selection during and after the recession of 2016-17 may be underway already.

Premiums of Composite insurers in nominal Naira millions



Premiums of Composite insurers in 2013 prices, Naira millions



Source: Companies, Coronation Research. Combined data for Leadway Assurance, AIICO, AXA Mansard Insurance, Cornerstone Insurance, Lasaco Insuranc, NSIA Insurance, Standard Alliance Insurance, Great Nigeria Insurance and Niger Insurance. We have used 9M 2018 data for Lasaco Assurance, Standard Alliance Insurance and Niger Insurance, and we use 2017 data for the 2018 results of NSIA Insurance and Great Nigeria Insurance while we await FY 2018 results. Thus our assessment of total 2018e data is likely to prove conservative.

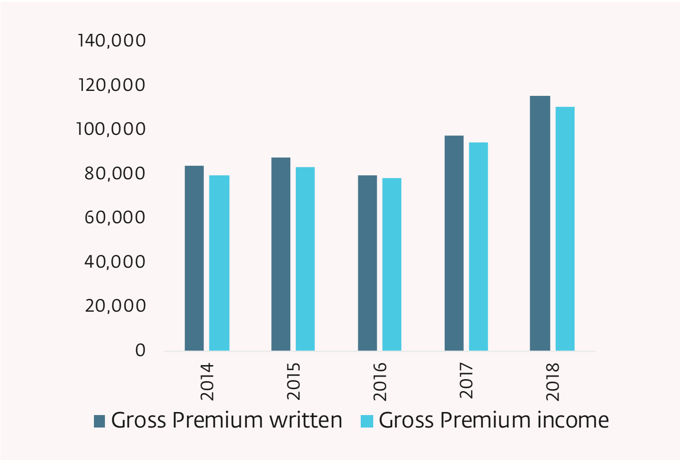
As the source note to the above charts makes clear, the data for 2018e is incomplete and our assessment, so far, of 2018e data is likely conservative. However, in inflation-adjusted terms Gross Premium Income for the eight Composite Insurers rose by 6.7% in 2017, and probably grew by more than one percentage point in 2018e. There are reasons to think that the Composite Insurance business model is resilient and that a business combination of Life and Non-Life companies in separate companies (almost the same thing as Composite) is resilient too.

While such moderate growth could be assessed as a satisfactory level of performance for the Composite Insurance sub-sector, it does little to address the explosive potential of an under-penetrated market, in our view. And, as we will see on the following page, the Non-Life insurance and Life insurance sub-sectors, taken individually, give little evidence of convincing growth. So, despite pockets of growth and some real-term growth in recent years, the industry remains small and stuck in a long-term phase of essentially flat development.

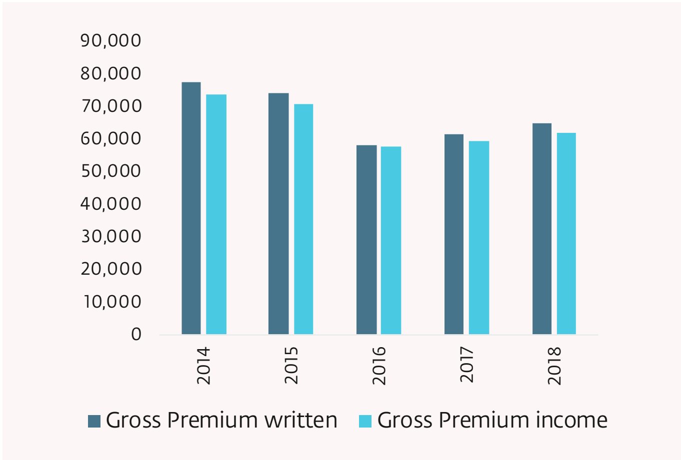
Recovery, rather than growth, among Non-Life insurers

While the Composite Insurers have shown a degree of recent growth, the leading group of 10 Non-Life Insurers has not done so well. Collectively these companies experienced a significant fall in business at the onset of the 2016-17 recession and have only begun to slowly climb out of it. In inflation-adjusted terms Gross Premium Income fell by 18.7% in 2016 and then rose by 3.3% in 2017 and by 4.4 % in 2018.

Premiums of top-10 Non-Life insurers in nominal Naira millions



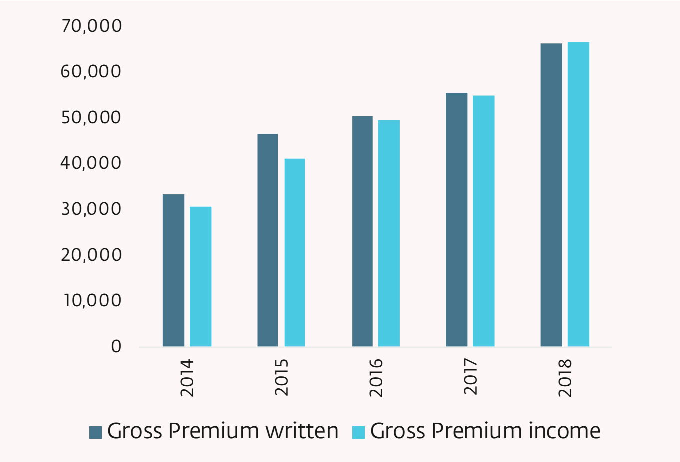
Premiums of top-10 Non-Life insurers in 2013 prices, Naira millions



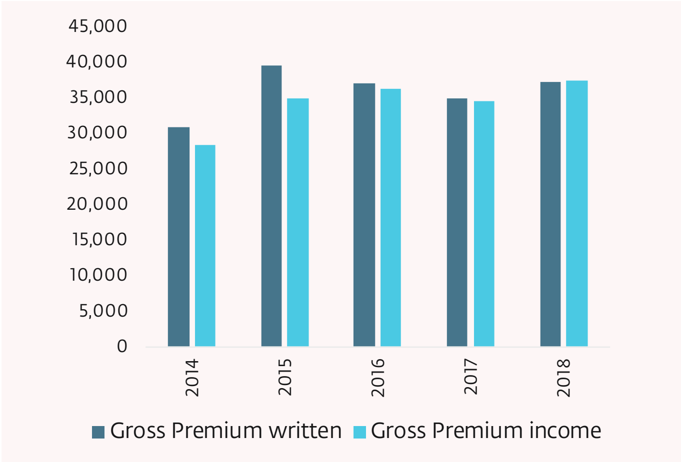
Source: Companies, NBS, Coronation Research. Combined data for Custodian & Allied Insurance, Mutual Benefits Insurance, NEM Insurance, Zenith General Insurance, Sovereign Trust Insurance, Wapic Insurance, Allianz Insurance, Royal Exchange General Insurance, Consolidated Hallmark Insurance and Regency Alliance Insurance.

The chart at the beginning of this section shows good inflation-adjusted growth for Life Insurers 2008-15, but essentially flat development after that. Currently, and given today's industry structure, growth is hard to come by.

Premiums of Life insurers in nominal Naira millions



Premiums of Life insurers in 2013 prices, Naira millions



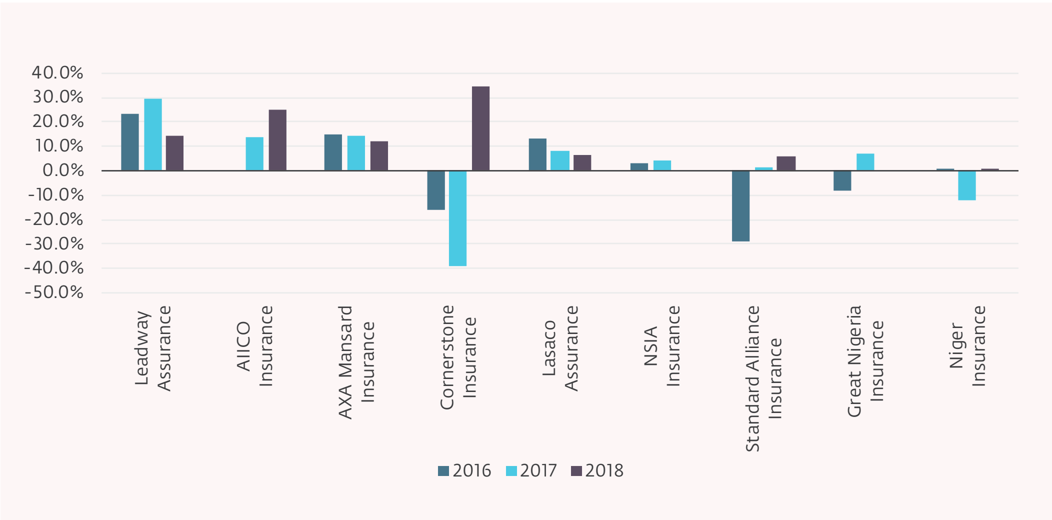
Source: Companies, NBS, Coronation Research. Combined data for African Alliance, Custodian Life, FBN Life Assurance, Mutual Benefits, ARM Life, Wapic Life Assurance, United Metropolitan Nigeria Life, Royal Exchange Prudential Life, Prudential Zenith Life.

Shareholder returns

Shareholder returns

Return on Equity - the industry struggles to meet its cost of capital

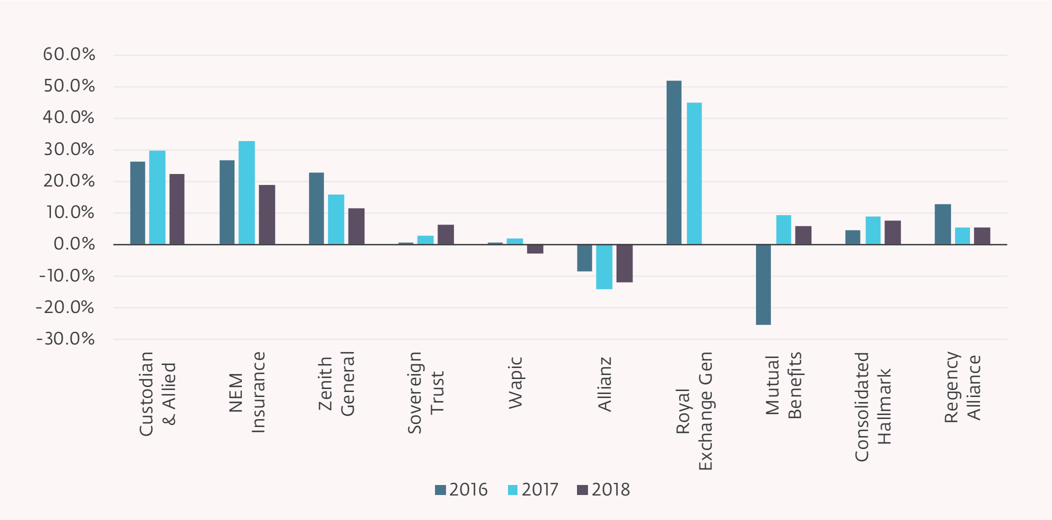
Later in this report we present, in three sections, our breakdown of the profitability of Nigeria's insurers. See: Profitability of risk transfer; Expense ratios; Combined ratios. In this section we present their overall post-tax profitability, namely Return on Shareholders' Funds, or Return on Equity (RoE). Recent history makes sorry reading. Few insurance companies match the risk-free rate, let alone their cost of equity.



Composite Insurers RoE

Source: Companies, Coronation Research. RoE is Net Profits divided by average total shareholders' funds. Excluding AIICO's 2016 RoE at 115.6%. Data for NSIA Insurance and Great Nigeria Insurance for 2018 not available. Niger Insurance's 2018 RoE in 2018 is measured at 0.2% (not visible in chart).

The simple average Composite Insurance RoE was 14.1% in 2018, compared with the year's average T-bill rate of 12.8%. The simple average Non-Life RoE (see chart below) in 2018 was 6.9%.

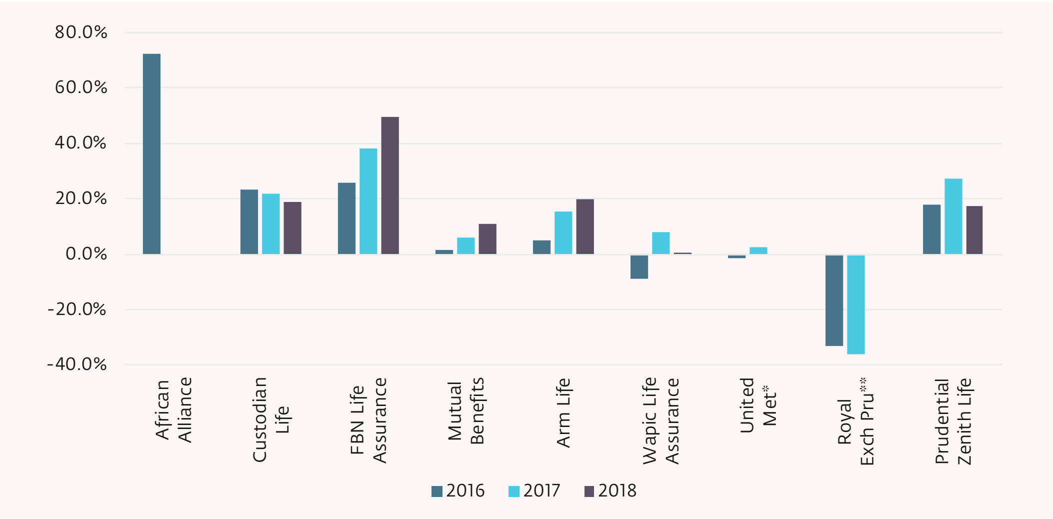


RoE of Non-Life Insurers

Source: Companies, Coronation Research. N.B. data for Royal Exchange for 2018 is not available. Sovereign Trust 2018 RoE in 2015 is measured at 0.5% and Wapic 2015 RoE measured at 0.6% (not visible in chart).

Return on Equity for Life Insurers is slightly superior

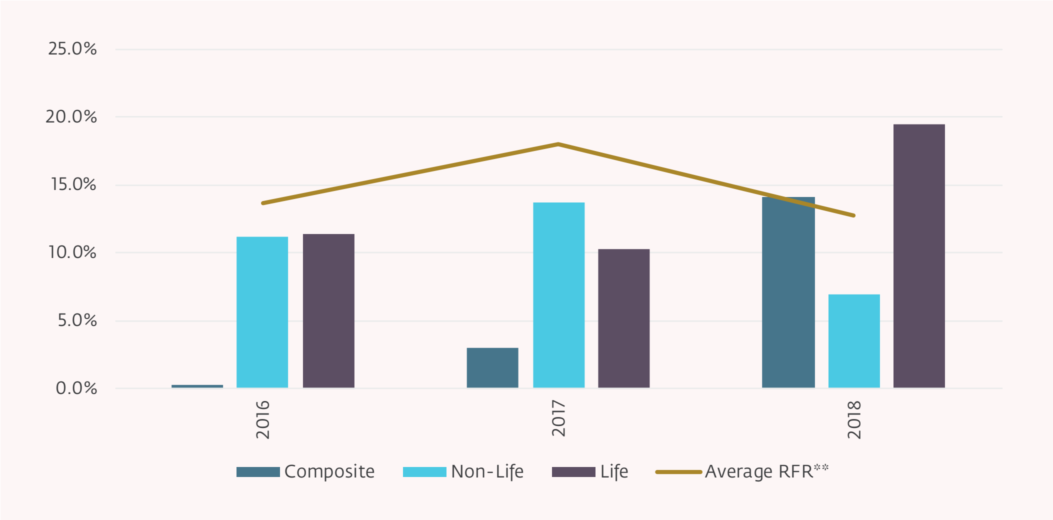
The simple average RoE of the Life Insurers covered here was 19.4% in 2018, better than the Composite and Non-Life companies, reflecting relatively low capital requirements.



Life Insurers RoE

Source: Companies, Coronation Research. RoE is Net Profits divided by average total shareholders' funds. Excluding African Alliance 2017 and 2018 RoE at -329.2% and -145.7%. N.B. Data for United Metropolitan Nigeria Life for 2018 and Royal Exchange Prudential Life for 2018 are not available. Wapic Life 2018 RoE measured at 0.1% (not visible in chart).

However, 2018 was a good year for Life Insurance companies (that year the regulator raised minimum premiums for group life policies). In 2017 the average RoE had been 10.3% and in 2016 11.4%. As the chart below shows, the industry's three sub-sectors seldom generate RoE above the risk-free rate. We estimate cost of equity at 20.0%.



Average* sub-sector RoEs

*Source: Companies, Coronation Research. *Simple average sub-sector (i.e. Composite, Non-Life and Life) RoEs for companies featured in this report. **Risk-free rate (RFR) is given as the average 1-year T-bill yield at auction in each year.*

Conclusions – economies of scale are needed

It is not surprising that the Nigerian insurance industry lacks profitability. We have already seen how, over the past 10 years, the industry has barely grown in real terms. One effect of lack of growth is that companies are unable to create economies of scale for their front and back office operations. When growth opportunities arrived, as we shall see in the section 'Profitability of risk transfer', the Life Insurers made the mistake of competing their premiums down to unsustainable levels in the rush to increase customer numbers, prompting the regulator to intervene with a new minimum premium level in 2018.

While lack of growth leads to excessive costs, low profitability creates another problem, namely lack of investment in technology. There are significant differences between the levels of automation among the different insurance companies featured in this report. But why invest in the technology to service tens of millions of customers when you only have tens of thousands, or even a few thousand? Without the prospect of a much larger customer base it may be difficult to persuade companies to invest.

NAICOM's reforms, therefore, are very significant, as the industry is being forced to raise capital. In return we believe it requires expansion to justify its new investment. As in banking and, as we shall see, the pension fund industry, Nigeria has a track record in rolling out financial services. In the next two sections we look at Nigeria's experience of financial inclusion and we consider insurance industry lessons learned in other countries.

Nigeria’s ability to increase financial penetration

Nigeria's ability to increase financial penetration

The development function of insurance

Imagine a family of six living in rural Nigeria: mother, father and four children. They are small-scale farmers, subsistent with a small quantity of cash crops and livestock. The children attend a state-run school in a nearby town while the parents work the fields and tend to their animals. Now imagine that one parent suffers a serious accident and loses a limb. The other parent, facing a doubling of his/her workload, withdraws the elder children from school to work on the farm. Their education is interrupted and their economic prospects – and those of Nigeria to a small extent – have been limited.

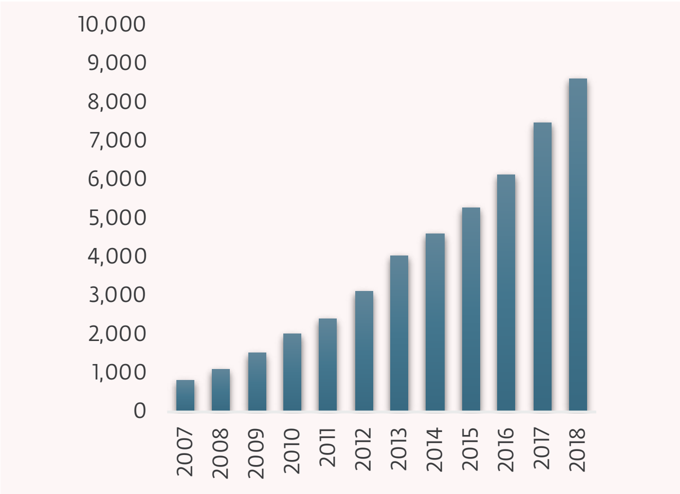
Following this logic countries such as India and Ghana (see next section) have rolled out micro-insurance as a key policy objective and have seen insurance take-up shoot up. Different countries distribute insurance in different ways, but the common goal is to create financial inclusion through mass – we mean tens of millions of people – roll-out of insurance products. This creates a safety net for households. Evidence suggests that the more varieties of micro-insurance that are offered, the greater their take-up.

Nigeria is good at rolling out financial products

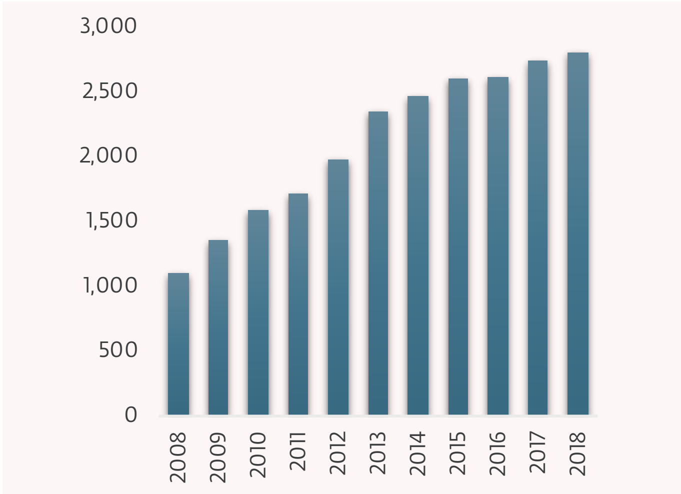
In this study we have shown that the Nigerian insurance industry did not grow in real terms 2008-18. Therefore, one might think that Nigeria, with a very uneven pattern of GDP growth during the years 2008-18, was not adept at creating financial inclusion. Yet this would be wrong: take-up of some financial products grew rapidly.

Take pension funds. The total assets under management of Nigeria's Pension Fund Administrators (PFA) grew, in nominal terms, at a CAGR of 22.9% 2008-18, which becomes a CAGR of 9.8% when we adjust for inflation. Even when Nigeria entered a five-quarter recession in 2016 there was a slight gain in real terms (0.5%), and the CAGR 2013-18 was 16.3% in nominal terms, 3.6% in real terms. In 2018 total PFA funds reached N8.6trn (US$24.0bn), equivalent to 6.7% of GDP and nearly equivalent to the entire annual budget of the Federal Government.

Total assets of Pension Fund Administrators in nominal Naira billions



Total assets of Pension Fund Administrators in 2008 prices, Naira billions

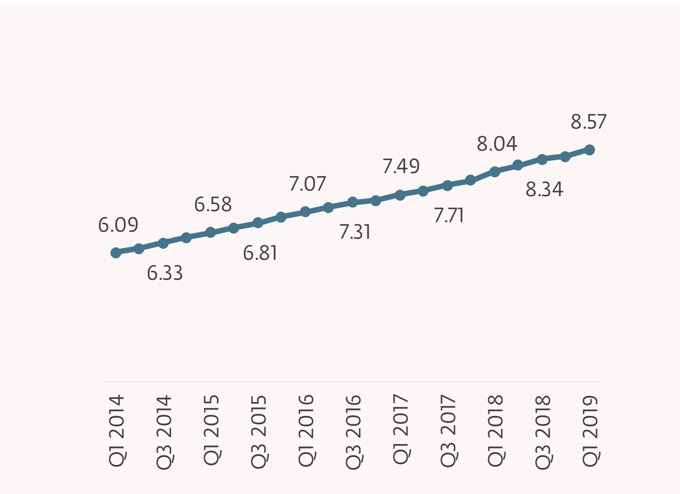


Source: National Pension Commission (PENCOM), National Bureau of Statistics (NBS), Coronation Research

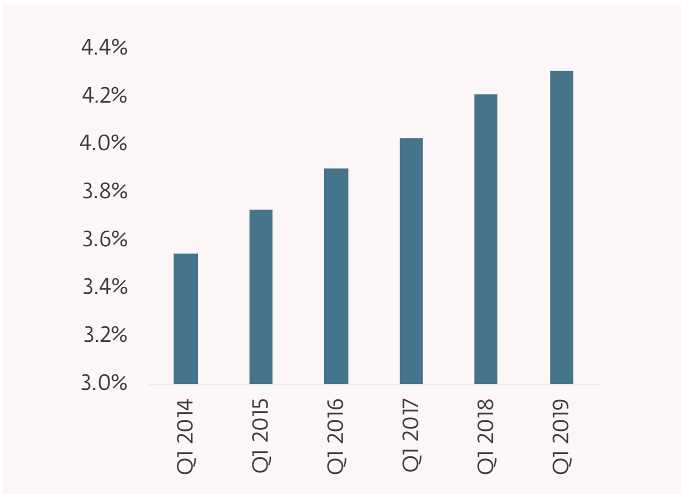
Actual number of pension fund account holders is rising

This would not mean much if the assets under management of Nigeria's PFAs were owned by a few people (or if the same number of people just saved more). But more and more people entered the system. The data we have, which admittedly goes back only five years, shows that the total number of retirement savings account (RSA) holders rose from 6.09 million in 2014 to 8.57 million in 2019.

Nigerians with Retirement Savings Accounts, millions

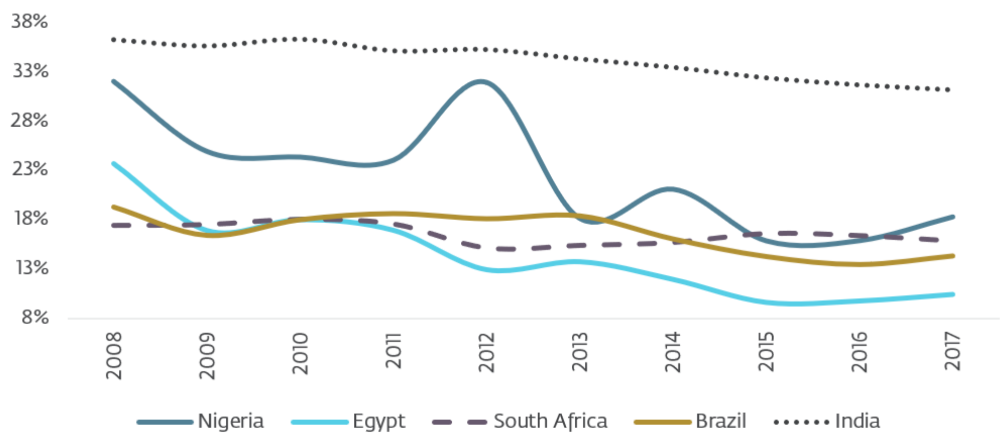


Take-up of Retirement Savings Accounts



Source: National Pension Commission (PENCOM), National Bureau of Statistics (NBS), World Bank, Coronation Research

Even this would not mean much if the increase in RSA holders only tracked the growth in the population as a whole. But taking RSA data and comparing it with population data shows that the take-up of RSAs rose steadily from 3.5% in Q1 2014 to 4.3% in Q1 2019. This is all the more remarkable when one considers that Nigeria's overall savings ratio, in common with other emerging and developing nations, has been falling.

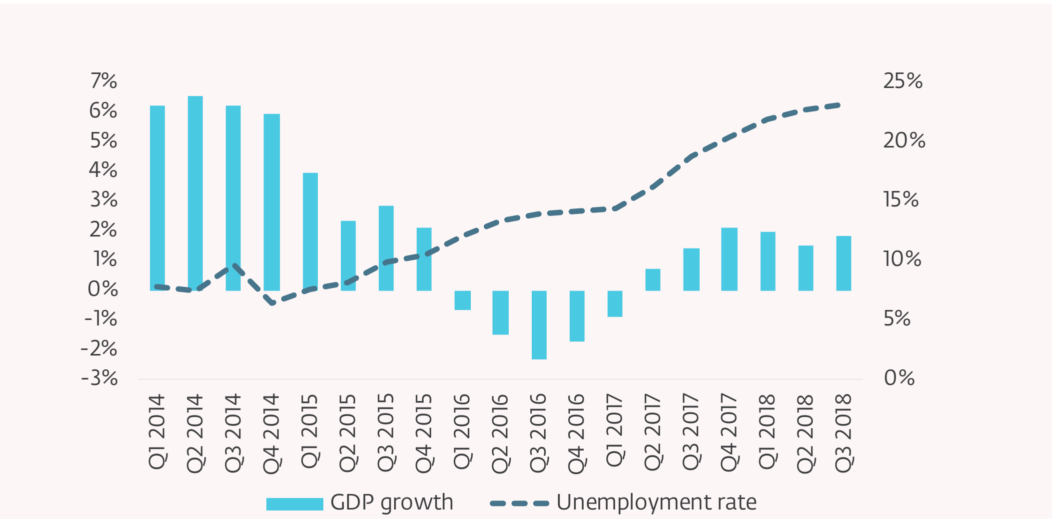


Savings ratios, selected nations

Source: World Bank, Coronation Research

Pension fund inclusion rises even as GDP development is uneven

The steady increase in PFA assets and RSA holders occurred against a background of low GDP growth and rising unemployment. Although the driving force was mandatory pension take-up in the formal employment sector, it shows that poor economic conditions are not unsurmountable when it comes to rolling out a basic financial service like pension provision.



Nigeria: GDP growth, y/y (lhs) and unemployment (rhs)

Source: National Bureau of Statistics (NBS), Coronation Research.

This may prove to be an important lesson for the roll-out of insurance and micro-insurance in Nigeria. After all, Nigeria's medium-term economic growth is generally forecast in a range of 2.0%-3.0% per annum and we do not expect foreign direct investment to replicate the high levels seen earlier this century. Therefore, there is no point predicating an insurance strategy on high economic growth, in our view.

The significance of the pension pot

Readers may have noticed that we are writing about the roll-out in pension provision and financial inclusion as related things. Financial inclusion frequently refers to a population's access to bank accounts and payment systems, but the term also includes pensions, savings, insurance and financial services generally.

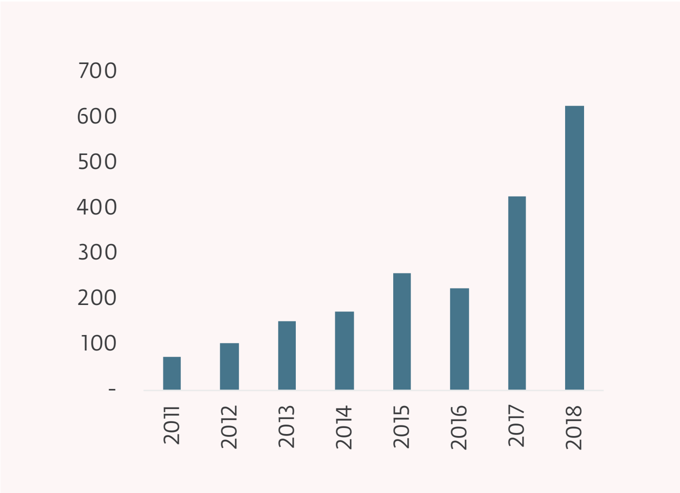
Nigerian pensions play a role in creating balance sheets for Nigerians. Contributions to an account consist of the employer's mandatory contribution, the employee's mandatory contribution, and may also include the employee's additional voluntary contribution. At retirement RSA holders are allowed to make withdrawals of lump sums. We have seen such withdrawals finance, or partly finance, house construction and purchases taxis. Pension funds create balance sheets for homes and businesses.

The roll-out of pension funds is, in many markets, associated with the rise of other forms of savings. In Nigeria we believe that informal investment clubs are one aspect of a growing savings culture. However, there is actual evidence of increased take-up of mutual funds alongside pension funds, which we show next.

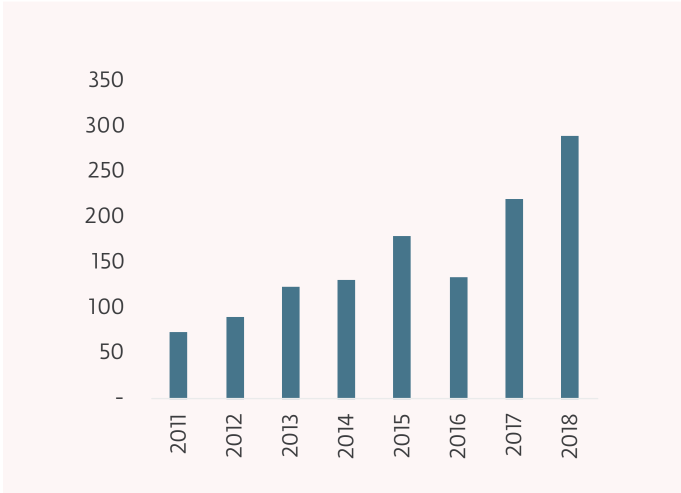
Mutual funds grow alongside pension funds

Mutual fund assets have been growing alongside pension funds. Naturally, and without the mandatory nature of pension fund contribution, total mutual fund assets are much smaller than total pension fund assets – they are equivalent to just 7.3% of the total pension pot. But these voluntary savings have been growing rapidly.

Total assets of Nigerian mutual funds, Naira billions



Total assets of Nigerian mutual funds, in 2011 prices, Naira billions



Source: Securities and Exchange Commission of Nigeria (SEC), National Bureau of Statistics (NBS), Coronation Research

The total assets of Nigerian mutual funds grew at a CAGR of 35.8% 2011-18, which becomes a CAGR of 21.6% when we adjust for inflation. Much of the growth has come in recent years due to the high rates of interest available from money market funds in 2017 and the early part of 2018. The five-year CAGR, 2013-18, when inflation-adjusted, was 18.5% compared with 3.6% for pension funds.

Conclusion

The most notable data from the above charts is that, in 2018, Nigerians voluntarily added close to N202.0bn (US$561.1m) to their holdings of mutual funds (admittedly a sum slightly inflated by accrued interest), roughly half the level of Gross Premiums purchased in the same year.

From this we conclude that it is not Nigerians' ability to spend or invest money that is the problem for Nigeria's insurance industry. It is much more likely that the real problem is lack of familiarity with insurance products combined with lack of faith in an under-capitalised insurance industry.

Rolling out micro-insurance products as a matter of national policy has created mass awareness of insurance in other countries. And mass awareness has been associated with expansion of the insurance industry as a whole and rising insurance penetration. Such policies have been implemented successfully in many countries, notably India and Ghana. We examine these next.

Lessons from other countries

Lessons from other countries

Asian countries and Ghana demonstrate how to grow

Where can the Nigerian insurance industry look to for examples of successful growth? In any survey of the global insurance industry Asia stands out for its recent gains in insurance take-up. To a large extent this has happened as Asian governments have prioritised the development of micro-insurance and demanded cooperation from regulators and insurance companies to achieve their objectives.

In Asian countries where micro-insurance has been rolled out, the insurance industry as a whole has benefitted from the familiarisation process that micro-insurance brings. As a result insurance penetration and density have risen quickly, as we shall see in this section. Levels of insurance take-up are now many times what they are in Nigeria.

Key case studies come from Malaysia, Philippines and India. We have garnered data from India and present it here.

An answer closer to home than Asia

And one need not go as far as Asia. Ghana is an example of a country where micro-insurance take-up has risen from almost nothing to 28% of the population over a period of eight years. If Ghana's experience could be replicated in Nigeria the effect would be revolutionary.

Will the multi-nationals bring their experience to Nigeria?

An important point about the Asian experience is that the same companies that cite Asia as a core geography for growth are the ones that have acquired insurance companies in Nigeria, for example Axa and Allianz. Axa bought Mansard Insurance in 2014 and Allianz bought Ensure in 2018. Other global insurers present in Nigeria are Prudential in its partnership with Zenith Life Insurance and Sanlam with FBN Insurance, as well as Saham of Morocco with Saham Unitrust.

Therefore the experience of Asia's roll-out of micro-insurance is familiar to the shareholders and management of several Nigerian insurance companies. There is no doubt that they could put their experience to use in Nigeria: the question is whether the legislative and regulatory environment will allow them achieve this.

Micro-insurance roll-out and partnerships with other industries

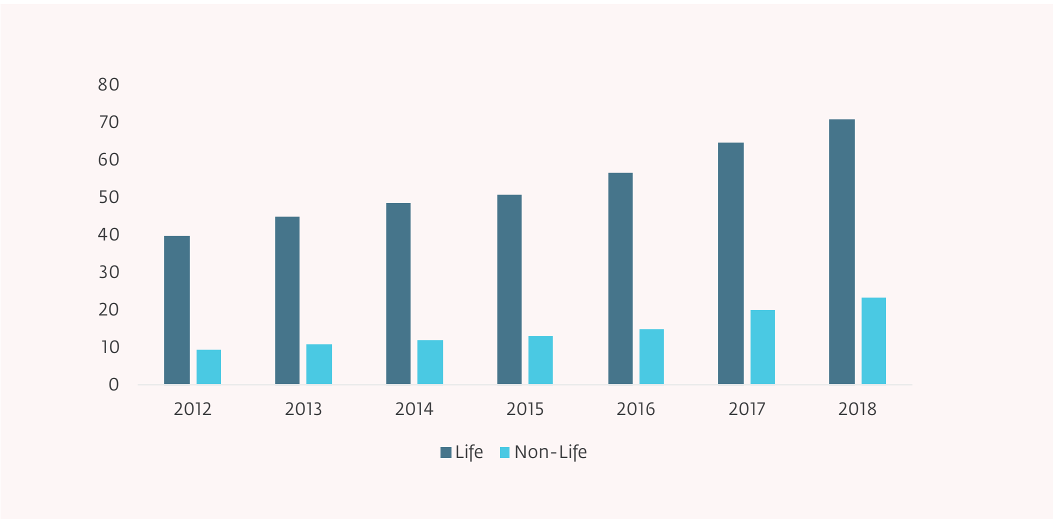
In Asia there are two conditions that spur the roll-out of insurance. The first is that governments sponsor the roll-out of micro-insurance and work to ensure that regulators work together. This means bringing central banks, insurance regulators and telecom regulators together to pursue the common objective of developing the insurance industry.

The second is that the roll-out of micro-insurance provides the education, mass-awareness and initial market penetration which the insurance industry requires. The initial micro-insurance roll-out involves partnerships that can be with banks (bancassurance) or with telecom companies or with government institutions. Even if insurance renewal data suggest that traditional insurance company outlets remain the main points of sale, it is partnerships that get the ball rolling by giving insurers access to the mass market in the first place.

India

Public support for microinsurance leads the way

India's insurance industry provides a good comparison with Nigeria's. We have chosen India because: a) it has a similar nominal GDP per capita as Nigeria (the IMF gives US$2,049 for Nigeria in 2018 versus US$2,036 for India); yet b) India has much higher insurance penetration at 3.69% (2017) compared with 0.31% (2018) for Nigeria.

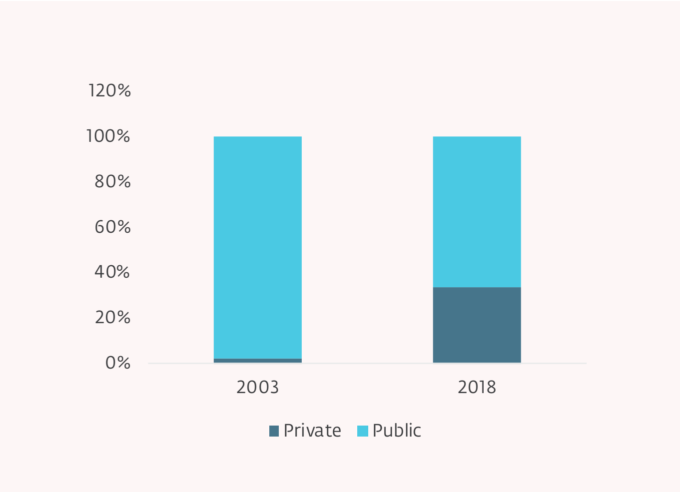


India, total insurance market premiums, US$bn

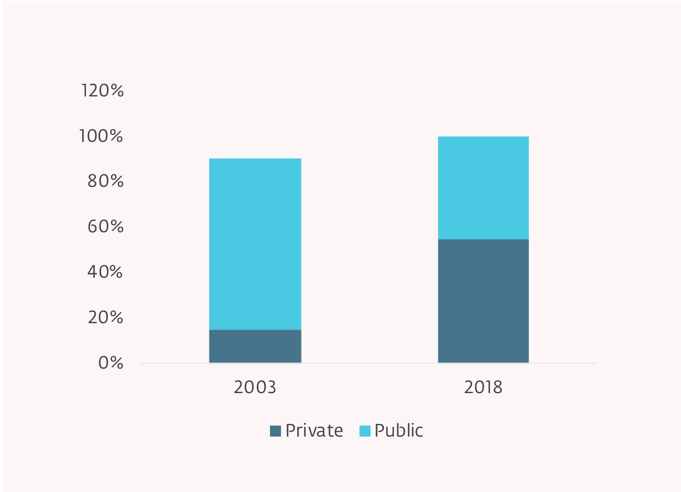
Source: Insurance Regulatory and Development Authority of India (IRDAI), India Brand Equity Foundation (IBEF), Coronation Research

India's insurance industry has been growing steadily. India's total insurance premiums, in US dollars, grew at a CAGR of 11.6% 2012-18, contrasting with Nigeria where they fell at a CAGR 6.2% over the same period.

India, share of public/private sectors in total Life Insurance premiums



India, share of public/private sectors in total Non-Life Insurance premiums



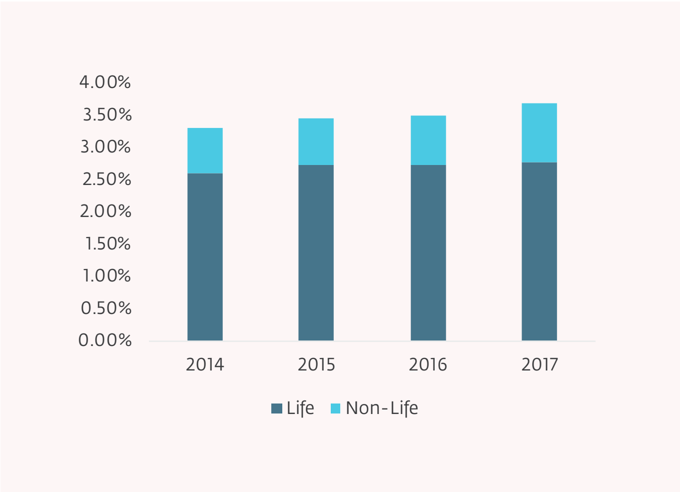
Source: IRDAI, Life Insurance Council (of India), IBEF, Coronation Research

The reason for India's out-performance is that government has encouraged the take-up of micro-insurance in order to foster financial inclusion. Micro-insurance has been rolled out through state-owned insurance companies for many years. On the back of this, private-sector insurance has grown to match the public sector in size.

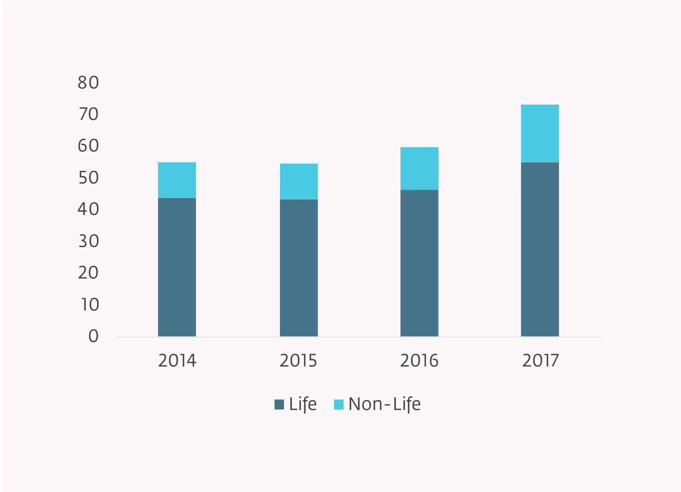
Insurance penetration and insurance density

The long-term success of India's policy is evident in steadily increasing rates of insurance penetration, where total insurance premiums are compared with GDP, and also in increasing insurance density which measures annual US dollar insurance premiums per capita.

India, insurance penetration



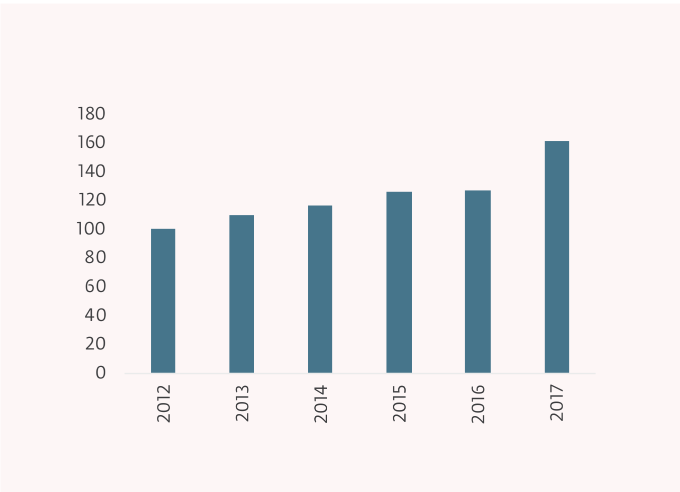
India, insurance density, US$ per capita



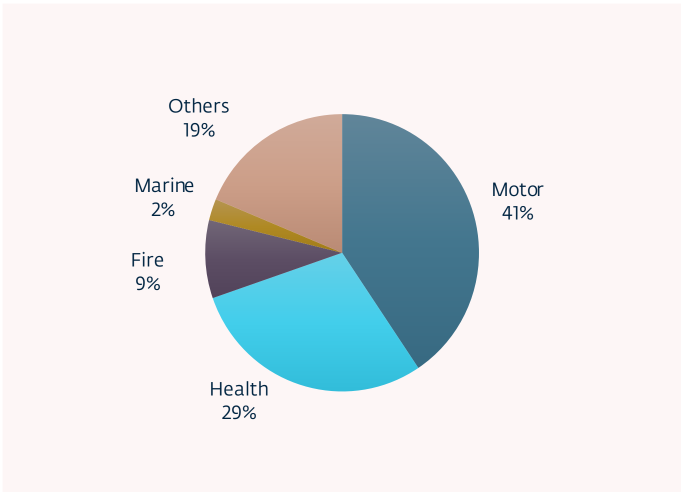
Source:Swiss Re Institute, IBEF, Coronation Research

A key feature of the development of Non-Life insurance in India has been the steady progress in the number of policies written (and therefore not just the overall value Gross Premiums), suggesting that the goal of financial inclusion is being met.

India, number of Non-Life policies, millions



India, Non-Life insurance breakdown



Source: : IRDAI, General Insurance Council (of India), Coronation Research

At the same time, and given India's population of 1.34 billion compared with the 161.17 million policies written in 2017, there appears to be plenty of upside potential for the industry today.

Lessons from India

The first thing we notice about India's insurance industry is that its regulator is called the Insurance Regulatory and *Development* Authority of India, therefore not just a referee for market participants. Responsibility for development has been shared with government, and microinsurance has been rolled out using public-sector insurance companies.

While the Federal Government of Nigeria almost certainly does not have the resources to roll out a public-sector microinsurance initiative on any meaningful scale, in our view, it is probably not beyond the scope of other industries and agencies in the country to achieve something similar to what has been done in India.

In particular, we believe insurance companies could spearhead the development of micro-insurance in cooperation with banks, telecom companies, international development agencies and non-profit organisations.

Other features of the development of insurance in India which we noticed are:

- Partnership between insurance companies and telecom companies to reach low-income clients. This contrasts with objections raised by the Nigerian Communications Commission (NCC) to the sale of insurance products in this way. We will return to the potential of partnerships between insurance and telecom companies later in this report;

- The use of agricultural insurance (insurance against infestation, floods, accidental disability, etc) to reach out to India's large population of farmers. This may have positive implications for such schemes in Nigeria. Agriculture forms some 15.87% of India's GDP and 24.87% of Nigeria's GDP (2018).

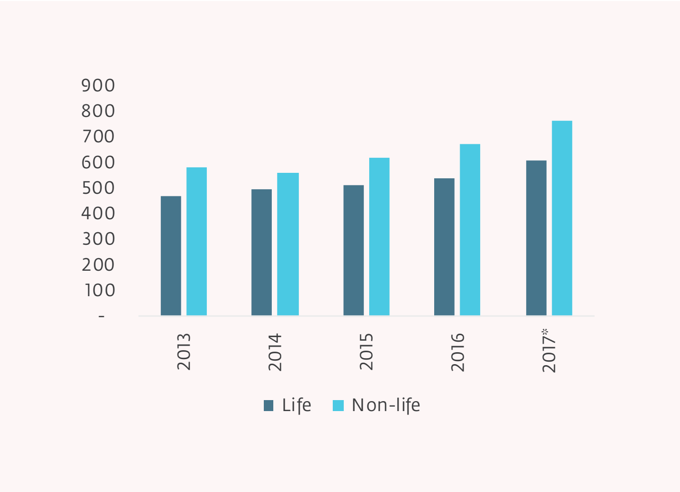
Ghana

Ghana contrasts with Nigeria

In Ghana the micro-insurance penetration rate increased from almost nothing in 2008 to 28.3% of the population in 2017. This contrasted with a take-up rate for micro-insurance in Nigeria of 1.2% in 2017, according to Enhancing Financial Innovation & Access (EFInA).

The roll-out of micro-insurance has been healthy for the Ghanaian insurance industry as a whole. Data from the Ghanaian regulator, the National Insurance Commission (NIC) shows an upward trend in total industry Gross Premium Income 2013-17. When we adjust these data for Cedi inflation, we arrive at a compound annual growth rate (CAGR) of 6.9% 2013-17. In US dollar terms Ghana's total Gross Premium Income increased by a CAGR of 5.1% 2013-17.

Total Gross Premium Income of Ghanaian Insurance companies in 2013 prices, Cedi millions



Total Gross Premium Income of Ghanaian Insurance companies in US dollar millions

Source: :National Insurance Commission (NIC) Ghana, Bloomberg, Coronation Research. Inclusive of Ghana Oil and Gas Insurance Pool.

This contrasts with Nigeria where data for total Gross Premiums show an inflation-adjusted negative CAGR of 3.7% 2013-17 and a negative CAGR in US dollar terms of 11.7% 2013-17.

EFInA attributes Ghana's success in developing micro-insurance to a level comparable with many Asia countries (for example, Ghana's 2017 penetration rate is similar to that of the Philippines) to combination of factors. These include: government backing which meant coordination of different agencies; supportive legislation; insurance companies that were prepared to innovate in their distribution, collection and payment methods; and the partnership with mobile telecom companies for distribution.

In summary, it seems that there are lessons to be learned from Ghana's positive experience in rolling out micro-insurance and in stimulating growth in its insurance industry as a whole. The roll-out of micro-insurance and creation of a strong insurance market overall is not confined to Asia.

Partnerships with banks and telecoms

Partnerships with banks and telecoms

Mobile telecoms and banks are needed

If we ask a sample of Nigerian consumers to name 10 things they want, insurance is unlikely to be one of them. Yet people in emerging and developing markets (particularly in Asia) regularly purchase insurance. Given the problem of low – actually declining – insurance take-up in Nigeria, we argue that mass familiarisation with insurance needs to be at the top of the industry's and the regulator's agenda.

How can this be done? One solution is to hand out insurance – or microinsurance – for free. This overcomes the initial objection people have to paying for something which they do not understand and may not trust. If regulators can be persuaded of the benefits, insurance could be bundled with other products. To take this one step further, microinsurance can be bundled and distributed by telecoms companies and banks. This happens in other markets.

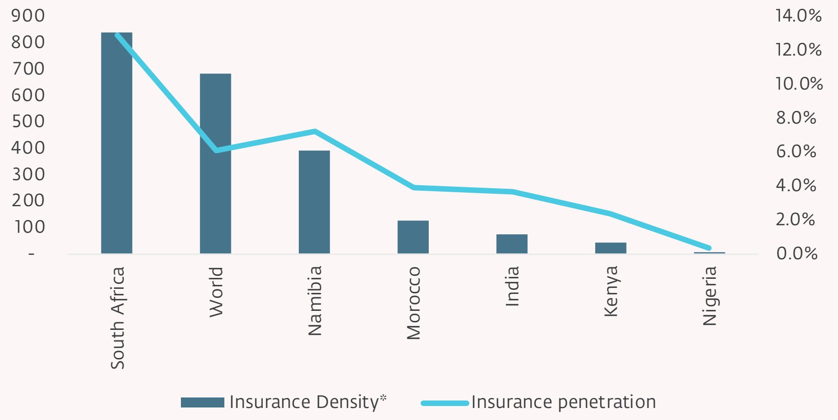
The overall architecture of mass-market microinsurance roll-out may be beyond the scope of any one existing Nigerian institution. But, as noted above, it may be possible with the involvement of government, regulators, insurance companies themselves, banks, telecom companies, development institutions and non-profit organisations.

Free insurance with telecoms

In India the telecom company Bharti Airtel offers free personal accident insurance to customers of its online payments bank, Airtel Payments Bank. The customer's mobile number is his/her account number, cash withdrawals and deposits are possible through merchant partners, and an online debit card is available through a partnership with MasterCard. Customers receive free accident insurance cover.

Free insurance with banking

In Pakistan 'U Microfinance Bank' (owned by the Pakistan Telecommunications Corporation) entered into a partnership with MicroEnsure Pakistan to launch an insurance product for bank customers in 2018. Customers with a minimum level of deposits in their business current accounts were offered free life and permanent disability cover.



Insurance density* (lhs) and insurance penetration** (rhs)

*Source: Swiss Re Global Insurance Report 2018, Coronation Research *Annual US dollar Gross Premiums per capita **Total industry Gross Written Premiums divided by GDP. Nigeria's data point for insurance density is US$6.0 per capital and for insurance penetration is 0.31%.*

Bancassurance experience in Nigeria

In Nigeria the job of realising financial inclusion has been given to banks. Banks are monitored with respect to the number of branches they provide in specific geographies and across the nation. The recent program to register bank customers with unique Bank Verification Numbers (BVN) resulted in registration of 38.5 million bank customers with 72.9 million active accounts.

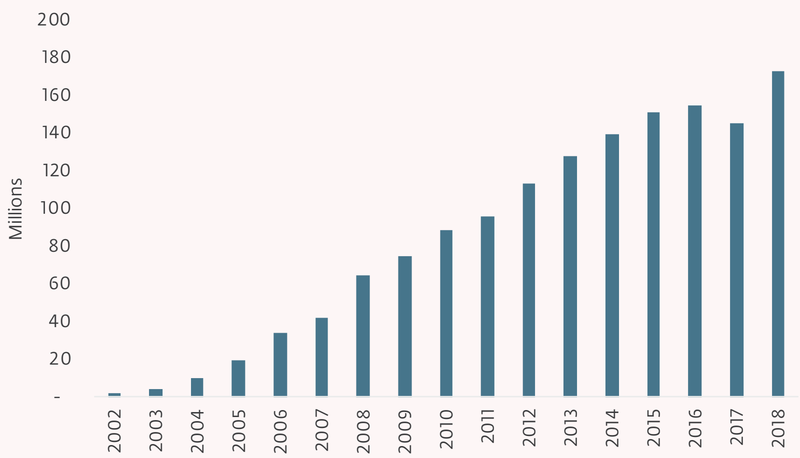
Bancassurance, which involves the distribution of insurance through banking channels, might be a potent method of expanding the reach of insurance products in Nigeria. However, under existing rules governing banks and insurance companies, each insurance company may only partner with two banks, and each bank may only partner with two insurance companies.

Given the current fragmentation of the insurance industry, the rules restricting partnerships act as a significant constraint, in our view. Clearly, consolidation of the insurance industry is set to improve this situation, but thus far bancassurance has not played a significant role in distributing insurance.

Mobile telecoms experience with insurance in Nigeria

For insurance companies mobile telecom companies could be more interesting partners than even banks. Although we do not have the actual number of customers, the number of registered SIMs in Nigeria is given at 172.9 million, suggesting a transformational distribution method for the insurance industry. For a brief period, 2016-17 a few Nigerian insurance companies did distribute insurance with mobile telecom companies. However, in view of regulatory issues this method of distribution was withdrawn in 2017.

In conclusion, we believe that regulatory changes in bancassurance and mobile telecoms could unlock significant distribution channels for Nigerian insurance companies.



Nigeria, mobile telephone subscriptions*

*Source: National Communication Commission (NCC), Coronation Research *Subscriptions by SIM card: some users have multiple SIM cards*

Profitability of risk transfer

Profitability of risk transfer

The industry's risk transfer businesses is generally sound

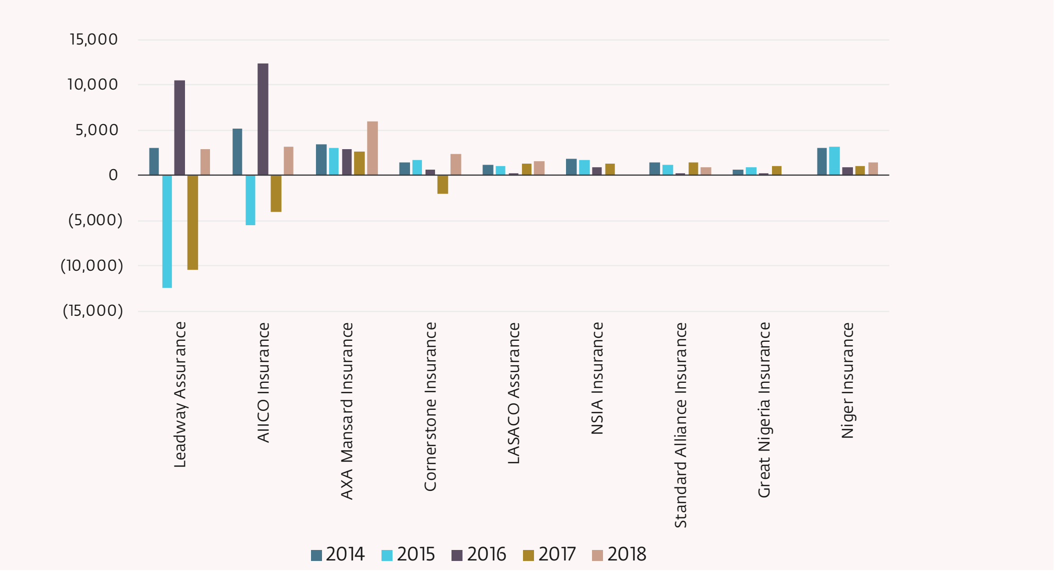
One of the allegations we hear about the insurance industry in Nigeria is that the basic risk transfer business, i.e. the underwriting of risk as a stand-alone business, is not profitable. If this were true then we might question the benefits of raising capital across the industry, since capital in itself does not improve underwriting skills. We might then recommend combining underwriting businesses with asset management businesses in order to create buffers (of fee income) to protect insurance companies.

However, as we shall see, there is not much evidence to back up these allegations, especially when we look at the largest companies and industry leaders. (And we see no reason to draw strategy lessons from the smaller and weaker companies, least of all those which do not publish sufficient financial information for analysis.)

Over the following pages we discuss whether underwriting risk in Nigeria is profitable. To study this we have selected data from the largest (by gross premiums) Composite, Non-Life (i.e. General) and Life insurers.

Risk transfer in Composite Insurers

In the chart below we present the pure underwriting results (i.e. Net Underwriting Income minus Net Underwriting Expenses) for nine of the 11 Composite Insurers. These nine publish sufficient data for our analysis.

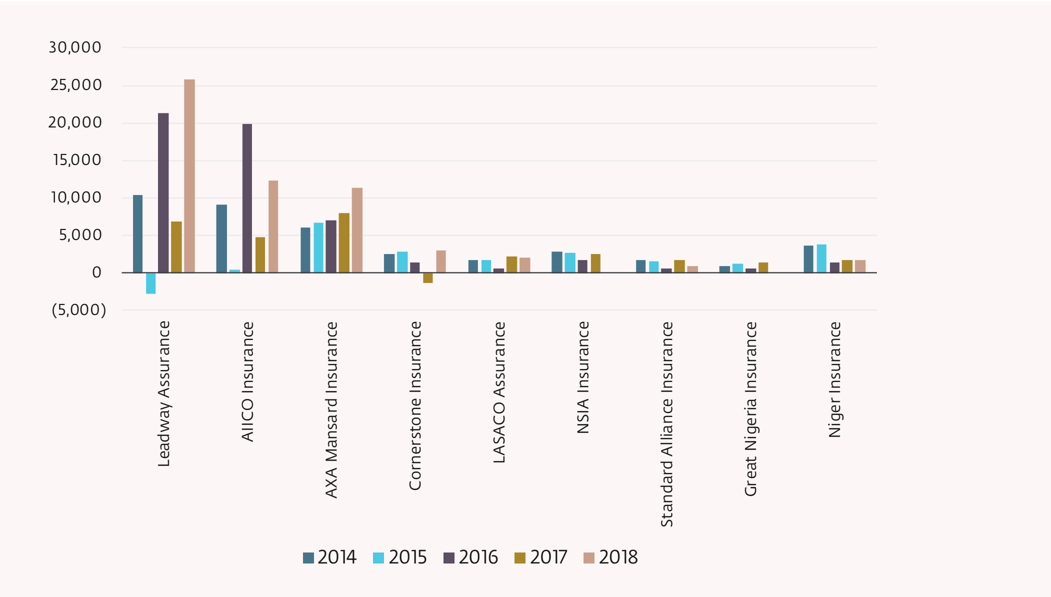


Underwriting profits of leading* Nigerian composite insurers, Naira millions

*Source: Companies, Coronation Research. *No data available for Industrial & General Insurance and NICON Insurance. N.B. for Lasaco and Standard Alliance we use 9M 2018 data. 2018 data not available for NSIA Insurance Company and Great Nigeria Insurance*

As the above chart shows, there have been big swings in the underwriting results of two of the biggest insurers, Leadway Assurance and AIICO Insurance. Other insurers have reported more consistent results (though Cornerstone Insurance made an underwriting loss in 2017 and Lasaco Assurance made an underwriting loss in 2018).

Digging into Leadway Assurance's P&L shows that it generated positive results in all the years except 2015 when we add back Investment Income (i.e. investment income from investment premiums, excluding earnings from its separate asset management business). And, as the next chart shows, the same measures show that AIICO Insurance also made money consistently on this measure, as did Lasaco Assurance.



Underwriting profits + investment income of leading* Nigerian Composite Insurers, Naira millions

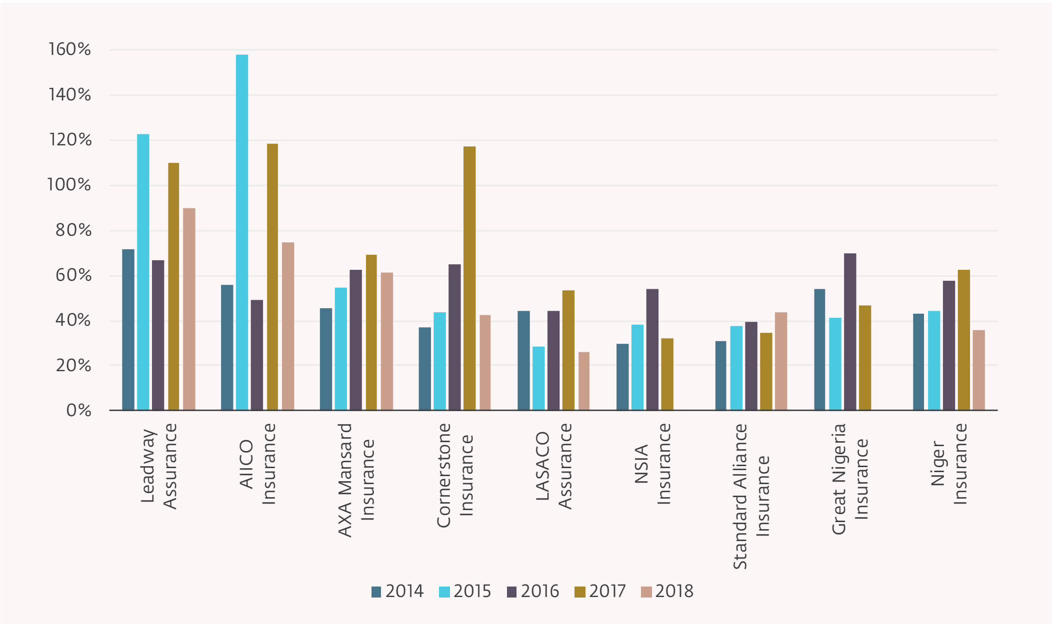
*Source: Companies, Coronation Research. *No data available for Industrial & General Insurance and NICON Insurance. N.B. for Lasaco and Standard Alliance we use 9M 2018 data. 2018 data not available for NSIA Insurance Company and Great Nigeria Insurance*

In fact, when we add back investment income (excluding earnings from asset management businesses) to underwriting results, most of the major Composite Insurers are profitable in most years. The exceptions (among those to provide sufficient financial information) are Leadway which made a small loss on this measure in 2015 and Cornerstone which made a small loss in 2017.

By and large, the risk transfer businesses of the major Composite Insurers are profitable over time, the more so if we factor investment income into the equation. Granted, there were some alarming swings in the results of Leadway Insurance and AIICO, but the Composite Insurers have generally made profits on their core risk transfer business. The next question to answer is about the degree of profitability.

Loss ratios of the Composite Insurers

To answer the question about the degree of profitability of the risk transfer business we use a simple industry measure, the loss ratio. The loss ratio measures Net Claims divided by Net Premiums, expressed as a percentage. In the case of Composite Insurers and Life Insurers we have grouped with Net Claims two other items, namely Increases in Annuity Fund each year and Increases in Individual Life Fund each year, in order to reflect their overall cost of risk.



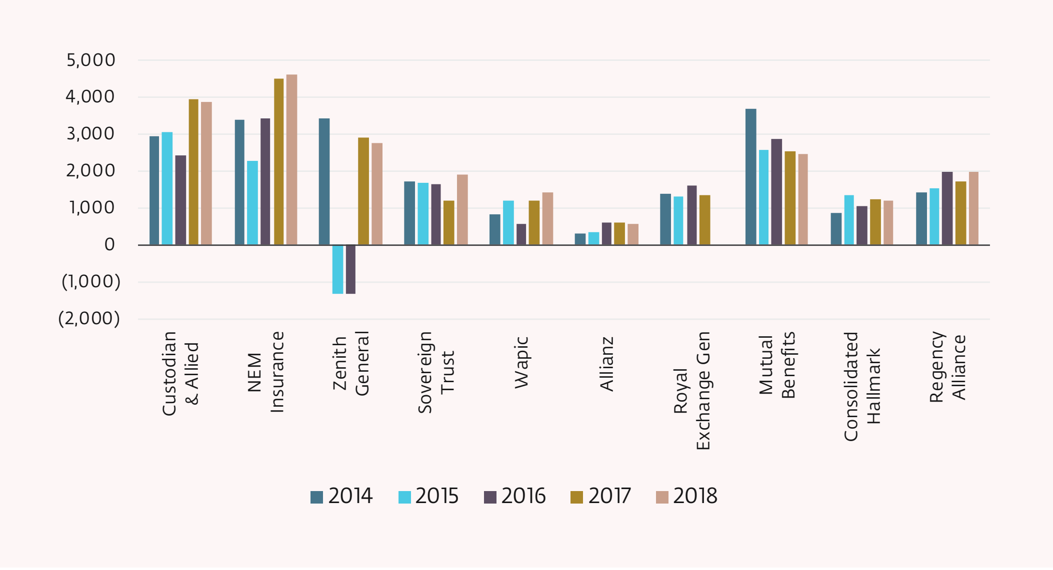
Loss ratio* of Composite Insurers

*Source: Companies, Coronation Research. *Loss Ratio defined as (Net Claims + Increases in Annuity Fund + Increases in Individual Life Fund) / Net Premium Income)) N.B. Data for 2018 for Lasaco Assurance, Standard Alliance Insurance and Niger Insurance is for 9M 2018.*

As we might expect from data we have already presented, Leadway Assurance and AIICO Insurance had bad years in 2015 and 2017, while Cornerstone reported a bad result in 2017. Overall, taking the simple average of these data 2014-18, the Composite Insurers reported a loss ratio of 58.1% 2004-18. If we strip out the five outlying data points (i.e. everything above 100%) this would come to 49.3%. In general, and as a rule of thumb, we would look for a result around the 40.0% mark. However, it would be wrong to think Nigeria's Composite Insurers are beset by underwriting errors: the overall result is within an acceptable range for the industry, in our view.

The risk transfer of the major Non-Life insurers is mainly profitable

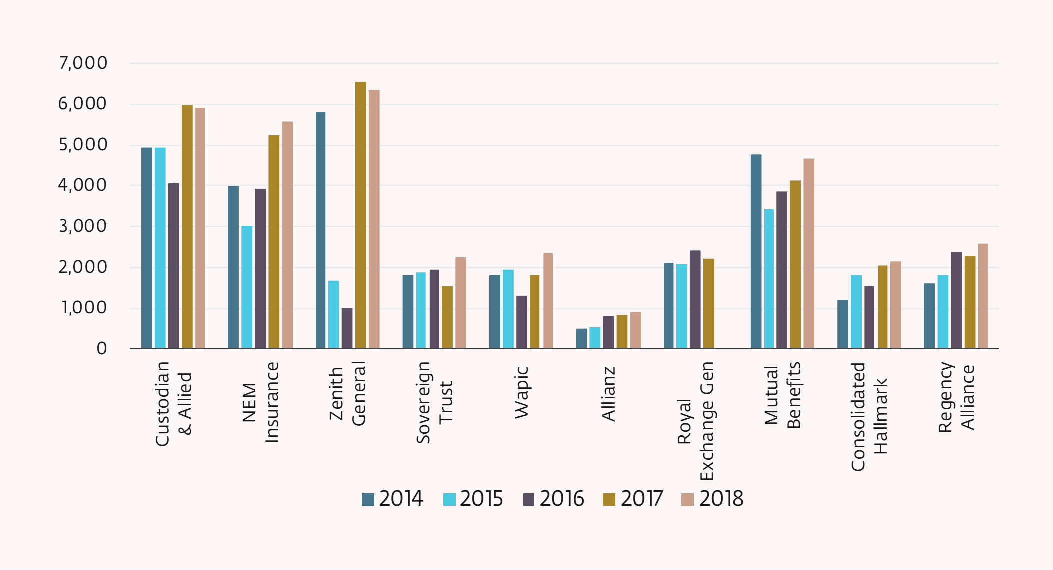
Although we could have some misgivings about the underwriting results of the Composite Insurers, we have few doubts about the results of the major Non-Life (or General) insurers. They are mainly profitable. We have selected 10 Non-Life companies with annual Gross Premiums over N5.5bn (US$15.3m) as the basis for this study.



Underwriting profits of leading Nigerian Non-Life insurers, Naira millions

Source: Companies, Coronation Research. N.B. data for Royal Exchange for 2018 is not available

The above chart shows the results from Net Underwriting Income minus Net Underwriting Expenses. The chart below adds investment income (excluding asset management fees).

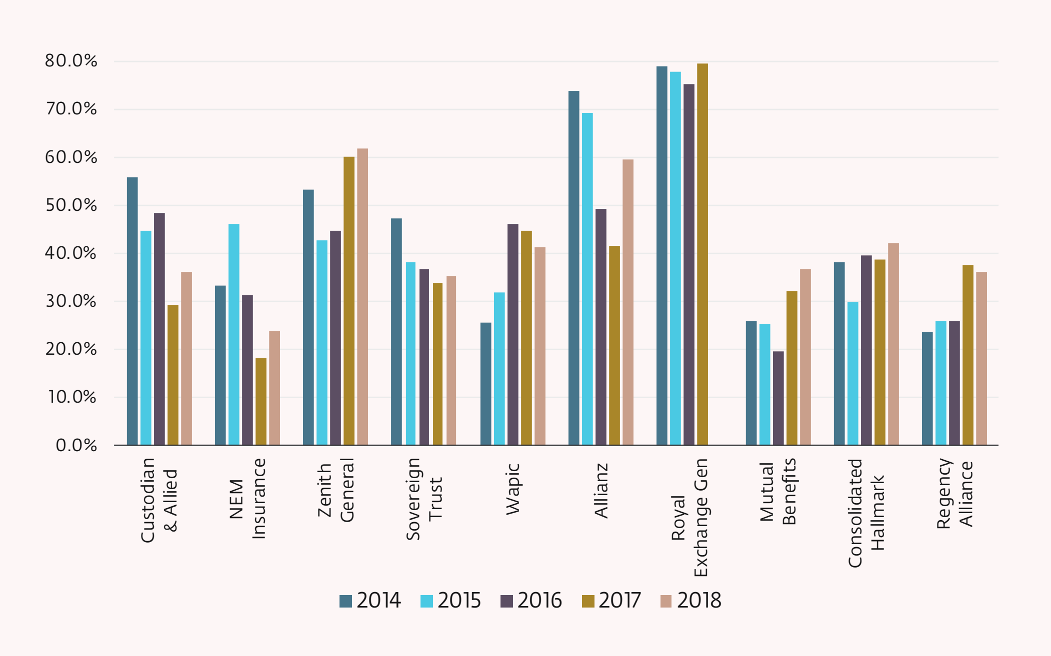


Underwriting profits + investment income of leading Nigerian Non-Life insurers, Naira millions

Source: Companies, Coronation Research. N.B. data for Royal Exchange for 2018 is not available

Loss ratios of the Non-Life Insurers

As with the Composite Insurers, it is necessary to establish the degree of underwriting profitability for the Non-Life Insurers, and again we use the industry standard loss ratio to arrive at this. (On this occasion there is no need to add Increases in Annuity Fund and Increases in Individual Life Fund to the figure for Net Claims.)



Loss ratio* of Non-Life Insurers

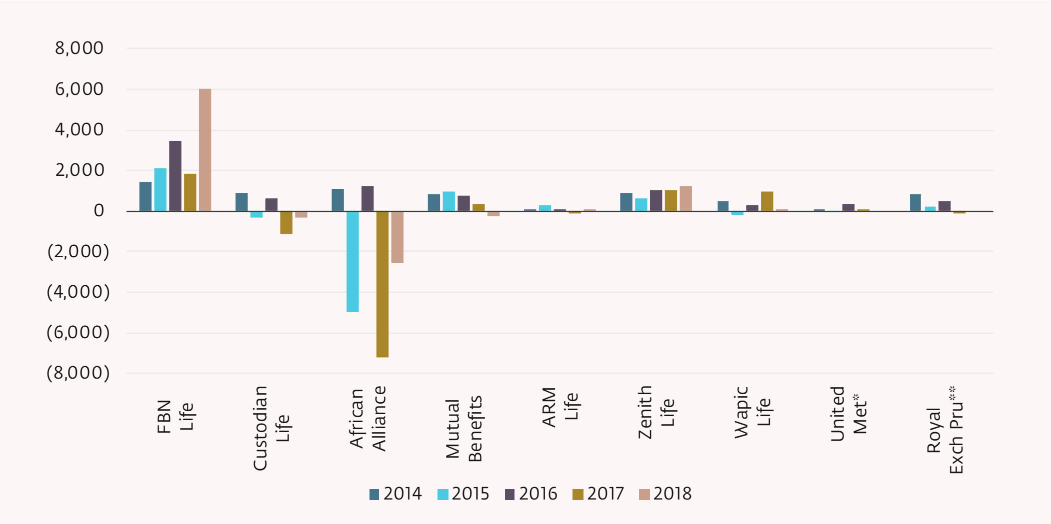
*Source: Companies, Coronation Research. *Loss Ratio defined as (Net Claims / Net Premium Income)*

There are several contrasts between the data for the top 10 Non-Life companies featured in the chart here and the data for the Composite Insurers. The first is that the swings in loss ratios from year to year are much lower. The second is that, to the extent that there are high loss ratios, they are concentrated in specific companies, notably Royal Exchange General Insurance 2014-18 and Allianz Insure (formerly Ensure Insurance) in 2014 and 2015. Third, the simple average loss ratio over the period 2014-18 for these data is 42.7%, much lower than the 58.1% we calculated for the Composite Insurers.

In terms of trend, the simple average loss ratio has trended gently downwards from 2014 (45.6%) to 2018 (41.5%), though we must caution not to read too much into a trend and that recent gains have been very small (e.g. 2017's simple average loss ratio was 41.6%). In any event, it appears to us that the simple average loss ratio for Nigeria's top 10 Non-Life insurers (41.5%) is very much in line with international industry norms.

The risk transfer of the major Life insurers is also mainly profitable

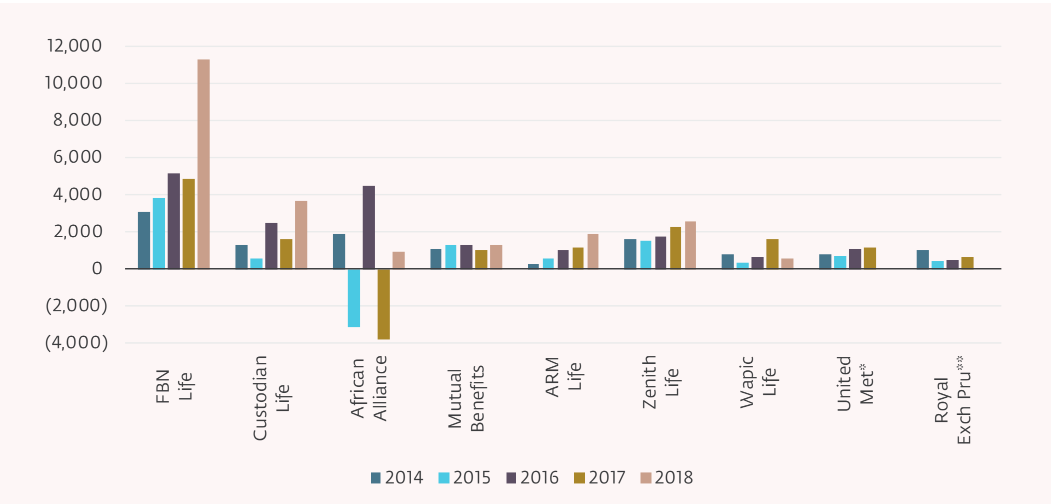
As with the Non-Life (or General) insurers, the leading Life Insurers mainly report profitable risk transfer businesses. The exceptions have been African Alliance in 2015, 2017 and 2018, with small underwriting losses occurring at: Custodian Life in 2015 and 2017; Mutual Benefits in 2018; ARM Life in 2017; Wapic Life Insurance in 2015; United Metropolitan Nigeria Life in 2015; and Royal Exchange Prudential in 2017.



Underwriting profits of leading*** Nigerian Life insurers, Naira millions

*Source: Companies, Coronation Research. *United Metropolitan Nigeria Life **Royal Exchange Prudential Life. N.B. 2018 data is not available for United Metropolitan Nigerian Life nor for Royal Exchange Prudential Life. ***Of 13 companies nine report information suitable for this analysis*

Adding investment income (excluding Asset Management fees) to pure underwriting results we arrive at a picture of a generally profitable Life Insurance sub-sector (below).

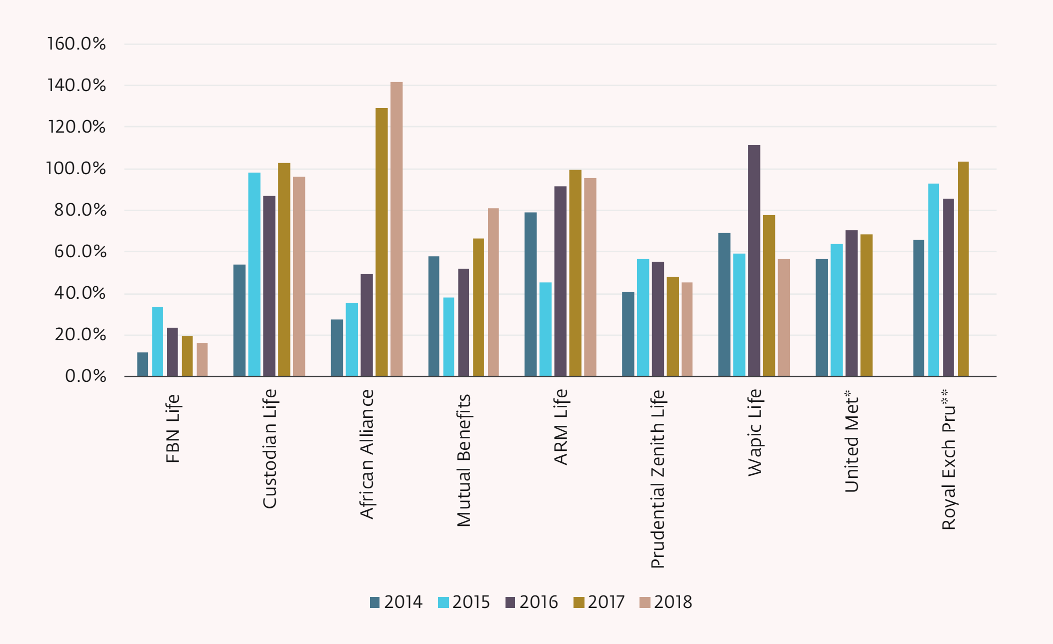


Underwriting profits + investment income of leading*** Nigerian Life insurers, Naira millions

*Source: Companies, Coronation Research. *United Metropolitan Nigeria Life **Royal Exchange Prudential Life N.B 2018 data is not available for United Metropolitan Nigerian Life nor for Royal Exchange Prudential Life. ***Of 13 companies nine report information suitable for this analysis*

Loss ratios of the Life Insurers. Profits sacrificed for growth

When it comes to measuring the loss ratios of the Life Insurers it is remarkable how different these are from both Composite Insurers (which are basically Non-Life and Life companies under single entities) and Non-Life Insurers.



Loss ratio*** of Life Insurers

*Source: Companies, Coronation Research. ***Loss Ratio defined as (Net Claims + Increases in Annuity Fund + Increases in Individual Life Fund) / Net Premium Income)) *United Metropolitan Nigeria Life **Royal Exchange Prudential Life. N.B. Data for United Metropolitan Nigeria Life for 2018 and Royal Exchange Prudential Life for 2018 are not available.*

The simple average ratio for the nine Life Insurers featured here between 2014-18 was 67.0%, far in excess of the 58.1% for the Composite Insurers and the 42.7% for the Non-Life Insurers. Moreover, the trend worsened during the period 2014-17 as the simple average moved from 51.5% in 2014 to 79.4% in 2017. The reason for this was the fierce competition in Group Life premiums which led to rates being cut repeatedly. Eventually NAICOM intervened with a mandatory minimum level of premium in early 2018. This likely led to a slight improvement in the simple average loss ratio, to 76.2%, in 2018.

Note that the decline in profitability came at a time of real-term growth for the Life Insurers. Industry data shows that premiums were growing (see the Growth section) in real terms in every year between 2008-15. Life Insurers, it seems, were tempted by the cost-effectiveness of offering group life policies to companies, thereby making multiple individual customer gains at low expense, but they were too aggressive in getting business, they competed with each other through insurance rates and paid the price in loss ratios 2014-17. Growth was not the same thing as profitability in the group life business.

By contrast, FBN Life, with a much lower exposure to group life business than most of its peers, and with distribution based on First Bank of Nigeria's extensive branch network, recorded the best risk transfer profits in our sample.

Conclusions

The profitability of the risk transfer business among the Composite, Non-Life (i.e. General) and Life Insurance companies featured in this report are not far from levels which we would expect in the industry. In particular, the top-10 Non-Life Insurers covered here appear to be in good shape. Discovering the price of insurance risk in Nigeria, at least among the companies covered here, does not seem to be an issue.

Having said this, problems were encountered among Life Insurers (and presumably some of the Composite Insurers as these businesses include life insurance) as they competed with each other to grow group life premiums in recent years, prompting the regulator to step in and impose minimum premium rates to salvage the situation.

However, it is not true to say that the insurance industry suffers from a systemic inability to price risk, at least when we look at the companies that report sufficient information for analysis. It is likely true that, among the companies that do not report sufficient information for our report, there are some companies unable to price risk effectively, and these are likely candidates for consolidation as the industry recapitalises.

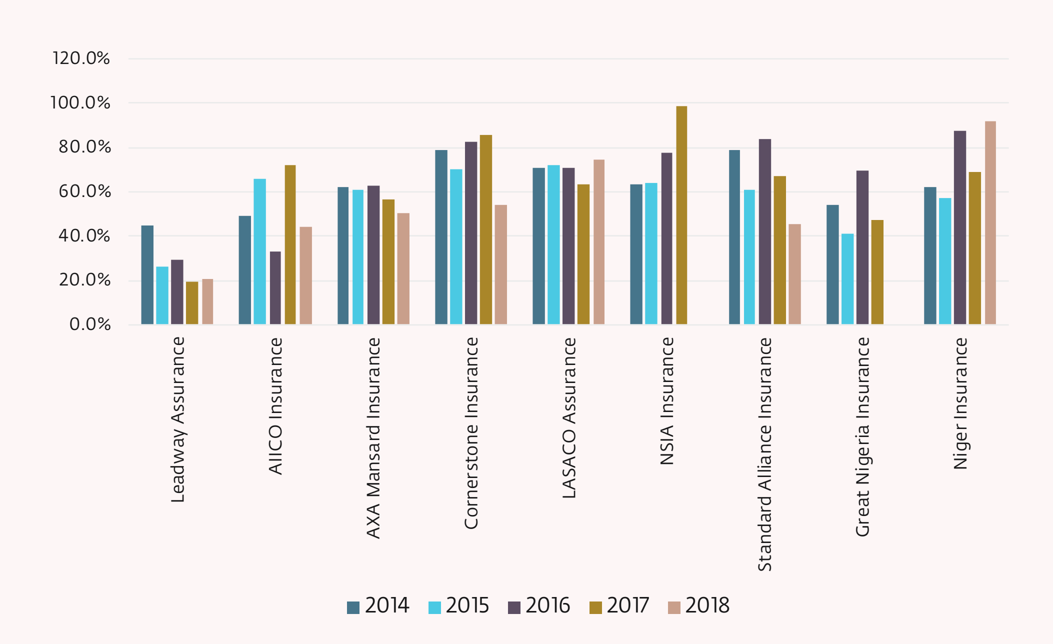
Expense ratios

Expense ratios

Expense ratios of the Composite Insurers

The expense ratio measures administrative, underwriting and management expenses as a percentage of Net Premium Income. In general, we believe insurance companies need to keep this ratio below 40% if they are to run sustainable businesses.

The bad news is that the expense ratio of the Composite Insurers averaged 61.0% during the period 2014-18.



Expense ratio* of Composite Insurers

*Source: Companies, Coronation Research. *Expense Ratio defined as ((Administrative expenses + Management expenses + Underwriting expenses) / Net premium income) N.B. Data for 2018 for Standard Alliance Insurance and Niger Insurance is for 9M 2018*

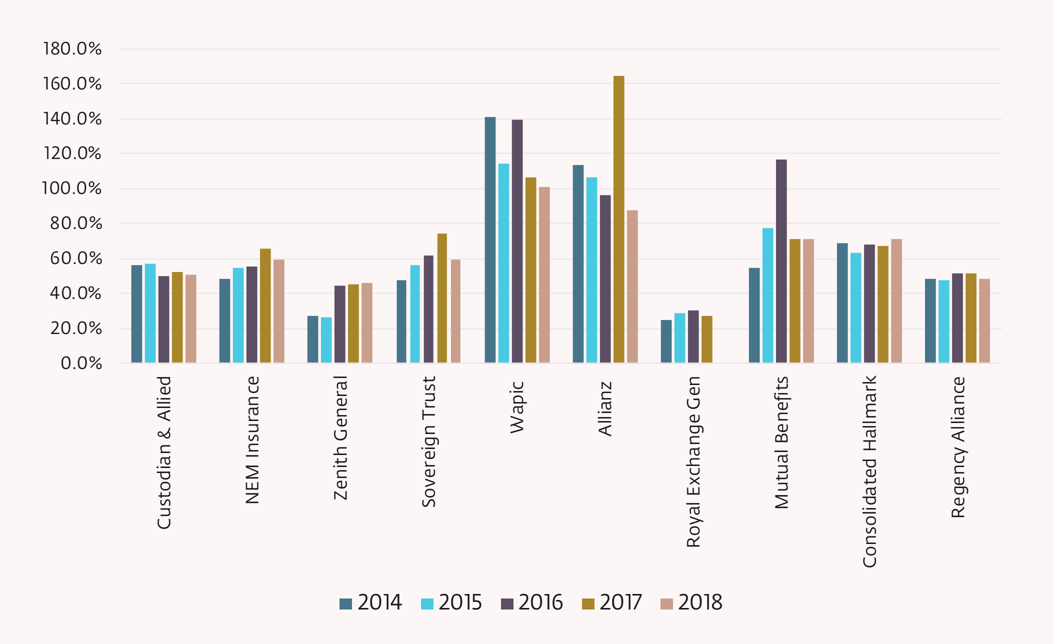
The key difficulty, we believe, is lack of scale. Composite Insurers, like all insurers, have a level of fixed costs which can only be justified by levels of business, but most Composite Insurers lack the level of business to absorb these central costs sufficiently.

The outlier in this study, with an average expense ratio of just 28.2% 2014-18, is Leadway Assurance which has almost two and a half times the level of Gross Premium Income as its closest competitor, AIICO. The smallest company (by Gross Premium Income) in this study is Niger Insurance and its average expense ratio 2014-18 was 73.5%, well above the sub-sector average.

Of course, it can be argued that all Nigerian service industries have high costs thanks to inefficiencies in energy supply and transportation, and therefore one would not expect a Nigerian Composite Insurer to have the same expense ratio as its international peer group. But this just underlines the necessity of scale in an industry which, historically, had enjoyed very little real-term growth.

Expense ratios of the Non-Life Insurers

The Non-Life (i.e. General) Insurers also have poor expense ratios. The average expense ratio between 2014-18 was 67.5%, even higher than for the Composite Insurers. The outliers are Wapic Insurance and Allianz with high ratios, and Zenith General Insurance and Royal Exchange General Insurance with relatively low ratios.

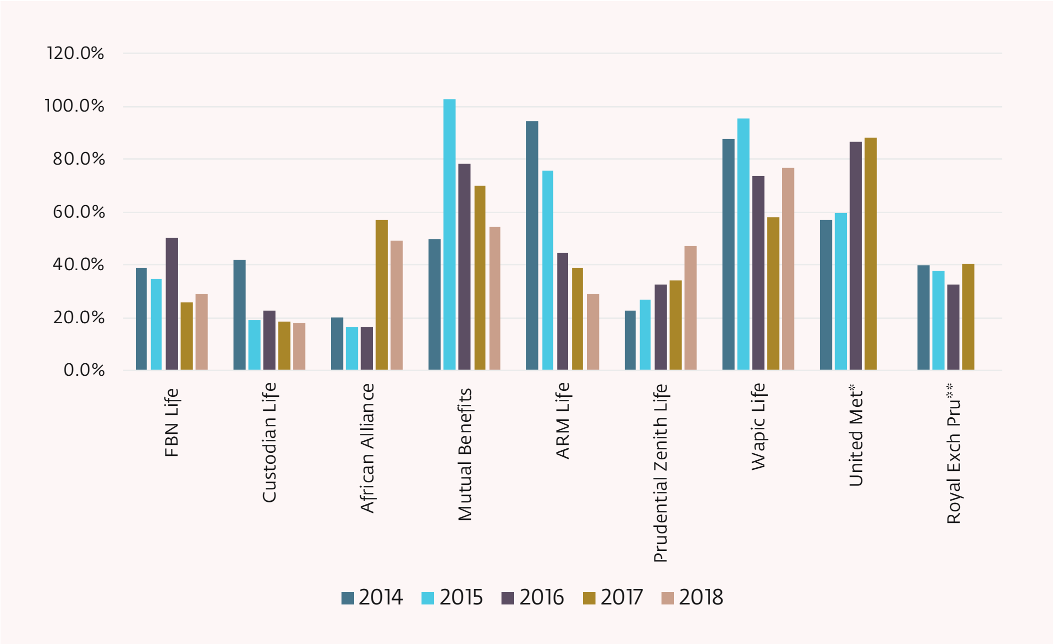


Expense ratio* of Non-Life Insurers

*Source: Companies, Coronation Research. *Expense Ratio defined as ((Administrative expenses + Management expenses + Underwriting expenses) / Net premium income). N.B. data for Royal Exchange for 2018 is not available*

Expense ratios of the Life Insurers

When it comes to the expense ratios of Life Insurers things are somewhat better than for the Composite Insurers and Non-Life Insurers. The average expense ratio 2014-18 was 48.4%.



Expense ratio*** of Life Insurers

*Source: Companies, Coronation Research. ***Expense Ratio defined as ((Administrative expenses + Management expenses + Underwriting expenses) / Net premium income). *United Metropolitan Nigeria Life **Royal Exchange Prudential Life. N.B. Data for United Metropolitan Nigeria Life for 2018 and Royal Exchange Prudential Life for 2018 are not available.*

However, the average percentage covers a significant degree of volatility, both between companies (compare Custodian Life with Mutual Benefits, for example) and between years (compare African Alliance's performance in the period 2014-16 with its performance 2017-18, for example).

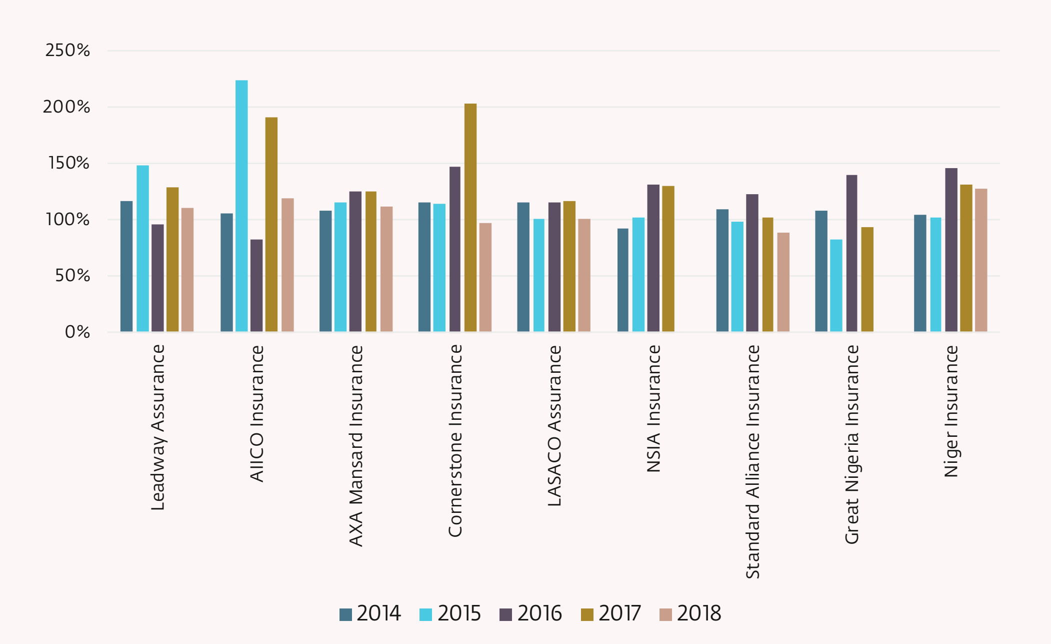
As we have already seen, the average loss ratio of the Life Insurers has historically been poor, so its relatively (relative to other sub-sectors) strong average expense ratio is of little comfort. As we explained in the previous section, an effective cost dynamic achieved by distributing group life policies to large number of underlying individuals has been offset by competing too hard with premium rates, thus creating high loss ratios.

Combined ratios

Combined ratios

Combined ratios of the Composite Insurers

The combined ratio is the sum of an insurance company's loss ratio and its expense ratio. The industry norm is to achieve a combined ratio of less than 100% and the target is to bring it as low as possible. The implication is that a combined ratio of over 100% equates to an unprofitable company, though insurance companies can still be profitable with combined ratios of 100% by having other income streams, such as fee income from asset management subsidiaries.



Combined ratio* of Composite Insurers

*Source: Companies, Coronation Research. *Combined Ratio defined as (Loss ratio + Expense ratio) N.B. Data for 2018 for Standard Alliance Insurance and Niger Insurance is for 9M 2018.*

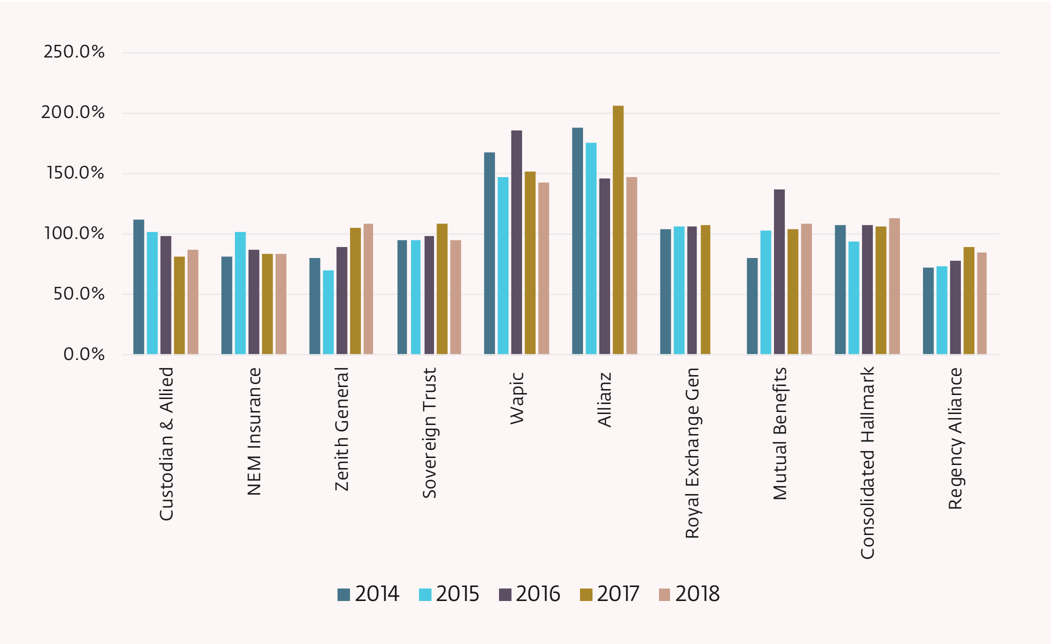
Starting with the nine Composite Insurers for which we have adequate financial information, the average combined ratio over the period 2014-18 was 119.1%. We do not have data for NSIA Insurance and Great Nigeria Insurance for 2018 (at the time of going to press) but, for the 43 data points available to us here only nine are less than 100.0%. In other words, over three quarters of the time the Composite Insurers are running at a combined ratio of greater than 100.0%.

What some Composite Insurers gain on loss ratios they throw away on expense ratios, and vice versa. For example, Standard Alliance Insurance has the best loss ratios in our study (an average 37.2% 2014-18, compared with the average of 58.1%) but has high expense ratios (an average 67.1% 2014-18, compared with the average of 61.0%), and therefore has a combined ratio over

100.0% (an average 104.3% 2014-18). Leadway Assurance has the best expense ratios in its sub-sector (thanks to economies of scale) but has experienced poor loss ratios and so ends up with an average combined ratio of 120.3% 2014-18, which is close to the average.

Combined ratios of the Non-Life Insurers

The combined ratios of the Non-Life (or General) Insurers studied in this report are, on average, better than those for the Composite Insurers, but not as much. The simple average of their combined ratios 2014-18 was 110.2% (Composite Insurers: 119.1%), again implying lack of underlying profitability. However, the poor performance is more concentrated among the Non-Life Insurers than among the Composite Insurers, which is significant. Of the 44 data points in the chart below (we do not yet have 2018 data for Royal Exchange General Insurance) 21 are less than 100%. In other words, the Non-Life Insurers report underlying profitability almost half the time, which is more than can be said for the Composite Insurers (and, as we shall see, the Life Insurers).



Combined ratio* of Non-Life Insurers

*Source: Companies, Coronation Research. *Combined Ratio defined as (Loss ratio + Expense ratio) N.B. data for Royal Exchange for 2018 is not available. N.B. data for Royal Exchange General Insurace for 2018 is not available*

There are several Non-Life Insurers which regularly report combined ratios of less than 100.0%: Custodian & Allied General Insurance; NEM Insurance; Zenith General Insurance (though not in 2017 and 2018); Sovereign Trust General Insurance; and Regency Alliance General Alliance.

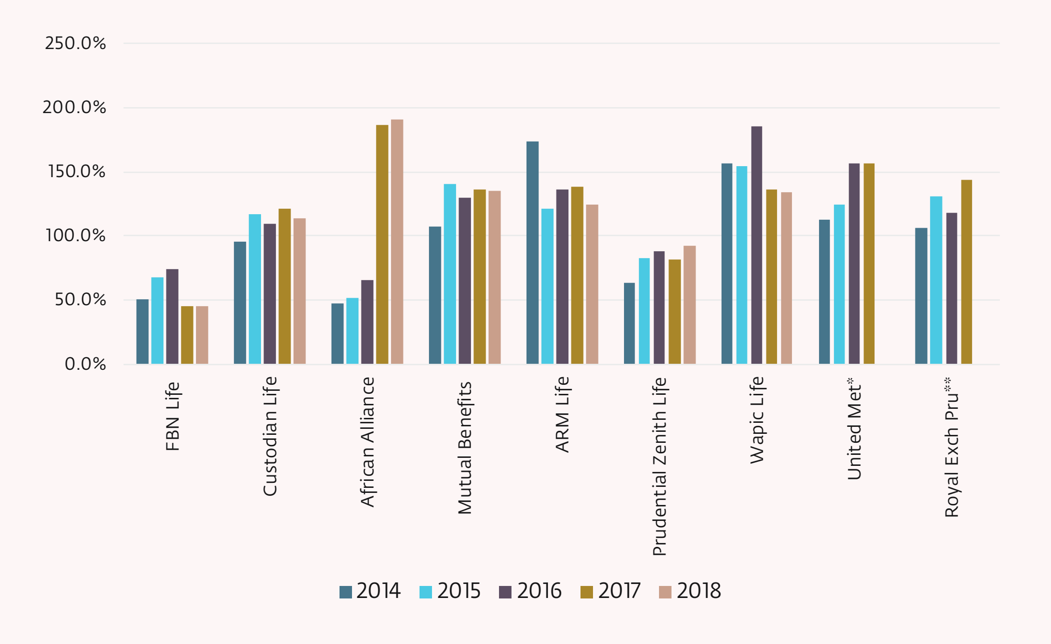
Other Non-Life Insurers suffer the problem of one ratio (either the loss or the expense) working well while the other one does not. Mutual Benefits Insurance has the best average loss ratio 2014-18 in our study, 28.0% but has an average expense ratio 2014-18 of 78.4%, well above the average (67.5%). Consequently it has combined ratio of 106.4%. By contrast, the average loss ratio between 2014-18 of Royal Exchange General Insurance, at 77.9%, is well above the average of 42.7%, but its average expense ratio 2014-18 is just 28.0%. Its average combined ratio between 2014-18, therefore, is 105.9%.

In some cases these contrasts reflect deliberate strategies. Market share and growth can create scale (and low expense ratios) even at the expense of underwriting quality. Cautious underwriting can pass up on growth opportunities. And high costs can also mean high levels of investment in technology to prepare for future growth. High ratios are not uniformly bad.

Combined ratios of the Life Insurers

Earlier in report we detailed how many of the Life Insurers, in their quest for growth in the group life business, sacrificed underwriting prudence and ended up with high loss ratios, though in many cases their expense ratios were attractive (i.e. under 40%).

The average combined ratio for the nine Life Insurers studied here, for the period 2014-18, is 115.4%, compared with 110.2% for Non-Life Insurers and 119.1% for Composite Insurers. In other words, their combined ratios are very much in the same ball park and imply, in general, lack of underlying profitability.



Combined ratio* of Life Insurers

*Source: Companies, Coronation Research. *Combined Ratio defined as (Loss ratio + Expense ratio) *United Metropolitan Nigeria Life **Royal Exchange Prudential Life. N.B. Data for United Metropolitan Nigeria Life for 2018 and Royal Exchange Prudential Life for 2018 are not available*

The concentration of underlying profitability among Life Insurers is again different from both Composite Insurers and General Insurers. Of the 44 data points in our study (we do not yet have 2018 data for United Metropolitan Nigerian Life) 14 are below 100.0%. So the Life Insurers are operating without underlying profitability for approximately two thirds of the time.

There are some notable exceptions. FBN Life has an average combined ratio of 56.8% between 2014-18, which is well below the average. We have already described the advantage which FBN Life enjoys over its rivals when it comes to distributing insurance products to individual clients. Prudential Zenith Life has an average 2014-18 combined ratio of 82.0%; not as good at FBN Life but well below the desired benchmark.

Risk pricing is not the problem: the problem is scale

When we examined the loss ratios in the section 'Profitability of risk transfer' we did not find much to be worried about. It is true (especially in the cases of Composite Insurers Leadway Assurance and AIICO Insurance) that there has been remarkable volatility in underwriting results. It is also true that the Life Insurers (and Composite Insurers are partly life insurers) entered into an unwise competition with each other to sell group life policies for a long period, which resulted in erosion of premium rates and rising loss ratios. These necessitated the intervention of the regulator in 2018.

That said, the major insurance companies for which we have sufficient financial data do not suffer from a systemic inability to price risk. Such an allegation would be false.

So, if the problem does not lie, fundamentally, with the profitability of risk transfer, where does it lie? After all, in our section 'Shareholder returns' we showed that our sample insurance companies usually do not make returns equivalent to the risk-free rate, and almost always fall short of their cost of equity.

The problem comes with expense ratios, which are so high that, added to loss ratios, they generate combined ratios of over 100.0% more often than not. In the case of Composite Insurers the industry is operating at a combined ratio of over 100.0% about three quarters of the time; in the Non-Life Insurance sub-sector for about half the time; and in the Life Insurance sub-sector for about two-thirds of the time. This is not the foundation of a strong industry, unless it can expand.

It is noticeable that the one Life Insurer which has cracked the distribution model, FBN Life, enjoys low loss ratios (because it is distributing predominantly to retail customers), moderate expense ratios, and a combined ratio which averaged 56.8% 2014-18. This shows what can be done when the distribution issue is solved and economies of scale are reached. Indeed, it could be argued that the largest company in this study, Leadway Assurance, follows a growth strategy, even at the risk of occasional spikes in loss ratios, because of the advantages of scale when is comes to expense ratios. A strategy based on achieving scale may make the best sense.

The conclusion we draw is that the insurance industry's core issue is with scale and therefore with its overall growth strategy.

Appendices

APPENDIX I

Compliance with NAICOM

Recent capital* levels compared with NAICOM minimum requirements

Naira millions	2018 Gross premiums	Paid-up capital + Retained earnings	Meets Mimum	Meets 75% of Minimum	Meets 50% of Minimum	Meets < 50% of Minimum
Composite - requires 18,000m						
Leadway Assurance	87,520	29,969	Yes			
AIICO Insurance	37,002	7,768				Yes (a)
AXA Mansard Insurance	23,027	14,956		Yes		
Cornerstone Insurance	10,493	9,312			Yes	
Lasaco Assurance	9,014	5,792				Yes (b)
NSIA Insurance	5,466	7,564				Yes
Standard Alliance Insurance	3,420	13,940		Yes		
Great Nigeria Insurance	2,877	5,024				Yes
Niger insurance	3,042	4,661				Yes
Sub-total	181,860	98,987	1	2	1	5
General - requires 10,000m						
Custodian & Allied Insurance	23,812	9,803		Yes		
NEM Insurance	15,049	7,628		Yes (c)		
Zenith General Insurance	10,968	19,963	Yes			
Sovereign Trust Insurance	10,513	4,287				Yes (d)
Wapic Insurance	10,373	12,886	Yes			
Allianz Insurance	10,008	8,599		Yes		
Royal Exchange Gen. Insurance	9,698	6,214			Yes (e)	
Mutual Benefits Assurance	8,018	4,000				Yes
Consolidated Hallmark Insurance	6,776	3,324				Yes (f)
Regency Alliance Insurance	3,408	5,130			Yes	
Prestige Assurance	4,792	3,663				Yes (g)
FBN General Insurance	4,389	4,363				Yes
Saham Unitrust Insurance	2,487	4,288				Yes
Guinea Insurance	939	3,408				Yes
Fin Insurance Company	1,017	4,787				Yes
Veritas Kapital Assurance	3,334	7,597		Yes		
Sunu Assurance	3,049	8,023		Yes		
Universal Insurance	809	8,825		Yes		
Law Union & Rock Insurance	4,541	3,645				Yes
Linkage Assurance	5,391	5,959			Yes	
Sub-total	139,371	136,394	2	6	3	9
Life - requires N8,000m						
African Alliance Insurance	6,796	24,658	Yes			
Custodian Life Insurance	13,680	6,690		Yes		
FBN Life Assurance	25,976	10,725	Yes			
Mutual Benefits Life Assurance	5,914	5,609			Yes	
ARM Life	5,836	5,587			Yes	
Wapic Life Assurance	2,055	4,796			Yes (h)	
United Metropolitan Nigeria Life	2,060	3,813				Yes
Royal Exchange Prudential Life	3,059	3,866				Yes
Prudential Zenith Life Insurance	3,801	8,508	Yes			
Sub-total	69,177	74,251	3	1	3	2
Total - Gross Premiums	**390,409**	n/a	**145,434**	**96,187**	**42,796**	**105,992**
Total - by market share	100.0%	n/a	37.3%	24.6%	11.0%	27.1%
Total - Number of companies	**38**		**6**	**9**	**7**	**16**

*Source: Companies, Coronation Research, *Capital is defined as (Paid-up capital + share premium account + retained earnings). The detailed notes on the page opposite form an integral part of this table.*

Further notes to the table in Appendix I

Data in this table is for 38 of Nigeria's 59 insurance companies for which Coronation Research has sufficient data, representing approx. N390.4bn of the industry's reported N400.0bn of Gross Premiums in 2018. Data is for full-year 2018 except for: NSIA - 2017 data; Standard Alliance Insurance - 9M 2018 data; Great Nigeria Insurance - 2017 data; Niger Insurance - 9M 2018 data; Saham Unitrust Insurance - 2017 data; United Metropolitan Nigeria Life - 2017 data; Royal Exchange Prudential Life - 2017 data.

Of the 38 insurance companies featured here, 10 are not featured in the main report for reasons of brevity: Prestige Assurance; FBN General Insurance; Saham Unitrust Insurance; Guinea Insurance; Fin Insurance Company; Veritas Kapital Assurance; Sunu Assurance; Universal Insurance; Law, Union & Rock Insurance; Linkage Assurance.

Data on capital levels (i.e. paid-up capital + share premium + retained earnings) has been taken from historic financial statements, as cited above, and will likely change due to future retained earnings, capital increases (including rights issues) and other factors including mergers and acquisitions. Therefore the table presented in Appendix I is a historic snapshot of how insurance companies were positioned with regard to NAICOM's minimum capital requirements at the time those capital requirements were published in May 2019, notwithstanding the fact that Coronation Research does not have up-to-date (i.e. full year 2018) data for certain companies, as detailed above.

Important notes to pages 7-8, and to this table

Several insurance companies have already announced plans to raise capital in order to bring themselves into compliance with NAICOM's requirements. We expect the list of eight companies raising capital, which we give below, to grow.

a) AIICO is reported to have shareholder approval to raise up to N25.0bn in new capital. (b) Lasaco Insurance is reported to have obtained shareholder approval to raise up to N10.0bn in new capital. (c) 29.9% of NEM's capital is reported to have been purchased by AFIG Funds. (d) Sovereign Trust Insurance is reported to be raising N4.2bn through a rights issue. (e) 39.9% of Royal Exchange General Insurance is reported to have been acquired by InsuResilience. (f) Consolidated Hallmark Insurance is reported to be raising N3.9bn through a rights issue. (g) Prestige Assurance is reported to have shareholders approval to raise N10.00bn in new capital. (h) Wapic Insurance plc is reported to have received shareholders' permission to raise N6.5bn in new capital.

Insurance companies with significant foreign investors

In this report we have made reference to several large international insurance companies present in Nigeria. Of these, we note that two of them are invested in Nigerian insurance companies that are already compliant with NAICOM's capital requirements. These are FBN Life, where Sanlam of South Africa is the investor, and Zenith Life Insurance, where Prudential of the UK is the investor.

Two other international heavyweights present in Nigeria are Germany's Allianz SE which owns Allianz (formerly Ensure), and Axa of France which owns Axa Mansard. We expect that Allianz will be able to raise capital from its parent and that Axa Mansard will be able to do likewise (and we note that its extra capital requirement is not large). However, at the time of going to press neither company has made an announcement about capital raising. Likewise we have not read any notification from investees of other foreign strategic investors: Great Nigeria Insurance (IRCSC); Universal Insurance (Liberty Holdings); Saham Unitrust (Saham). However, we understand that Old Mutual of South Africa is committed to raise the capital of its Nigerian investment.

APPENDIX II

Asset Management Income

The small role of asset management in insurance company groups

All insurance companies manage assets since they manage the premiums held on their balance sheets. Income from these investments is important to their profitability, as we have seen in the section 'Profitability of risk transfer' where we distinguish between 'Underwriting income' and 'Underwriting income plus investment income'. A small number of insurance companies outsource the management of their liquid assets to specialist asset managers but, for the most part, managing liquid assets is a core competence of Nigerian insurance companies.

A few Nigerian insurance companies take this a step further, and have asset management companies of their own which manage external clients' funds. There is a strong logic to this, in our view. Once an insurance company has established the trading and settlement structure plus the investment expertise to manage its own balance sheet, why not offer them to outsiders as well? As we have seen, in the section 'Nigeria's ability to increase financial inclusion', pension and mutual fund management are growth industries so it would be logical for insurance companies to join them.

However, and surprisingly, not many Nigerian insurance companies, or Nigerian insurance company groups, have asset management subsidiaries.

Among those disclosing data, it is noticeable that few enjoy a significant uplift from their asset management businesses. The ones that do are Zenith General Insurance, Prudential Zenith Life Insurance and Custodian and Allied Insurance. It must be said, however, that in some significant cases information is lacking. For example, the financial statements of ARM Life and Standard Alliance Insurance do not break out asset management contributions (because of their group structures), nor do those of Leadway Assurance (which in any case sold its asset management business in 2018).

Asset management Profits Before Tax (PBT) as a proportion of insurance PBT

Naira millions	Insurance PBT 2014	Asset Man PBT 2014	Insurance PBT 2015	Asset Man PBT 2015	Insurance PBT 2016	Asset Man PBT 2016	Insurance PBT 2017	Asset Man PBT 2017	Insurance PBT 2018	Asset Man PBT 2018
Composite										
AIICO Insurance	3,110	250	1,448	358	11,196	467	1,471	845	2,967	354
AM PBT as % of Insurance PBT		*8.0%*		*24.7%*		*4.2%*		*57.5%*		*11.9%*
Axa Mansard Insurance	1,026	(82)	689	64	1,264	98	1,446	111	1,828	184
AM PBT as % of Insurance PBT		*-8.0%*		*9.2%*		*7.7%*		*7.7%*		*10.0%*
Cornerstone Insurance	1,374	(463)	(342)	(112)	(1,516)	(37)	(2,582)	(110)	1,397	191
AM PBT as % of Insurance PBT		*-33.7%*		*32.9%*		*2.4%*		*4.2%*		*13.7%*
Non-life										
Custodian and Allied Insurance	3,666	933	3,525	1,076	5,598	1,191	6,283	1,580	6,102	1,727
AM PBT as % of Insurance PBT		*25.4%*		*30.5%*		*21.3%*		*25.2%*		*28.3%*
Zenith General Insurance	718	2,706	1,700	3,382	1,671	5,970	4,000	5,630	(924)	3,832
AM PBT as % of Insurance PBT		*377.1%*		*199.0%*		*357.3%*		*140.7%*		*-414.6%*
Royal Exchange*	159	7	141	9	(331)	51	(188)	10	n/a	n/a
AM PBT as % of Insurance PBT		*4.6%*		*6.5%*		*-15.3%*		*-5.2%*	n/a	n/a
Life										
Prudential Zenith Life	533	840	234	1,078	163	847	474	1,307	194	1,291
AM PBT as % of Insurance PBT		*157.7%*		*461.4%*		*518.0%*		*276.0%*		*666.3%*

*Source: Companies, Coronation Research, **Royal Exchange General and Royal Exchange Prudential Life Insurance*

APPENDIX III

Annuity Income

The potential of the annuity business

As we have seen in the case of Nigerian pension funds, the savings and retirement industry has proven fertile for growth over the past 10 years. Assets under management (AUM) of Nigeria's pension funds grew by an inflation-adjusted CAGR of 9.8% 2008-18. It makes sense, at first sight, for insurance companies to get into this business. Although there is not a lot of published data on the annuity businesses of Nigerian Composite Insurers and Life Insurers, there is some data to suggest that premiums from annuities can, for some insurance companies, outstrip the premiums from group life and individual life policies combined.

However, there are issues with running annuity businesses in Nigeria. First, there is the problem of matching liabilities with assets given the frequent shortage, and illiquidity, of long-term financial instruments – annuities can require 30-year duration or longer. Second, interest rates in Nigeria are inherently volatile, so pricing can be difficult. As the data in the table below shows, while some companies appear to do very well out of their annuity business, others are inconsistent and can make underwriting losses.

A note on sources

Of the 15 Composite Insurers and Life Insurers which we study in this report only four break out their annuity from their individual life and group life streams of income. This gives us little data from which to establish any meaningful trend. What we have is presented here.

Selected companies' annuity business in comparison with life businesses

Naira millions	Individual life	Group life 2016	Annuity	Individual life	Group life 2017	Annuity	Individual life	Group life 2018	Annuity
Composite									
Leadway Assurance:									
Gross Premiums	1,027	2,443	28,119	2,547	2,584	56,157	1,410	4,107	51,764
Underwriting profits	(1,091)	13	3,428	733	(247)	11,594	(1,206)	(1,092)	2,945
AIICO Insurance:									
Gross Premiums	12,749	2,073	3,959	16,413	2,043	3,222	21,085	2,913	2,618
Underwriting profits	2,494	1,612	4,549	(1,668)	(18)	(6,314)	53	394	(892)
AXA Mansard Insurance:									
Gross Premiums	863	2,293	289	783	2,536	258	3,450	1,276	10
Underwriting profits	259	846	388	783	2,536	258	421	1,927	264
Life									
ARM Life:									
Gross Premiums	68	698	62	68	781	2,727	112	1,077	4,510
Underwriting profits	148	517	498	257	743	649	449	650	1,026

Source: Companies, Coronation Research

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FBNH	1-Jan-19	Buy	21-Dec-18	Buy	8-May-19	Buy	7.5	12.5
Zenith	1-Jan-19	Buy	21-Dec-18	Buy	8-May-19	Buy	20.45	27.5
UBA	1-Jan-19	Buy	21-Dec-18	Buy	8-May-19	Buy	6.6	11.5
GT Bank	1-Jan-19	Hold	21-Dec-18	Hold	8-May-19	Hold	32.3	35
Access	1-Jan-19	Buy	21-Dec-18	Buy	8-May-19	Buy	7	8.7
Fidelity	1-Jan-19	Buy	21-Dec-18	Buy	8-May-19	Buy	1.85	2.4
Stanbic IBTC	1-Jan-19	Buy	21-Dec-18	Buy	8-May-19	Buy	43.5	66
Sterling	1-Jan-19	Hold	21-Dec-18	Hold	8-May-19	Hold	2.7	1.9

	Date	Recommendation	Current price, Naira/s	Target price, Naira/s
Nestle Nig.	17-May-19	Hold	1,300	1,213.89
Flour Mills of Nig.	17-May-19	Hold	13.50	18.29
Unilever Nig.	17-May-19	Hold	29.45	28.39
PZ Cussons Nig.	17-May-19	Hold	5.90	8.22

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