REPORT ON RECAPITALISATION OF INSURANCE COMPANIES: THE TIER BASED MINIMUM SOLVENCY CAPITAL (TBMSC)

Further to the directive of the President to review and advise the Council appropriately in respect of the newly introduced Tier-Based Minimum Solvency Capital (TBMSC) for the recapitalization insurance companies, which was presented to the Insurers' Committee by the National Insurance Commission on 25th July, 2018, we present here below as requested.

The Committee observed that although, the general expectation was that NAICOM was first going to embark on the recapitalization of insurance brokers, the programme of recapitalization of insurance companies at this moment was coming at the right time.

The Committee also feels that although the policy guideline was targeted at insurance companies, it is critical that the insurance broking industry examine the effect of the policy on its industry, as the health and well-being of insurance companies is a critical factor for the survival of the insurance broking industry as the brokers cannot exist without the insurers.

The Committee therefore sought to address at the onset, the impact of the new capital regime on insurance brokers and the insurance broking industry in general, then the insurance companies and the economy, and presents its findings hereunder.

REVIEW OF THE TBMSC

The need to arrest declining public confidence in the insurance sector since the last recapitalization exercise was done a little over ten years ago in 2007 has been in the air for some time. There has been clamour for another regime of recapitalization, especially in recent times following the official further devaluation of the naira. The undercapitalization in the insurance industry has become even more pronounced in the light of increasing forex based risks and the inability of insurers to take the opportunities from the local content policy without undue exposures, or meet contractual obligations to clients and other stakeholders. A major fall out of the last

recapitalization was the lack luster performance of insurance companies as evidenced by inadequate returns to shareholders and zero share appreciation of companies quoted on the stock exchange.

Following the clamour the insurance companies met with NAICOM in February this year and agreed to a desirable recapitalization. NAICOM hopes to achieve this recapitalization through the introduction of a Tier-Based Minimum Solvency Capital (TBMSC) programme as a complimentary measure to its ongoing implementation of the Risk-Based Supervision (RBS) programme.

TIER LEVELS

The TBMSC model is a 3-Level capital structure which introduces proportionate capital requirement that supports the nature, scale and complexity of the business conducted by insurance companies. NAICOM hopes to do this without the cancellation of the license of any insurance company or requirement for the injection of fresh capital, subject to solvency control levels.

In the implementation, insurance companies will be grouped into three tiers after a detailed assessment of their business and operations had been carried out by the NAICOM Implementation Team. The companies will then be restricted to underwriting specific classes of business based on any of the tier in which they fall into post-assessment. Insurance companies would only be required to inject new capital or take other measures, where they seek to underwrite other classes of business above the tier in which they find themselves after the assessment.

The advertised tiers and classes of business that the companies in each tier will be able to underwrite, and the percentage increase that would be required over the existing minimum capital for insurance companies seeking to underwrite business above the tier in which the assessment places them are as stated in the table below.

Ranking	LIFE COMPANIES	TBMSC (NBn)	Increase over existing capital

Tier 3	Individual Life	**2Bn**	NIL - Existing MPUC (*Base Capital*)
	Health Insurances		
	Miscellaneous Insurances		

Tier 2	*All Tier 3 Risks*	**3Bn**	50% additional on Base Capital
	Group Life Assurance		

Tier 1	*All Tier 2 Risks*	**N6Bn**	200% additional on Base Capital
	Annuity		

Ranking	**NON LIFE COMPANIES**	**TBMSC (NBn)**	**Increase over existing capital**

Tier 3	Fire	**3Bn**	NIL - Base Capital (Existing MPUC)
	Motor		
	General Accident		
	Engineering (Compulsory)		
	Agriculture		
	Miscellaneous Insurances		

Tier 2	*All Tier 3 Risks*	**4.5Bn**	50% additional on Base Capital
	Engineering (All inclusive)		
	Marine		
	Bonds		
	Credit Guarantee		
	Suretyship		

Tier 1	*All Tier 2 Risks*	**N9Bn**	200% additional on Base Capital

	Oil & Gas		
	Aviation		

Ranking	COMPOSITE COMPANIES	TBMSC (NBn)	Increase over existing capital
Tier 3	Life - All Tier 3 Risks	**5Bn**	NIL - Base Capital (Existing MPUC)
	Non Life - All Tier 3 Risks		
Tier 2	Life - All Tier 2 Risks	**7.5Bn**	50% additional on Base Capital
	Non Life - All Tier 2 Risks		
Tier 1	Life - All Tier 1 Risks	**15Bn**	200% additional on Base Capital
	Non Life - All Tier 1 Risks		

CONTROL LEVELS

Resulting from the detailed assessment to be carried out using the 2017 financial statements of the insurance companies and other criteria by the Commission, different levels of intervention may be required to ensure that all the insurance companies continue in operation profitably. In this regard, the Commission has established what it calls “Intervention Level” that it derives from “Safety Levels” which are a range of parameters indicative of the minimum solvency capital requirement of each of the tiers. Based on this, “Control Levels” are established into which insurance companies will be categorized. The control levels range from 1 to 4 and determines the actions that will be required from the insurance companies and level of intervention that the Commission may make to ensure the continued profitable existence of the insurance companies. The intervention and safety levels and the safety parameters are as stated in the table below.

Intervention Levels	Safety Levels	Safety Parameters
1	X ≥ 130%	The Parameters indicate the excess over the Minimum Solvency Capital Requirement of each of the Tier
2	120% ≤ X < 130%	
3	100% ≤ X < 120%	
4	X < 100%	Less than base safety level at TBMSC

In addition to the minimum solvency capital requirements, NAICOM's detailed assessment of the internal operations of each of the insurance companies will be a major determinant of the control level under which each insurance company is placed. NAICOM's extent of intervention under each control level is described in more detail below.

Control Level 1

Companies well run, all financial and non-financial indicators within acceptable range. No action required by the insurance company. Regular filings with NAICOM can continue. No action required by NAICOM and it will continue its regular review of the returns of the insurance company.

Control Level 2

Companies reasonably well run with a few financial and non-financial indicators outside range or deteriorating. Such companies will be required to submit

business strategies on how to sustain their solvency levels whilst NAICOM will hold meetings with their Executive Management and monitor them intensely.

Control Level 3

Company generally acceptable but with a number of indicators outside range or have been deteriorating. NAICOM will require such companies to inject additional capital and hold periodic meetings with the Board of Directors of such companies in addition to the requirements for companies under control level 2.

Control Level 4

Significant number of indicators outside acceptable range or have shown significant deterioration. NAICOM will consider an intervention in such companies and take measures to prevent the winding up and/or liquidation of such companies including encouraging a takeover by a stronger company.

ISSUES OF CONCERN

The TBMSC is generally regarded as desirable for numerous advantages some of which are already enumerated in the presentation of NAICOM and further detailed in other sections below. However, there are several issues of concern which have been identified as possible impediments to the success of the programme and may affect us as insurance brokers. Some of these are detailed hereunder:-

TIER POSITIONING CRITERIA

In determining the Tier into which insurance companies are placed, NAICOM used only the minimum capital base requirement without consideration for the minimum solvency capital of requirement for the insurance companies. In this regard for example, companies can be positioned in Tier 1 and have the intervention requirements of Control

Level 4. It is unimaginable that any insurance broker would want to place any business with such a company much more special risks business at that. In view of this, it is advised that a combination of the capital base and the solvency margin should be used in placing companies into Tiers with weights attached to each criteria if so desired.

RESOLUTION OF CLAIMS

The resolution of claims during the implementation and intervening period may be a major issue for insurance brokers if sufficient focus is not placed on it as clients stand the risk of losing out with the attendant consequences of possible litigation where outstanding claims are not conclusively attended to during this period. Proper tracking and monitoring systems will have to be put in place to ensure complete and satisfactory resolution of all claims.

TIMING

The Committee is of the opinion that the timing for the implementation of the programme is extremely tight given the critical nature and likely impact of the programme on the insurance industry, and level of activities that insurance companies may be required to undertake. Publicly quoted insurance companies for instance may require regulatory approvals for any change in their capital structure which would be outside their sphere of control and even that of NAICOM.

There is a strong possibility that insurance companies may consider the M & A option which require detailed activities that can be time consuming in itself.

ASSESSMENT CRITERIA

The financial statements of insurance companies for the year ended 31st December 2017 will be used for the assessment to be carried out by NAICOM according to the guideline. This may deny some insurance companies their 2018 performance which could have placed them in better stead. In addition, the short notice would likely jeopardise the ability of insurance

companies to raise funds as may be required to place them in their desired tiers.

As no insurance company will want to be left behind, they may resort to all kinds of survival strategies, where the constrain of time threatens their survival.

It is therefore our considered opinion that the notice given is not sufficient and implementation timelines are too short and may actually jeopardize the programme.

RISK PRICING & COMPETITION

It is envisaged that the TBMSC will introduce very stiff competition as the management of each emergent company attempts to justify the huge investment and confidence reposed in it. Some of the leading insurance companies will be challenged for the advantages they currently enjoy by the emerging strong companies. There will be stiff competition across all the tiers and this heightened competitive pace may instigate a price war where smaller nimbler companies may be able to take businesses away from the big companies where clients have a preference for low premiums as it is typical of the Nigerian market which can then lead to avoidable exposures if not well managed.

RESTRICTION ON BUSINESS DEALINGS

In view of the restrictions placed the classes of business that the different tiers can write, the guideline may restrict business dealings and risk placing permutations that may further enhance the performance of insurance companies.

POLITICAL & BUSINESS ENVIRONMENT-

The TBMSC is being implemented at a time when the primary focus is on the forthcoming elections. This may make it a difficult time to attract the

injection of new funds, particularly in the light of the very poor returns to shareholders from the last recapitalization exercise and the poor performance of the shares of insurance companies on the stock market. Most companies may therefore look towards M & As with its attendant challenges, especially in the light of the short period available for implementation.

HUMAN RISK FACTORS

There is a major risk of serious job cuts, changes in placements and rationalization as new companies emerge either through M & As or new investors entering into existing companies. The human risk factors may include the downplaying of employees welfare in merger and acquisitions, dealing with employee resistance to change under the new reality, loss of job commitment, redundancy, and employee turnover with concomitant loss of key talents.

MICRO INSURANCE COMPANIES

The role of micro insurance companies need to be reviewed in the new dispensation as they could pose serious threats to the survival of the companies that end up in the Tier-3 category. According to the Micro-insurance guidelines, micro-insurance companies will be able to underwrite same policies as Tier-3 category companies, being only restricted to sums insured of not more than two million naira.

LIKELY BENEFITS

It is envisaged that a successful implementation of the TBMSC will bring about a stronger and more vibrant insurance industry.

Some of the identified benefits of the programme as it relates specifically to brokers are:-

STRONGER INSURANCE COMPANIES

Stronger insurance companies will be able to negotiate better terms with reinsurers thus giving brokers better deals that they can pass on to their clients. Several insurance companies actually only just take the business and send abroad especially in the areas of oil & gas, aviation and power, or reinsure locally with the attendant complications in the event of a claim. Successful implementation of the programme will lead insurance companies with bigger capacities that will boost the confidence of brokers.

PREMIUMS RETENTION

More of the gross premiums generated will be retained by insurance companies for the benefit of the economy. This will in turn lead to the growth of the insurance companies for the ultimate benefit of its stakeholders.

LOCAL CONTENT REQUIREMENTS

Brokers have had to contend with NAICOM's insistence that local content be satisfied. It will be easier for brokers to comply with this whilst their client's exposure to the weak insurance companies that they have had to accommodate will be reduced.

NEW INVESTORS

The TBMSC regime may also significantly increase the number of foreign insurance companies in the Nigerian market. This will further intensify the competitive tempo of the operating insurance companies. This implies that the quality of services which Nigerian insurance companies are expected to render to their customers must improve if they are to retain their customers.

NEW TECHNOLOGY

With increased investment, the industry will be able to attract the latest technology and new expertise whilst enhancing innovation at all levels.

BETTER POSITIONING

The incursion of new investors in the insurance industry will result in higher levels of investments and thus put the insurance industry in a better position amongst other players in the Nigerian financial services sector.

CONTRIBUTION TO GDP

Increased premiums retention along with increased levels of investments in the insurance industry will lead to a higher contribution by the industry to the nation's GDP.

INTERNATIONAL COMPANIES

The bigger and stronger insurance companies will also be able to extend their frontiers into African countries and beyond in the same manner that some big banks have done and probably take an increased share of the African insurance market.

KNOWLEDGE/EXPERTISE

With the level of increase, the insurance industry will be more attractive and will attract better professionals and the much needed expertise. Specialist insurance companies may also arise thus deepening market penetration. Capacity building for the operators in the industry will also be enhanced

International investors who partner with local companies will open up fresh ideas and attract new brains into the industry.

RATING

With stronger financials, our insurance companies can get international ratings thus enhancing their international status and reducing level of risks to be carried overseas.

MARKET PENETRATION

The strong companies emerging will also be able to properly deploy retail strategies that will ensure deeper insurance penetration to capture the opportunities available in the retail market.

MERGER & ACQUISITIONS

It is expected that the number of insurance companies in the market will shrink. Companies will likely explore mergers and acquisitions as a survival option, although with the associated human risk factors. New players will also likely come into the industry with a stronger and more dynamic industry emerging at the end of the day.

CLAIMS SETTLEMENT

With availability of more funds claim settlements can be more effective and the brokers will be better for it. In addition, higher risks can be written with confidence as claim settlements, with proper management of the company will not be an issue.

RECOMMENDATIONS

The Committee is of the opinion that the insurance industry has been in a state of comatose for some time. Not only has the industry in general been seriously underperforming in the area of returns to shareholders and share appreciation for those quoted in the capital market, several insurance companies have actually shown signs of distress and illiquidity with some companies being unable to meet contractual commitments.

The TBMSC will give NAICOM the opportunity for the long overdue clean up that is much needed in the insurance industry. Whilst there are numerous benefits as already highlighted, the possible impediments are extremely critical and can easily wipe the benefits out.

The Committee feels that TBMSC will ensure that the insurance industry realizes its great potentials and therefore recommends that the Council should give NAICOM its full backing whilst highlighting the likely

impediments to the successful implementation of the programme as enumerated above.

Accounting Sub-committee
23rd August 2018