# The role of insurance in inclusive growth: Nigeria in brief

## Note 4

December 2018

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*DFID has partnered with the World Bank, FSDA and Cenfri to conduct a series of diagnostics to understand how insurance market development can contribute to sustainable and inclusive growth.*

# Table of contents



## Abbreviations

| | |
|---|---|
| ABP | Anchor Borrowers' Programme |
| AYI | area yield insurance |
| CPS | Contributory Pension Scheme |
| ERGP | Economic Recovery and Growth Plan |
| MSME | micro, small and medium-sized enterprises |
| NAIC | Nigerian Agricultural Insurance Corporation |
| NAICOM | National Insurance Commission |
| NIA | Nigerian Insurers Association |
| NIRSAL | Nigeria Incentive-Based Risk Sharing System for Agricultural Lending |
| NGN | Nigerian Naira |
| SME | small and medium-sized enterprises |
| USD | United States dollar |

## USD/NGN Exchange rate

The local currency in Nigeria is the Nigerian Naira (NGN). Throughout this note, an exchange rate of NGN360 per USD was used, unless specified otherwise.

# 1. About this note

This is the fourth note in a series of six notes that explore the role of insurance in sustainable development and inclusive growth in sub-Saharan Africa (SSA) from three perspectives: (i) in building household resilience, (ii) in supporting business resilience and enterprise development and (iii) in capital market development. The notes in this series are summaries of larger diagnostic studies to explore the development path and contribution of the insurance market in four countries: Ghana, Kenya, Nigeria and Rwanda.

The series is organised as follows:

- Note 1 introduces the series and positions the scope of the diagnostics.
- Notes 2 to 5 respectively present the findings for each of the case study countries.
- Note 6 synthesises key themes across the case studies and draws conclusions and recommendations for SSA on how to further develop insurance markets to support sustainable growth and economic development.

This note explores the state of the insurance sector in Nigeria and unpacks the key drivers of market development, its current role in inclusive growth and what can be done to enhance its role. It draws on desktop research, analysis of data from the EFInA Access to Finance Survey (2017) and the Nigerian Insurance Association's Digest 2016, as well as in-country stakeholder consultations conducted in March 2018.

# 2. Drivers of market development

***A large economy with a strong diversification imperative.*** Nigeria is a populous country, home to one in every five Africans. The population is growing. It is also urbanising rapidly. While the formal economy is unable to absorb the growing workforce, the informal economy is buoyant, particularly driven by small-scale traders. The economy has a strong economic growth track record in recent decades, largely on the back of the oil-and-gas sector, but it experienced a recession in the aftermath of the global oil price slump in 2014 and 2015. As the economy recovers from recession, there is a strong policy focus on diversification through the Economic Recovery and Growth Programme (ERGP), with particular emphasis on industrialisation via the SME sector as well as agricultural value chain development for food security.

Table 1 outlines summary indicators for Nigeria as quoted in the diagnostic study:

| | | |
|---|---|---|
| **Demographics** | Population<br>Population urbanised | 189 million<br>90 million |
| **Macroeconomic** | GDP per capita<br>Oil & gas as % of total exports<br>Inflation rate | USD1,994.2<br>83% (2017 Q4)<br>15.7% |
| **Financial inclusion** | Banked population | 38% of adults |

| | | |
|---|---|---|
| **Insurance uptake** | Insurance uptake | 1.9% of the adult population |
| **Size of the insurance market** | Insurance market penetration | 0.3% of GDP |
| | Number of life insurers | 27 (13 composite) |
| | Number of general insurers | 41 (13 composite) |
| | Number of local reinsurers | 2 |
| | Life insurance: GWP (2016) | USD421 million |
| | General insurance GWP (2016) | USD629 million |
| **Value and performance** | Life insurance: average claims ratio | 60% |
| | Life insurance average profit margin | -4% |
| | General insurance: average claims ratio | 30% |
| | General insurance average profit margin | 3% |

**Table 1: Key statistics**

***Insurance can serve diversification imperative, but pervasive structural constraints.*** There should be opportunities for insurance on the back of the turnaround of the economy; and, in principle, insurance can support several of the ERGP pillars. Foreign acquisitions of local insurers over the past few years confirm the opportunities in the Nigerian market. However, several market features challenge insurers' ability to reap the returns:

- ***Fragmented market with often poor performance.*** At 59 licences across a relatively small premium pool, the insurance market is fragmented. Apart from a few larger and stronger insurers, there is a large tail-end of insurers with small balance sheets and often weak business fundamentals[1]. For many insurers, expense ratios are high and claims ratios are either too low to provide consumer value or too high to attain profitability.
- ***Limited asset base constraining capacity to absorb risk***. The ability of the insurance sector to fulfil its role as risk manager in the economy is determined, to a large extent, by the size of its assets. Insurance companies hold only 2.5% of total financial sector assets, with the majority of those assets being on the balance sheets of general insurers.
- ***Skills constraints***. Technical skills are scarce, and the number of insurance professionals is disproportionately low for the number of insurers and brokers in the market. The scarcity of technical skills also affects the regulatory authority and its ability to regulate and supervise the market.
- ***Trust deficit***. Poor-performing insurers and a poor claims track-record are fuelling public distrust in insurance. The market's reputation is further tainted by compulsory insurance lines that are poorly enforced and seen by the populace as a tax, rather than a benefit.

Overall, Nigeria exhibits features of relatively low insurance market development: Corporate and compulsory general insurance still accounts for the bulk of premiums. Life and health insurance is largely provided on a group basis, serving only a small, relatively high-income base, and the individual retail insurance market is nascent.

Against this backdrop, how is insurance in Nigeria faring in supporting household resilience, business growth and capital market development, respectively; and where do the main opportunities and imperatives lie?

[1] Such that the insurance sector is the worst-performing sector on the Nigerian Stock Exchange with trading prices often close to zero

# 3. Current role in inclusive growth

## Role of insurance in individual and household resilience

***Limited current impact on individual and household resilience.*** Less than 2% of Nigerian adults have insurance and most people rely on family and friends to cope with risk. Alternatively, they forego consumption or draw on savings, thus decreasing their resilience. The limited uptake is underpinned by low trust in insurers and a lack of awareness of insurance. Health insurance is the most popular, but at 609,000 adults, it serves only a fraction of the adult population. Other notable categories include life insurance (including compulsory group life), vehicle insurance (including compulsory third-party liability insurance) and endowment savings products.

***Reach limited to urban, high-income segments, mostly male***. Insurance uptake is concentrated in urban areas, largely in the south and within specific target markets that are typically easier to reach. Almost half of the 1.8 million adults who have insurance work as salaried employees; and 65% of all those with insurance are male.

***Distribution challenges to reaching the mass market***. Distribution is largely broker-driven, and most premium collection is done through corporate payments. Agent sales are growing, but agent distribution is limited to a few insurers that are proactively pursuing retail insurance. Bancassurance holds much potential given the large number of banked individuals without insurance, but there have not been any significant developments so far, partly due to recent bancassurance guidelines being perceived as restrictive.

***Opportunities for enhancing individual and household resilience.*** The diagnostic report identifies several opportunities for the insurance market to contribute towards the resilience of individuals and households:

- ***Easy-to-reach target market.*** The formally employed market of 7.9 million individuals remains largely untapped (only 10.6% having insurance, 33% being women) and presents a ready distribution channel via employee groups. Voluntary group health presents scope to deepen the employee benefits market for the growing middle class. The annuities market is growing fast on the back of pensions market growth and is seen as a core growth area for many life insurers.
- ***Aggregator-based distribution.*** To reach individuals in rural areas and the urban mass market, distribution through aggregators that have an existing relationship with clients is needed. Mobile distribution, bancassurance and retailer distribution all hold potential. In each case, however, several barriers would need to be overcome: the trust barrier on the demand-side, a supply-side innovation-barrier and a regulatory framework largely orientated to broker distribution.
- ***Takaful insurance.*** Sharia-compliant insurance products hold potential to increase the penetration of insurance to northern parts of the country, but indications are that reach is still limited, largely due to distribution constraints in serving the northern regions and the limited availability of individuals that can serve on the requisite Shariah boards.
- ***Microinsurance.*** Microinsurance is regarded as an opportunity for innovation, but overall market interest is lacklustre – understandably so, given the constraints in serving even the upper end of the retail market. Claims ratios are low. Regulatory restrictions

that have held back the development of mobile money and the use of airtime to pay premiums prevent scale via mobile insurance distribution.

## Role of insurance in business resilience and enterprise development

***Insurance contribution to business resilience mainly via extractive industry – but domestic insurance sector fulfilling a limited part of that role.*** To date, the role of the insurance sector in economic growth has been primarily through sustaining activity in the extractive industries, particularly oil and gas. Despite local content legislation that requires the bulk of oil-and-gas risks to be carried domestically, limited balance sheets and capacity constraints mean that the majority of premiums are reinsured and, eventually, most risks are carried abroad.

***Insurance able to serve as an enabler for SME industrialisation, but current role limited.*** Many small businesses face substantial challenges such as poor infrastructure, obsolete technology, weak access to markets, inconsistent government policies, regressive multiple taxation and limited access to credit. Insurance has an important role to play in principle in helping to cover risks and grant access to credit; but in practice very few, if any, MSMEs are covered. The current landscape is indicative of a market still struggling with the basics of corporate insurance, with limited ability or incentive to innovate to serve more difficult-to-reach, less lucrative small business and trader clients.

***Pervasive insurable risks in agriculture.*** Agriculture supports the livelihoods of many Nigerians, yet it is unable to meet domestic food security needs. Weather-related and biological risk events often have devastating effects on yields and disrupt the entire value chain from input suppliers to ultimate food processors. Risk mitigation through insurance provision in agriculture has been limited to date, largely provided by the state-owned Nigerian Agricultural Insurance Corporation (NAIC). The market has only recently been made more accessible to private-sector participation, through public-driven schemes such as Nigeria Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL) and the Anchor Borrowers' Programme (ABP) [2].

***Opportunities for enterprise development***. The diagnostic report identifies the following opportunities for insurance to contribute to business resilience and enterprise development:

- ***Access to credit for MSMEs***. Insurance, as a risk management tool, can be an important enabler of access to credit by reducing the risk of lending to SMEs for credit providers. In particular, meso-level insurance distributed via credit providers presents an opportunity, but indicators are that the bancassurance guidelines pose challenges to bank-based distribution, especially in rural areas.
- ***Public–private partnership in agro value chains.*** The fragmented nature of smallholder farmers means that, for agricultural insurance to reach scale, distribution needs to be anchored to a central off-taker, lender or processor. Government-driven schemes such as the NIRSAL and ABP enable value chain development, credit expansion and guarantees through public–private partnerships, but indications are that much efficiency gains can be had in public-driven initiatives.

[2] NIRSAL mobilises financing for Nigerian agribusinesses by using credit guarantees to address the risk of default, while ABP creates economic linkage between smallholder farmers and reputable large-scale processors with a view to increasing agricultural output and significantly improving capacity utilisation of processors.

- ***Introduction and expansion of index-based products.*** The development and launch of area yield insurance in Nigeria was spurred through the coordination of NAIC, NIRSAL, and private insurance and reinsurance companies, and weather index insurance is planned. However, the feasibility and scalability of index-based insurance in Nigeria is constrained by low access to capital, inadequate technical skills and limited good-quality data.

### Role in intermediation of capital

***Intermediation role of insurers constrained by small balance sheets.*** The poor performance of the insurance industry is reflected in the poor performance of the share prices of insurers. Consequently, insurers have struggled to raise capital on the public capital market, which has inhibited their ability to efficiently manage large risks in the economy. Where the role of insurers as institutional investors is concerned, the relatively small premium pools and short-term nature of their liabilities constrain the ability of insurers to play a significant intermediation role, thereby limiting the impact of insurers on capital market development.

***Larger role for pensions sector***. When also considering the role of the pensions sector more broadly, the capital market development role expands greatly. The pensions market, as long-term savings pool, has an asset base approximately seven times bigger than the insurance industry, reaches many millions more clients and is an important source of domestic credit to the government.

***Opportunities for capital market development.*** The report identifies the following long-term opportunities for insurance markets to support capital market development.

- ***Annuity market a growing source of investable funds***. The annuities market is the direct linkage between the insurance and pensions sector.[3] From 2013 to 2016, pension fund assets increased by more than 50%. Therefore, the annuities market represents a significant growth opportunity for life insurance that, in turn, helps to build the longer-term investment allocation role of the insurance sector. However, capitalising on the annuities opportunity requires advanced skills and capabilities.
- ***Development of appropriate and suitable long-term investment instruments.*** For more of the potential role of insurance and pensions in intermediating investments for growth to be realised, viable longer-term investment instruments must be developed that can effectively compete with government debt.

# 4. What can be done?

According to its industry development plan, NAICOM aims to increase insurance penetration seven-fold in the medium term. Doing so requires a dramatic step-up in the market's performance. This note has shown that insurance market development in Nigeria faces many challenges. However, if the constraints are overcome, the opportunities are massive given the scale of the market. The diagnostic identifies the following imperatives to do so:

[3] A Contributory Pension Scheme (CPS) requires employers and employees to contribute to an employee's retirement; and at retirement, the accumulated savings of retirees can be utilised either in a Programmed Withdrawal or a Retirement Annuity.

- ***Improve market fundamentals.*** Mergers or exit of unsustainable insurers is required to limit the erosion of public trust by poor market performance and to build the capacity required to underwrite large industrial risks. Raising capital requirements, in itself, will not be sufficient to achieve this objective without better enforcement and a broader move to embed a risk-based approach to governance and greater professionalism in the market.
- ***Ensuring better value in the compulsory insurance market.*** Greater cross-agency collaboration is required to improve enforcement of compulsory insurance. Even more so, efficient consumer redress systems and increased claims ratios are necessary to enhance awareness of insurance and ensure better value for consumers.
- ***Broader distribution options.*** Agent and aggregator-based distribution is required to unlock the retail insurance market opportunities. The Microinsurance Guidelines already broaden the intermediation space beyond brokers and agents. An equivalent regulatory dispensation is needed in the market at large for the development of alternative distribution channels.
- ***Deal with unintended regulatory consequences.*** Government is already coordinating around some of the bottlenecks to mobile distribution. However, more needs to be done to achieve results and drive market development. Bancassurance regulation is perceived as too restrictive, product-approval processes are experienced as slow and inefficient, and institutional investment guidelines entrench overly cautious asset allocations. It is important to find a speedy resolution that will help to kick-start momentum in the market.
- ***Skills development***. The technical skills gap creates an imperative for a concerted skills development initiative to improve the ability of the insurance sector to cover risks appropriately. This includes underwriting skills, actuarial and cost management skills, alongside capacity in product design and delivery.
- ***Revisiting implications of local content requirements.*** The ability of the local insurance industry to safely and sufficiently carry risks in the oil-and-gas sector is compromised by small balance sheets. The negative economic impact of insurance failure is greater than the upside of keeping premiums on-shore. The local content regulation is already being circumvented to a large extent via global reinsurance. This indicates that the local industry recognises its own inability to carry the risk and asks for a reconsideration of how best to achieve local industry development policy objectives.

The imperatives outlined above centre on a need to incrementally improve market fundamentals to create a more innovative market environment that will, in turn, trickle down into a more pronounced role for insurance in household and business resilience and build greater capital market linkages. This requires a strong regulatory framework and regulator.

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