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The Nigerian Insurance Industry

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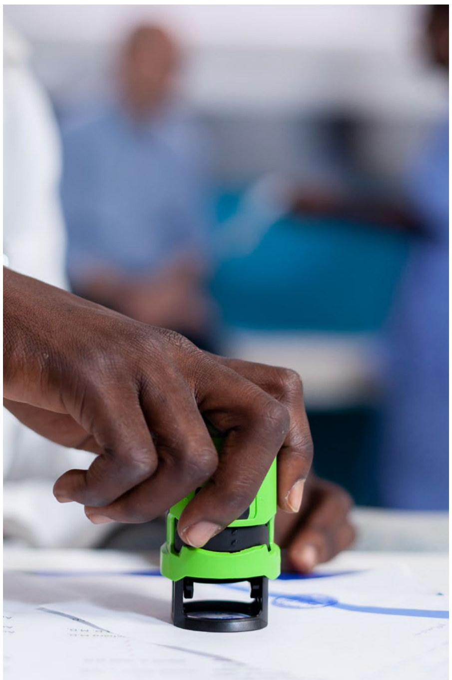
Executive Summary

The Nigerian insurance industry is poised for substantial transformation. 2025 has arrived with promising attempts by the insurance regulator and key insurance industry stakeholders to create robust frameworks amidst a period of multidimensional structural change in the industry.



The Nigerian insurance industry is poised for substantial transformation. 2025 has arrived with promising attempts by the insurance regulator and key stakeholders to create robust frameworks amidst a period of multidimensional structural change in the industry.

In 2024, the Chairman, Senate Committee on Banking, Insurance & Other Financial Institutions presented an insurance bill to the National assembly sparking the resurgence of the much-awaited reforms in the insurance industry. In March 2025, shortly before this paper was published the House of Representatives passed the Insurance Industry Reform Act 2024.

The proposed reforms include provision of compulsory insurance cover substantial increases in minimum capital requirements, aimed at enhancing financial stability, and improving consumer protection. While the objectives outlined in the bill are commendable, the increased capital requirements may pose significant challenges for smaller players, potentially leading to market consolidation and reduced competition. This paper analyses the potential impact of the reforms on market structure, competition, and consumer affordability, while exploring strategies for mitigating the potential negative consequences.

Furthermore, the paper delves into the critical issue of recapitalisation, examining the challenges and opportunities associated with raising the required capital. It considers accessing diverse funding sources, optimizing capital allocation, and ensuring efficient capital utilization. The importance of strategic planning and robust risk management frameworks to successfully navigate the recapitalization process is emphasised.

Recognising the pivotal role of risk management, the paper explores the significance of the Risk-Based Capital (RBC) regime. It discusses the key principles of an effective RBC framework, including identifying and quantifying key risks, setting appropriate capital levels to absorb potential losses, and continuously monitoring and adjusting capital requirements based on evolving risk profiles.
The paper further emphasises the crucial role of Asset-Liability Management (ALM) in ensuring the long-term sustainability of insurance companies. It analyses the challenges and opportunities associated with managing the interplay between assets and liabilities, including mitigating various risks such as interest rate risk, credit risk, and liquidity risk.

Beyond compliance, IFRS 17 implementation continues to have significant impact on insurers globally. This paper delves into the critical aspect of post-implementation issues of IFRS 17, particularly its interplay with finance transformation, the RBC regime, and ALM.

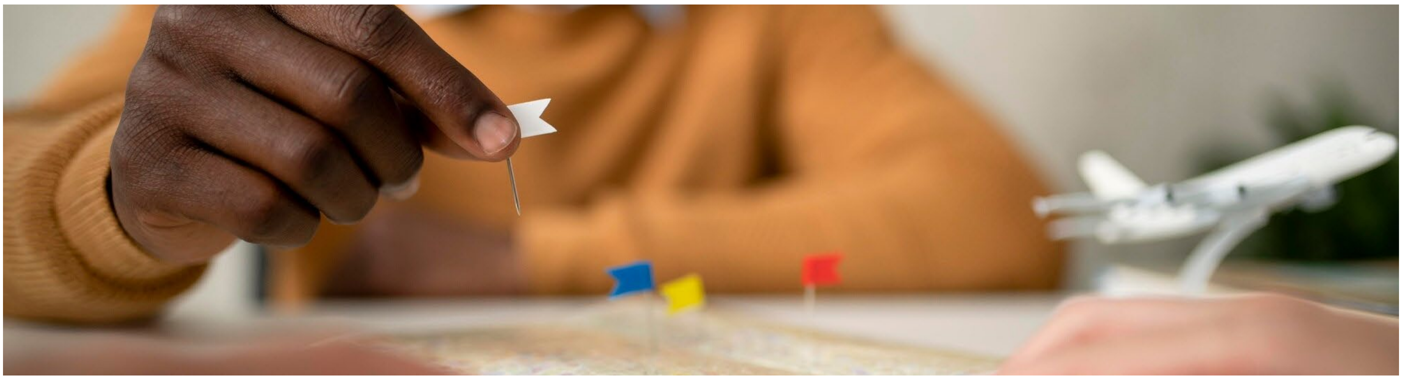
Finally, the paper considers the evolving sustainability considerations for the Nigerian insurance industry, including the impact of climate change on underwriting, investment portfolios, and operational risks. It also explore how insurers can integrate sustainability principles into their business strategies, including developing sustainable insurance products, investing in climate-resilient infrastructure, and readiness for compliance with IFRS S1 and S2

Key Takeaways:

- The Nigerian Insurance Industry Reform Bill presents both challenges and opportunities for the insurance sector.
- Achieving successful recapitalisation requires careful planning, strategic capital allocation, and a robust risk management framework.
- Implementing a robust Risk-Based Capital (RBC) regime is essential to ensuring the financial stability and long-term viability of insurance companies.
- Inclusion and deliberate enforcing of compulsory insurance cover is likely to boost insurance penetration in Nigeria.
- Effective Asset-Liability Management (ALM) strategies are essential for mitigating liquidity and other market risks.
- IFRS 17 continues to significantly impacts the insurance industry, requiring significant changes to accounting practices, risk management, and business models.
- The new sustainability-related disclosure standards will significantly impact the insurance industry, requiring significant changes to accounting, risk management, and business models. Integrating sustainability principles into business strategies is crucial for long-term success

We trust that you find our outlook to be a guiding document amidst the regulatory changes, challenges and surprises anticipated in 2025. As always, we are available to help you chart a successful course.

Insurance Bill 2024



The Nigerian insurance landscape is on the verge of a significant transformation, with the Nigeria Insurance Industry Reform Bill of 2024 ('the Bill'). The Bill, currently under consideration, encompasses a wide range of reforms, including a substantial increase in minimum capital requirements for insurance companies. While the increased capital requirements aim to bolster financial stability and enhance the sector's capacity to absorb shocks, they may be potential challenges for smaller players in the industry and could impact market competition.

The successful implementation of the Bill will depend on careful planning and execution. Addressing concerns related to affordability, ensuring a level playing field for all market participants, and fostering a conducive environment for innovation will be crucial to realising the full potential of this transformative legislation.
As the insurance industry navigates this period of significant change, proactive engagement and thoughtful discourse among all stakeholders, including regulators, insurers, consumers, and other industry players will be crucial. This collaborative approach is essential to achieving the intended outcomes of a stronger, more resilient, and inclusive insurance sector for Nigeria.

Key Provisions

The key provisions of the Bill are set out below:

Classification of business	• The Bill retains the classification of insurance business into Life and Non-life insurance. • No major change in the subcategories of business, except that annuity business is now separated from individual life business. • Energy (oil, gas, and power insurance) replaces oil and gas, allowing exploration of power insurance in non-life business.
	Implications: Overall no major changes from the previous requirements.

Specialisation	• Insurers can no longer receive composite licenses, but NAICOM may issue the licences to reinsurers. Existing composite insurers have 5 years to separate into Life and Non-life entities. • Licenses will be specialised, though Life businesses can hold shares in Non-life companies, and vice versa.
	Implications: Entities holding composite insurance licenses will be required to undergo structural separation. Currently, there are 12 composite insurance companies operating in Nigeria.
Capital requirements	• The minimum capital requirements for insurance licenses have significantly increased: - Non-life insurance: Higher of N25 Billion or Risk-Based Capital (RBC) as determined by NAICOM (previously N10 Billion). - Life insurance: Higher of N15 Billion or RBC as determined by NAICOM (previously N8 Billion). - Reinsurance: Higher of N45 Billion or RBC as determined by NAICOM (previously N20 Billion). - RBC requires insurers to calculate capital based on the risk they face including insurance, market, credit, and operational risks. • It should be noted that where the Commission considers it appropriate, having regard to the nature, size and complexity of the insurance business carried on or proposed to be carried on by an insurer, and to the insurer's risk profile, the Commission may issue a directive requiring the insurer to increase its capital requirement to an amount higher than the minimum capital requirement specified earlier. • Existing insurance companies are expected to comply with the capital requirements within 12 months of the commencement of the Bill.
	Implications Insurance entities need to consider recapitalisation options soon. With the passage of the Bill, insurersl race to meet the 12-month deadline. Increasing the capital base is vital to improve capital adequacy affected by inflation, interest rates, currency volatility, and forex illiquidity. This will enable Nigerian insurance companies to accept and retain more business.
Operation of insurance company	• In addition to current reporting requirement, every insurer shall, on or before to 31st of March of each year prepare and submit to the Commission, a report of its RBC levels as at 31st of December of the preceding year.
	Implication: Insurance entities will need to develop internal capacity to monitor the RBC level and reporting to the Commission

<table>
<tr><td>Premiums and commissions</td><td>

• The Bill retains the “no premium no cover “principle.
• It also retains the maximum commission payable for different class of business. In addition, the maximum level for group life and workmen’s compensation was included as stated below:
- Commission payable should not exceed (except with prior approval from the commission)
- a) 10 per cent of the premium in respect of group life assurance; - not in 2004 Act
- (b) 12.5 per cent of the premium in respect of motor insurance business;
- (c) 15 per cent of the premium in respect of workmen’s compensation; or not in 2004 Act
- (d) 20 percent of the premium in respect of any other class of non-life insurance business.
• Subject to regulation, insurer will be at liberty to grant incentives in the form of ‘no claims’ discount, (NCD) risk improvement discount, profit share and other similar forms of incentives in respect of any class insurance, and the Commission shall from time-to-time issue Regulations for the application and administration of such incentives.

Implications:
Insurance entities may be permitted to adopt a risk-based pricing model, subject to the Commission’s directive. This approach is commonly followed in other developed countries.
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<tr><td>Compulsory insurance</td><td>

1. Group Life Assurance

• The Bill mandate that every employer shall maintain a Group Life Assurance policy for each employee for a minimum of three times the annual total emolument of the employee and premium shall be paid not later than the date of commencement of the cover.
• An employer who fails to comply with this section shall be liable to a fine of NGN250,000 for every employee without a Group Life Assurance Policy or as the Commission may determine from time to time.

Comment: While the change is commendable, enforcing these requirements for every employer may be challenging. These may be more practical to apply it to employers with a minimum number of employees.

2. Insurance of building under construction.
• The Bill retains compulsory insurance for building under construction of more than 1 floor (in the previous act, it was 2 floors).
• Penalty for non- compliance- is a fine of NGN5,000,000.00 or imprisonment to a maximum term of 12 months or both. This marks a significant change relative to the 2004 Act where penalty for non-compliance is a fine NGN250k or 3 years or both.

Comment: The significant increase in the penalty may serve as deterrent to builders. However, just as the existing act, the issue of enforcement was not addressed.

3. Insurance of public buildings.
• The Bill retains the requirements of compulsory insurance for every public building
- “public building” includes a tenement house of more than 1 floor (British building standard), hostel, a building occupied by a tenant, lodger or licensee and any building to which members of the public have access for the purpose of obtaining educational or medical service, or for the purpose of recreation or transaction of business.
• The penalty for non- compliance is a fine of not less than NGN1,000,000.00 or imprisonment for a term not exceeding 12 months or both. This marks a significant change relative to the 2004 Act where penalty for non-compliance is a fine 100k or 1yr imprisonment or both .

Comment: The retention of public building Is needed to boost the penetration level. However, definition of “public” should also encompass individual buildings, which is the common practice in other developed markets.
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Premiums and commissions	**4. Insurance of Government Assets and Employees** • The Bill introduces insurance of all federal government assets and employees. • The Bill mandates insurance for all federal government assets and employees against hazards and perils, as determined by the Commission. **Comment**: Given the size of federal government assets and employees, his provision is likely to result in increase in the market size of insurance business in Nigeria to the extent of full compliance by the federal government agencies. In the future, we anticipate inclusion of state and local government. **5. Insurance of petroleum and gas stations; and products in transit.** • All petroleum and gas stations must be insured against third-party losses from fires or explosions. • Non-compliance may result in at least 2 years imprisonment, a NGN1,000,000 fine, or both. **6. Motor Vehicle Insurance (THIRD PARTY)** • Insurance for motor vehicles (minimum of third party) remains mandatory. • Compensation for death or total permanent disability total permanent disability (TPD) is set at NGN2,000,000.00, or a higher amount as determined by the Commission in its regulations. **7. Credit Life** • Credit providers must require borrowers taking loans over NGN10,000,000 to get credit life insurance. This covers the loan balance if the borrower dies or becomes permanently disabled. • The insurance cost must be transparently disclosed to the borrower. **8. Insurance of container** • An importer, broker, or agent must obtain insurance from a Nigerian-licensed insurer for container delivery. • Non-compliance results in a NGN1,000,000.00 fine.
Other areas	**1. Road accident victims' compensation fund.** • A Fund called the Road Safety and Accident Victims Compensation Fund (the "Fund") is established. • It will receive 1% of the net premium from every motor vehicle insurer. This adds costs to the insurance business. **2. Contract with foreign insurer and reinsurer.** • Except as otherwise exempted by the Commission , a person shall not place insurance or reinsurance business with a foreign insurer or reinsurer in respect of any life, asset, interest or other properties in Nigeria classified as domestic insurance or reinsurance business unless with a company licensed under the Bill. **Comment:** The expectation is that with the increased capital base, the retention ratio would increase for both insurance and reinsurance entities **3. Human resource training for special risk business.** • Insurers and reinsurers must allocate at least 3% of their net premiums from special risk businesses to human resource training. • Non-compliance will result in a fine of NGN5,000,000.00. **Comment:** This would encourage capacity building of staff of insurance entities

The Bill presents both challenges and opportunities for the insurance sector in the country. The challenges and opportunities are outlined in the next subsections.

2.2 Challenges

- Higher capital requirements pose a concern, especially for smaller insurance companies, which may struggle to meet new new thresholds and may lead to mergers or acquisitions and reduced competition.
- Impact on affordability of insurance: Increased operational costs for insurance companies due to higher capital requirements could translate to higher premiums for consumers, making insurance less affordable for some.

Implementation challenges: Successfully implementing the new regulations will require careful planning, deliberate enforcement and execution to avoid disruptions to the insurance market.

2.3 Opportunities

- Improved consumer protection: The reforms may lead to better corporate governance practices and stronger consumer protection measures, enhancing trust in the insurance sector.
- Enhanced financial stability: Higher capital requirements could strengthen the financial position and solvency of insurance companies, making them more resilient to shocks and better able to meet their obligations to policyholders.
- Attracting foreign investment: A more stable and well-regulated insurance sector may be attractive for foreign investment, bringing in capital and expertise.
- Increased innovation: The Bill may create an environment that encourages innovation and the development of new insurance products tailored to the evolving needs of the Nigerian market.
- Many industry players argue that the larger insurance companies with more financial strength to underwrite large insurance deals are better placed to benefit from the new reforms. The higher capital requirements may encourage mergers and acquisitions, creating larger, financially robust insurance companies similar to the banking industry's consolidation. Note that this may also result in risks such as contagion risk and concentration risks.
- The deliberate enforcement of compulsory insurance may lead to improvement in insurance penetration ratio.

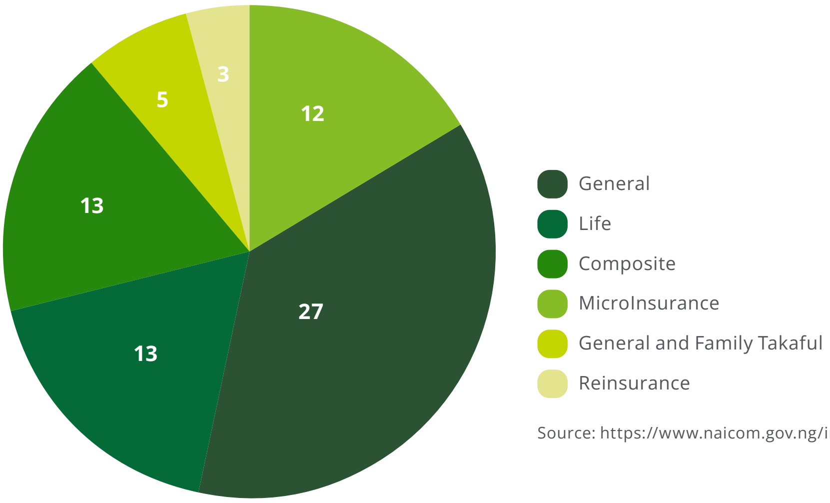
The final provisions of the Bill may differ from the current draft, and the actual impact of the reforms will depend on the implementation and enforcement.

Recapitalisation of Insurance Industry

3.1 Insurance Business in Nigeria

The Nigerian insurance industry supports economic growth by mitigating risks for individuals and companies. It provides protection against events like natural disasters, accidents, and health emergencies, encouraging confidence and innovation. Additionally, by investing premiums in sectors like infrastructure and government securities, it contributes to capital formation and further stimulates economic development.

Nigeria Insurance Industry by type of License



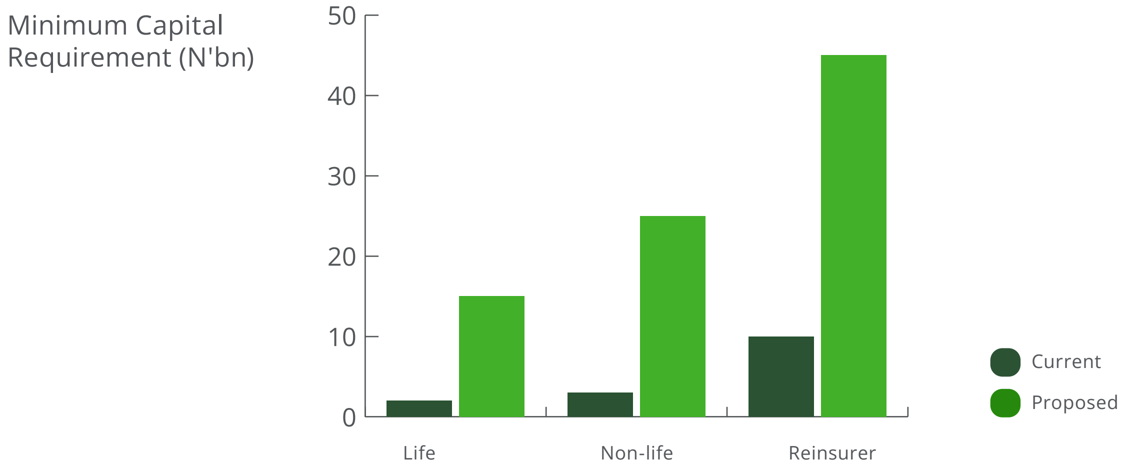
Source: https://www.naicom.gov.ng/insuranceindustry

The Nigerian insurance industry comprises of a mix of large, established players and smaller, new entrants. Distribution channels include conventional methods such as agents and brokers, as well as innovative channels like bancassurance and digital platforms.

The Nigeria Insurance Industry Reform Bill, 2024 marks a significant milestone in the development of the Nigerian insurance sector. By increasing capital requirements, the reform aims to foster the industry development while simultaneously safeguarding the interests of the policyholders.
The minimum capital requirements for insurance licenses have significantly changed:

- Non-life insurance: Higher of N25 Billion or Risk-Based Capital (RBC) as determined by NAICOM (previously N10 Billion).
- Life: Higher of N15 Billion or RBC as determined by NAICOM (previously N8 Billion).
- Reinsurance: Higher of N45 Billion or RBC as determined by NAICOM (previously N20 Billion).

The Nigerian insurance industry plays a vital role in supporting economic growth and development by providing crucial risk mitigation mechanisms.



3.2 Options Available to Insurers

Insurance companies can explore various recapitalization options, including issuing new shares through rights issues or public offerings, pursuing mergers and acquisitions with other insurers, and reinvesting profits. The optimal strategy will vary depending on factors such as the company's financial position, market conditions, and strategic objectives.

Injection of fresh equity capital through private placements, rights issue and/offer for subscription

Insurance companies can meet the increased capital requirements through the injection of fresh equity capital. This can be achieved through private placements, where companies seek investment from a select group of investors such as private equity firms or institutional investors. While this method offers greater flexibility and control compared to public offerings, it could also lead to a potential increase in the cost of capital due to higher cost of equity capital relative to debt.

Alternatively, companies can conduct rights issues, offering existing shareholders the right to purchase additional shares at a discounted price. This method can enhance shareholder loyalty and maintain their proportionate ownership.

Finally, companies may opt for an offer for subscription, issuing new shares to the public through an Initial public offering (IPO) or a follow-on public offering. While this can provide access to a broader investor base, it may involve greater regulatory scrutiny and exposure to market volatility.

Given the additional capital requirements, Insurers may turn to foreign portfolio investors. An influx of foreign capital would boost the country's forex liquidity, potentially boosting the stability of the local currency. The big insurance companies, with their established reputations, are likely to raise the required capital within the stipulated time frame, while others will need to foster a more concerted effort with this option.

Mergers and acquisitions (M&A)

Mergers and acquisitions (M&A) can help Nigerian insurance companies meet capital requirements by pooling resources and increasing their capital base. M&A can lead to cost synergies through economies of scale in operations, distribution, and technology. It may also expand market share, diversify products, and enhance competitive advantages. However, M&A may not fully achieve capital raising goals due to the exclusion of certain shareholder funds from qualifying capital and debt raising.

M&As should be considered for their pre- and post-acquisition impact on the insurer's operations. Smaller insurers might explore M&As alongside capital injection, but determining suitable partners is crucial. Larger insurers may pursue strategic acquisitions for expansion and operational synergies. Insurers with M&A experience can better manage process hurdles like valuation agreements, while those without experience should seek qualified M&A advisers.

Despite these challenges, M&A activity is likely to increase significantly in the Nigerian insurance sector as companies seek to meet the new capital requirements and enhance their competitiveness. Strategic alliances and acquisitions will play a crucial role in shaping the future landscape of the Nigerian insurance industry.

Dividend recapitalisation – Use of retained earnings

Retained earnings provide a significant avenue for insurance companies to meet the increased capital requirements. By reinvesting a substantial portion of their profits back into the business, companies can organically increase their capital base without diluting existing shareholder ownership. This approach allows for gradual and sustainable growth, minimizing the risk of over-reliance on external funding sources. However, relying solely on retained earnings may not be feasible for all companies, particularly those with lower profitability or those facing significant growth pressures. Furthermore, the pace of capital accumulation through retained earnings may be slower compared to other options, potentially impacting the company's ability to quickly meet the regulatory deadlines.

Strategic alliances and acquisitions will play a crucial role in shaping the future landscape of the Nigerian insurance industry.

3.3 Implication of Recapitalisation

3.3.1 Risk, Capital and Accounting Considerations

Regulators globally mandate higher capital requirements, believing it makes the insurance industry more resilient, increases loss absorption, and reduces insolvency risk. Recapitalisation impacts risk, capital, and accounting management, as insurers comply with regulatory options.

It is noteworthy to mention that the proposed recapitalisation will impact capital planning and key risk metrics (e,g Capital adequacy ratio) prescribed by the regulator. The array of options to be adopted by insurance companies could have varying effects on the regulatory capital and risk metrics. It is most likely that at the initial phase post recapitalisation, many risk and capital ratios would immediately become very impressive, substantially exceeding the minimum regulatory thresholds.

After recapitalisation, insurers will need to demonstrate efficient capital deployment, affecting their risk metrics and future capital ratios. This is particularly important for those complying through M&A. Acquiring insurers should evaluate the assets, liabilities, and capital exposures of targets, which may impact risk-based capital calculations. Both pre and post-recapitalisation risks and capital statuses should be key factors in decision-making, including assessing how capital metrics will respond to mildly stressed scenarios.

From an accounting perspective, there are significant reporting requirements that will be triggered irrespective of the options considered by insurers to meet the CBN directive. Business combination in line with IFRS 3, treatment of capital raise cost under IAS 32, acquiring insurance contract under IFRS 17, IFRS 7 on disclosure of financial instruments, IAS 33 earnings per share (EPS) noncurrent assets held for sale and discontinued options are but a few of the accounting standards that will be triggered.

Insurer must consider these ahead and model the resulting impact on the books including disclosures. Below are the specific risk, capital and accounting considerations for each possible option.

A. Mergers & Acquisition

M&A can contribute to a successful recapitalisation in some ways such as providing economies of scale. i.e., merging can lead to cost savings and improved efficiency, potentially freeing up resources for the acquirer to raise additional capital through retained earnings; enhanced market position – attraction to new investors, making it easier to raise capital through new share offerings; diversification of the acquirer's customer base, potentially improving its overall financial health and risk profile, which can be beneficial during recapitalisation.

M&A between insurers typically focuses on consolidating businesses, not directly increasing the acquirer's paid-up capital during a recapitalisation. However, to address the NAICOM probable objective of enhancing paid up capital or keeping it within the minimum threshold for the capitalisation groups just like the other options, merger arrangement must involve the issue of new acquirer shares as the acquisition currency.

With proper pricing, the net assets of the acquiree may be substantially reflected in the newly issued shares thereby boosting the paid-up capital in a manner that achieves the recapitalisation objective.

Risk and Capital Implication

From a risk perspective, M&A in the Nigerian insurance sector presents both opportunities and challenges. On the one hand, mergers can mitigate operational risks by improving efficiency and reducing costs through economies of scale. For example, combining IT systems and back-office functions can lead to significant cost savings. Furthermore, a larger, more diversified entity may be better equipped to withstand unforeseen shocks and market fluctuations, thereby reducing overall operational risk which is a critical risk component in risk based capital calculation

However, M&A transactions also introduce new risks. Integration risks, such as cultural clashes, conflicting business philosophies, and difficulties in integrating disparate systems and processes, can disrupt operations and negatively impact performance. Cybersecurity risks may increase with the integration of different IT systems, potentially exposing the combined entity to cyber threats. Moreover, reputational risks can arise from negative publicity associated with the M&A process, such as customer dissatisfaction or employee unrest. Thorough due diligence, careful planning, and effective integration strategies are crucial to mitigate these risks and ensure a successful M&A outcome.

The capital adequacy ratio (CAR), (a key metric used to ensure that insurers maintain sufficient capital reserves to absorb potential financial losses) of most insurers are currently above minimum threshold and so in a merger arrangement, substantial dilution of CAR is not envisaged. It is however important to consider the current market portfolio of the target insurer as key impact factors in post-merger CAR.

Accounting Implication

The critical standard here is IFRS 3 Business Combinations. Other accompanying standards such as IFRS 13 and IAS 36 are also relevant in view of the specific measurements of assets and liabilities. The acquisition method of accounting is what will be used even if both insurance companies are relatively of similar size. Consequently, there must be an acquirer and an acquiree Purchase price/purchase method, Goodwill or Bargain purchase, which are the three accounting terms that can change the dynamics in terms of resulting position of post-merger from a recapitalisation perspective.

Also, there is IAS 33 Earning per share (EPS) Impact in calculating the weighted average number of shares of outstanding (the denominator for the earning per share calculation) during the period in which the acquisition occurs and the resulting possible dilution or synergetic upgrade of EPS.

IFRS 17 Impact

IFRS 17 has increased the importance of transparency, accuracy and consistence in financial reporting. Under IFRS 17, financial statements provide a more comprehensive and comparable view of an insurer's financial performance. This enhanced transparency is crucial for M&A valuations, due diligence processes, and post-merger integration.

IFRS 17 has driven a shift in focus towards long-term profitability and cash flows. This has led to a greater emphasis on the long-term implications of M&A deals in insurance industry, including the impact on future profitability, cash flow generation, and capital requirements. The Impact of IFRS 17 on business combination can be viewed from different lenses including:

- Contractual Service Margin (CSM) Implications: The CSM captures the expected profit over the life of an insurance contract. When acquiring a portfolio of insurance contracts, the acquirer must re-evaluate the CSM based on its own assumptions and risk profile. This can lead to significant adjustments to the purchase price, as the acquired CSM may differ significantly from the CSM recognized by the seller.
- Impact on Profitability and Capital: The re-evaluation of CSM can have a significant impact on the acquirer's financial statements, including its profit and loss (P&L) balance sheet. Changes in CSM are recognized in profit or loss over the life of the insurance contracts, impacting the acquirer's reported profitability. Furthermore, changes in CSM can also impact the required capital for the acquirer, as regulatory capital requirements often consider factors like the level of risk associated with the insurance contracts.
- Integration Challenges: Integrating acquired insurance contracts into the acquirer's existing portfolio under IFRS 17 can be complex. This requires harmonising data systems, aligning risk management processes, and ensuring consistent application of accounting policies across the combined entity.

IFRS 17 has increased the complexity of financial reporting for insurers particularly the life insurers. This can make M&A transactions more challenging, as acquirers must carefully assess the impact of IFRS 17 on the target company's financial performance and prospects. This requires a deep understanding of the target company's business model, its insurance contracts, and its IFRS 17 implementation.

B. Injection of fresh equity capital

The option of injecting fresh capital through vehicles like IPO, rights issue or private placement will generally improve liquidity, leverage, and capital adequacy ratios of insurers. Insurers can also use this fresh capital to expand its assets and change the composition of its risk portfolios. As positive as this may sound, rebuilding capital positions essentially by attracting fresh investment is more than a simple re-stocking exercise. To attract new capital, or to be able to retain earnings without losing the confidence of investors, insurers will need to be seen as investable businesses both locally and internationally. There is a possibility of unintended

effects on profitability in terms of return to equity.
The point to note here is the practical challenge insurers may face in raising new capital amidst severe economic challenges and recapitalisation exercise ongoing in the banking sector. Interest rates are at record high levels, looming credit impairment , real sector capacity to produce is stifled and foreign exchange net flow deficit is not encouraging. The economic picture by its variables and metrics alone gives less confidence around the timing of recapitalisation via fresh capital injection from the public if the bill implementation is to happen now

Foreign portfolio investors are a suitable direction for insurers in search of fresh capital. With the depreciated naira, foreign investment inflows will help to ease dollar illiquidity and boost external reserves accretion.

Another good option (if not for regulatory restrictions) is pension funds. With the mammoth cash in pension funds, meeting these capital requirements by some of the most profitable and stable insurers (by risk and performance ratios) would have been an easier ride.

Risk and Capital Implication

As indicated earlier, insurers will have elevated leverage ratios alongside improvements in capital adequacy ratios (CARs). This strong position will precede the redeployment of the additional capital raised towards the expansion of the business and asset. The risk and capital implication largely depend on how the insurer strategically plans the equity injection and how the insurer utilizes the recapitalisation in either increasing its asset portfolio or decreasing leverage. Capital from the fresh issue is not a free commodity, it comes with its own cost that must be covered by the insurer. The management must design a credible pathway to demonstrate the economic viability of the insurer in generating capital returns that exceed capital cost.

Accounting Implication

Earnings Per Share EPS (IAS 33): Where equity increase is purely from capital market events as against organic generation of equity, the profit after tax will gradually grow towards current capital levels, hence there will be a decrease in the earning per share. Where an insurer decides to raise capital through an IPO, are subject to increased disclosure and filing requirements. These statements will need to be transparent and clearly reflect the impact of the IPO on the insurer’s financial position.

Share Issuance Cost: Insurers will incur costs associated with the IPO process, such as underwriting fees, legal fees, and marketing expenses. These costs are typically treated as deduction to equity in line IAS 32 on presentation of financial instruments to the extent that they are incremental costs directly attributable to issuing equity.

3.3.2 Tax and regulatory consideration

Some tax considerations for the options available to insurance companies include:

1. **Injection of fresh equity capital through private placements, rights issue and/offer for subscription:**

This option attracts minimal tax implications given its simplicity. Tax consideration would be whether the private placements, rights issue/offer for subscription will create any tax exposure for the insurance company or existing shareholders or prospective investors. There is no transfer or capital gains tax on issuance of shares. However, where the share capital of the insurer is increased as a result of the rights issue and/ offer for subscription, stamp duties would be applicable at an ad valorem rate of 0.75% on the value of the increased share capital of the insurance company. Generally, all transaction costs involved in the capital raise will be non-deductible as they are considered capital in nature. However, insurance companies may make a special case for deductibility of these costs relying on the “accord and satisfaction” principle relied upon in Shell v FBIR. This is on the premise that the increase in capital is as mandated by the Bill and these costs were wholly, reasonably, necessarily and exclusively incurred in maintaining its license for income generation.

2. **Merger and acquisition:**

Under this option, an insurance company may consider acquiring the shares of another insurance company and thereafter merge with the acquired insurance company. It is also possible to adopt an outright merger without initial acquisition of shares. Regardless of the structure of the merger, it is important to note that there are tax consequences as well as opportunities that can be harnessed. Some of the relevant implications are set out below:

a. Capital Gains Tax (CGT)

i. Share transfer - Capital gain from the sale of shares of a company is taxable under the Capital Gains Tax Act (CGTA). Section 30 (2) of the CGTA imposes CGT at 10% on any capital gain made by a person on disposal of shares in any Nigerian company except any of the following conditions is met:
  - where the disposal proceeds are less than NGN100m in any 12 consecutive months, or
  - where the sale proceeds are reinvested in shares of a Nigerian company within the same year of assessment, or
  - where the shares are transferred between an approved Borrower and Lender in a regulated Securities Lending Transaction.

  Based on the above, any acquisition which does not fall within any of the exceptions above triggers CGT. In this regard, strategic acquisitions may be conducted in tranches below NGN100mn threshold to eliminate the CGT impact. This is in view of the provision of CGT (albeit theoretical) that seems to suggest that a sale of an asset is voidable until applicable CGT has been settled. For mergers, this provision may not be triggered as shareholders of the submerged insurance company obtain shares in the resultant entity, thus considered investment in another Nigerian entity.

ii. Transfer of assets – Any gain realized on the disposal of an asset is subject to CGT at 10%. Mergers typically involve transfer of assets and liabilities, thus the transferor may be obliged to pay CGT at 10% on gain arising from the disposal of the asset. There is, however, room to enjoy relevant incentives in this regard.

b. Companies Income Tax (CIT)

Similarly, based on the Companies Income Tax Act (CITA), there could be CIT implications for the transferor depending on the value at which the assets are transferred vis-a-vis the tax written down value (TWDV) of the assets transferred. This may or may not result in a deductible allowance or a taxable charge.

c. Other Transaction Taxes

The transferee will also be required to pay value added tax (VAT) at 7.5% and stamp duty at 1.5% of the value of assets transferred.

NOTE: Insurance companies seeking to merge can take advantage of the tax incentives in the CITA, Value Added Tax Act, Stamp Duty Act and CGTA, provided they meet certain conditions. Some of these incentives include: deeming assets transferred as a result of the merger as transferred at TWDV and exemption of such assets from CGT and stamp duties.

One of the key conditions for enjoying the tax incentives above is that the merging entities must be related companies with one of the companies controlling the other or both being controlled by some other persons or being members of the same group of companies. Also, this relationship must have been in place for 365 days (about 12 months) prior to the merger date. Consequently, insurance companies wishing to take advantage of the above incentives will have to ensure this condition is met. The merging companies will also be required to obtain the approval of the Federal Inland Revenue Service before the merger/acquisition is concluded, in line with section 29 (12) of CITA.

Finally, another key consideration for insurance companies looking to merge is the potential loss of some tax assets such as accumulated capital allowances, unrelieved tax losses and unutilised withholding tax (WHT) credits of the merging entities. This is because the position on whether these assets can be utilised by the surviving/emerging entity, post-merger, is not clear in CITA. Consequently, this gives room for the tax authority to exercise discretion. Nonetheless, insurance companies would have to examine the potential risk of losing tax assets in determining the recapitalisation option to adopt.

3. Capitalisation of undistributed profits:

In line with section 9(3)(a) of CITA, any distributions from retained earnings, including bonus issues, are deemed as dividend distribution to existing shareholders. Therefore, this will attract all tax consequences applicable to dividend distribution. Dividends are subject to WHT deduction at 10% except where the recipient is resident in a treaty country in which the double tax agreement (DTA) specifies a reduced WHT rate. Also, in line with section 19 CITA, dividend paid out of the retained earnings of a company is exempted from excess dividend tax provided that such retained earnings have been previously subjected to tax.

Furthermore, where the bonus issue results in an increase in the share capital of a company, stamp duties would be payable at 0.75% of the value of the increase.

Regulatory considerations of the proposed options

Considering that the insurance industry is a highly regulated industry, any option chosen by insurance companies would involve regulatory approvals, notifications and processes to comply with the extant rules. We have provided below a high-level consideration of the regulatory impact of each of the options below:

1. Injection of fresh equity capital through private placements, rights issue and/offer for subscription

The injection of fresh equity capital through private placements, rights issue and/offer for subscription would require a approval from the National Insurance Commission (NAICOM). This is required to be obtained before any restructuring can be done by an insurance company in Nigeria. Additionally, all securities must be registered with the SEC. Notification will be given to the Corporate Affairs Commission (CAC) upon completion of the procedure.

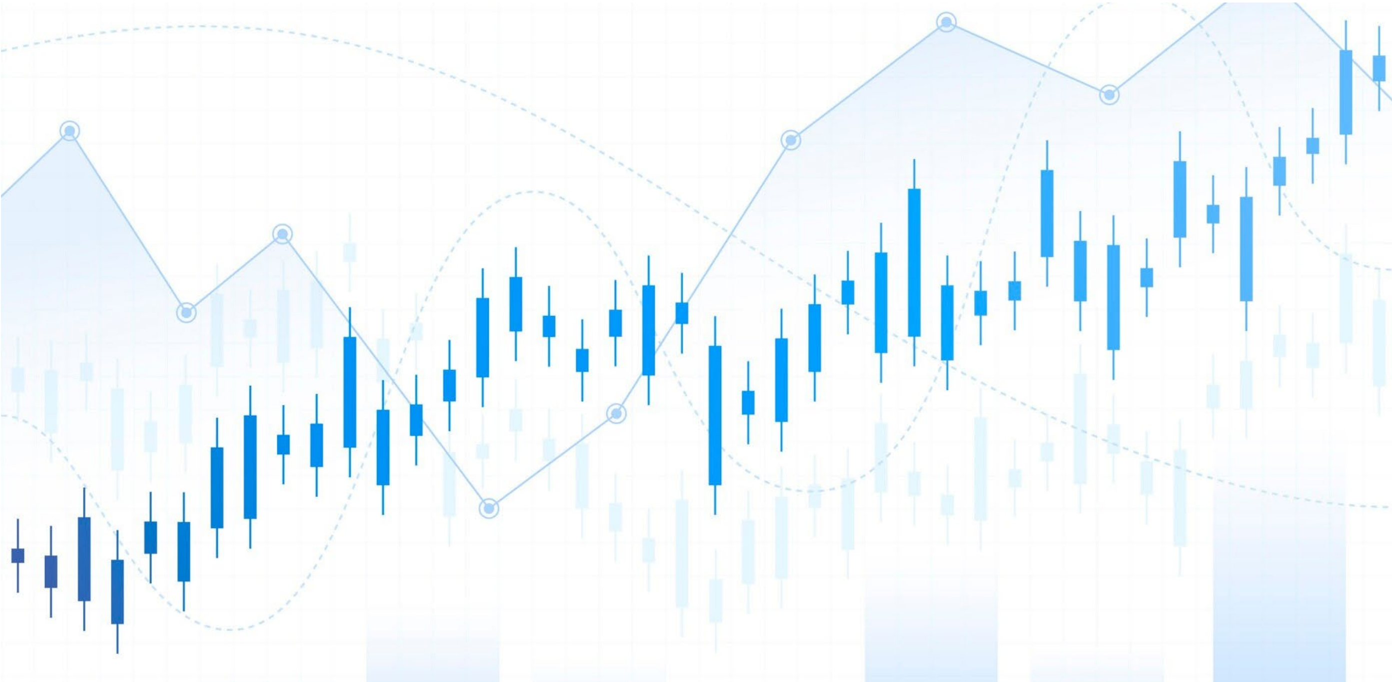
2. Mergers and acquisitions

In addition to the due diligence and transaction execution noted above, there are relevant regulatory approvals required for a merger and acquisition. A written consent from NAICOM must be obtained before any insurance company can enter into an agreement or arrangement of merger and acquisition. There is also need to obtain the approval of the Federal Competition and Consumer Protection Commission. An order of the Federal High Court will be obtained to sanction the scheme of Merger and acquisition. There would also be notification to CAC, States Inland Board Revenue, Land Registries, Financial Reporting Council etc. There may also be contractual approvals/notification required – ranging from lenders to bondholders among others.

3. Capitalisation of undistributed profits

An application must be made to register the bonus issue with SEC within one month of the passage of the resolution by the company’s shareholders in line with Rule 279(4)(b) SEC rules 2013.

Risk Based Capital Regime



4.1 Introduction

On 14th October 2024, NAICOM released the exposure draft on Insurance Risk Based Capital (RBC) regulation 2024 which provides the framework for the implementation of the RBC regime. The RBC regime aims at strengthening Nigeria policyholders' protection by ensuring the regulatory capital requirements of insurers reflect their actual risk exposures and incentivising improved risk management. This paradigm shift marks a departure from the traditional, often arbitrary, capital requirements and ushers in an era where capital adequacy is determined by the specific risks undertaken by each insurance company.

On 17th December 2024, the Nigeria Senate passed the Insurance Reform Bill 2024 which provides the legislative framework for the implementation of the RBC regime. The RBC is targeted to be effective in early 2025. With the effective date approaching soon, all insurance companies in Nigeria need to be ready for implementation. This requires reassessing the capital held in the business against the new requirements, introducing governance and controls in insurer's Own Risk and Solvency Assessment (ORSA) and ensuring actuarial and financial reporting processes are compliant with the new regulations.

In this paper, we will explore the core principles of a robust RBC framework, key provisions of the draft regulation, potential benefits, challenges, implications for the Nigerian insurance landscape. Lessons learnt from other regions will also be touched on. Furthermore, we provide Deloitte's insights on how insurers can materialise the business benefits of RBC beyond regulatory compliance through operationalisation strategies.

4.2 Risk Based Capital Framework in Insurance.

There has been an increased interest by insurance regulators across Africa to introduce risk-based capital ('RBC') regime. This has been necessitated by the desire of the regulators to see that insurers review their underlying risks and manage those risks actively.

Implementation of RBC would present an opportunity for Nigeria insurers to manage their risks and capital more efficiently. The banking sector in Nigeria, for example, has implemented Basel II & III, an RBC requirement, and is in the process of advancing to Basel IV. RBC aims to improve risk management and to align the solvency requirement with international regulatory approaches. There has been implementation of RBC frameworks in Europe, Asia and South Africa which aligns with the Solvency II framework.

Solvency II is the risk framework for insurance companies operating in EU member states that came into force on 1 January 2016. Solvency II regulations use a three-pillar approach to the solvency position of insurance companies, with each pillar governing a different aspect of the solvency position of insurance companies. It is similar to Basel II for banks:

Pillar 1:Quantitative Requirements

Pillar 1 contains the quantitative requirements designed to capture underwriting, credit, market and operational risks. Companies have to meet two capital requirements, a Solvency Capital Requirement (SCR) and a Minimum Capital Requirement (MCR). Both levels of capital represent the different levels of supervisory intervention. MCR is the minimum solvency requirement where a breach would trigger ultimate supervisory intervention. The SCR is a risk based capital requirement that can be assessed using a standardised approach or a company's own internal model.

Under the Solvency II framework, companies may calculate their capital requirements using a standard formula which is based on the correlation method. Smaller insurers are expected to opt to use the standard formula to save on costs involved in building internal models while bigger companies may opt to use an internal model. This is because the standard formula may not appropriately model the complex nature of their risks.

Pillar 2: Qualitative requirements

This covers the firm's internal controls and risk management activities as well as the supervisory process. Specifically, insurers are required to carry out their Own Risk and Solvency Assessment (ORSA) to illustrate their continued ability to meet the SCR and MCR in the near future, given their identified risks and associated risk management processes and controls. The review process itself may occasionally lead a supervisory authority a capital add-on.

Pillar 3: Reporting and disclosure requirements

Covers supervisory reporting and disclosure to the public with the aim of enhancing market discipline and increasing comparability.

4.3 Key Provision of the draft Exposure draft

Minimum Capital Requirement	The exposure draft set out that the capital requirement applicable to a licensed insurer shall be the greater of a. The amount equal to the minimum capital requirement as specified below • Non-life insurer: N10 billion • Life insurer: N8 billion • Reinsurer: N20 billion b. Its risk-based capital- The risk based capital is the aggregate of the capital required to address all relevant and material risk categories **Comments:** We observed disparity in the minimum capital requirement stated in the exposure draft compared to the draft insurance reform bill. We believe the finalised bill and RBC framework would aligned.
Risk Based Capital	The risk-based capital requirement of an insurer shall include capital requirement for insurance risk, market risk, credit risk and operational risk and shall be calculated in accordance with the following formula **Risk Based Capital = √[(Insurance Risk Capital)^2+(Market Risk Capital)^2+(Credit Risk Capital)^2 +Operational Risk Capital]** Insurance risk capital – capital required by an insurer or reinsurer to cushion against unexpected changes in the level and trend to the amount of the technical provisions. • Market risk capital – capital required by an insurer or reinsurer to cushion against volatility in the market prices of assets held by the insurer/reinsurer used to back policyholder liabilities. • Credit risk capital – capital required by an insurer or reinsurer to cushion against risk of losses resulting from counterparty default. • Operational risk capital – capital required by an insurer or reinsurer to cushion against losses that may arise from inappropriate or failed processes, systems, and people. The exposure draft provided a standardised approach to calculating each of the risk capital based on a capital charge rate for the different types of risk exposures. **Comments:** We observed the draft regulation framework primarily rely on standard formulas to determine capital requirements for insurance companies. This may be due to factors like limited data availability, resource constraints, and a focus on initial market stability, while gradually transitioning towards more sophisticated approaches as data improves and regulatory capacity. While standard formulas can provide a basic level of capital adequacy, they have limitations in capturing the full spectrum of risks faced by insurers. As the insurance industry evolves and becomes more complex, there is a growing need for more sophisticated RBC frameworks that can accurately reflect the risk profiles of individual insurers. Internal models allow insurers to parameterise and quantify their capital requirement based on their own risk profile. This is something the standard formula may not be able to capture, therefore enabling insurers to monitor and manage risks in line with their risk appetite and to ensure optimum capital allocation. The use of internal models (or partial internal model) are usually subject to regulatory approval.

<table>
<tr><td>Risk Based Capital</td><td>Furthermore, the draft framework lack provisions for diversification benefits between the different risk components, potentially leading to overly conservative capital requirements by neglecting the potential for offsetting risks across different risk components.</td></tr>
<tr><td>Capital Adequacy</td><td>

An insurer shall maintain at all times a Minimum Capital Requirement (MCR) which represents a Capital Adequacy ratio (CAR) of 100%
-CAR ratio = Available capital/Required Capital
-Available Capital= Tier 1 capital + eligible Tier 2 capital - sum of the inadmissible assets
-Required Capital = Higher of Minimum capital requirement and Risk based capital
The tier 1 capital is the highest quality, most loss absorbent and permanent form of capital. The minimum capital required of an insurer shall be required to be made up of at least 80% of tier 1 capital.
Tier 2 are capital instruments that are “less permanent” compared to Tier 1 resources, but may be available to serve as buffer against losses made by the insurer. Examples of these instruments include cumulative or redeemable preference shares and certain subordinated debt.
Tier 2 capital is eligible for the purposes of determining the Capital available of an insurer or a reinsurer only to the extent that it does not exceed the Tier 1 capital of the insurer or reinsurer.
NAICOM shall implement the following statutory actions based on the insurers CAR position

<table>
<tr><th>CAR range</th><th>Regulatory Implication</th></tr>
<tr><td>>200%</td><td>The Commission shall monitor the insurer or reinsurer without imposing any financial requirement</td></tr>
<tr><td>Between 150% and 200%</td><td>Insurer or Reinsurer shall be required to submit an acceptable plan to improve its capital position</td></tr>
<tr><td>Between 110% and 150%</td><td>The Commission shall specify actions to be taken by the insurer or reinsurer including imposing financial requirements</td></tr>
<tr><td>Between 100% and 110%</td><td>Commission takes over control of an insurer (Statutory Management)</td></tr>
<tr><td><100%</td><td>The Commission initiates wind-up process of the insurer or reinsurer</td></tr>
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</td></tr>
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4.4 Likely challenges and opportunities

Capital Impact – Potentially higher regulatory capital cost compared to the current framework. Should the market average CAR decrease, the use of more reinsurance to lower capital requirements is most likely. This will also require robust stress testing and scenario analysis, active liquidity and cash management, capital management and optimisation.

Operational Impact – Potential impact includes higher regulatory compliance cost, automation of certain reporting processes (example: modelling when internal based models become allowable), allowance for additional resources, time and cost of implementation, continuous maintenance and focus on data quality.

Shortage of Skilled resources - Skilled resources are required for the implementation of RBC and lessons learnt from regimes worldwide that have implemented RBC indicate a shortage of skilled resources to be one of main challenges to the development of such a framework. This problem will not be an exception to the Nigeria Insurance market either where there is an obvious shortage of actuaries and other trained professionals who are well placed to implement RBC. However, there is a positive trend seen in Nigeria, with an increasing number of registered actuarial students undertaking actuarial examinations provided by recognised professional bodies like the Institute and Faculty of Actuaries (IFoA) (UK) and Society of Actuaries (USA).

Business Strategy Impact – Potential business strategy impact includes change in risk appetite and internal capital trigger points, change in level playing field for some companies (example local reinsurers), review of investment strategy, comprehensive ERM framework, improved ORSA process and culture, better decision making i.e. using capital more efficiently.

4.5 What are the next steps

The draft RBC regulation is a very important step in the transition to RBC regime, nonetheless it is one step in what is still a relatively long process. We also expect to see more industry engagements involving insurers and professional bodies working together to develop some of the more detailed aspects of reform (internal models, risk management, disclosures etc), particularly through supporting delegated acts and supervisory guidance.

For regime that has implemented RBC framework, Quantitative impact studies (QIS) were deemed vital to prepare insurance companies and the industry in general for a smooth transition to RBC regime. For example, in South Africa –to gain a better understanding of the likely impact on the industry, three rounds of quantitative impact study (QIS) exercises and various industry wide data collection took place.

Implementing an RBC regime is not a quick undertaking. It requires significant time and effort from both regulators and insurers. Conducting both qualitative and quantitative studies to prepare the market is advisable to avoid disruption, prepare the market and ensure regulatory effectiveness.

While practitioners who have been involved in SAM implementations in South Africa and risk-based implementations elsewhere are available in Africa, lessons can be learnt across most roles (staff, executives, board members and various control functions).

In preparation for implementation, insurers should spend time understanding the scope of changes and how these will apply to them and develop a strategy for implementation, while monitoring and taking account of developments in relation to supporting regulations and guidance.

Asset Liability Management

5.1 Introduction

On 29th January 2025, NAICOM released the additional regulatory requirement with an effective date of 1st February 2025 for underwriting of annuity business in Nigeria which provides further guidance to ensure best practice on management of annuity portfolio particularly as it relates to Asset liability management (ALM). Recognising the long-term nature of annuity contracts and the critical role of sound ALM, these regulations provide insurers with much-needed guidance to ensure best practices in this area. By emphasizing prudent investment strategies that align asset characteristics with long-term liabilities, NAICOM seeks to safeguard the interests of annuitants and maintain the stability of the insurance market.

In this paper, we began with a brief overview of ALM principle in practice and their significance in the context of annuity business. Subsequently, we will delve into the key provisions of the NAICOM circular, analysing their implications for insurers' ALM practices. Furthermore, we will examine the specific ALM responsibilities that insurers must fulfill to comply with these regulations. Finally, we will discuss the key challenges that insurers may face in implementing and maintaining effective ALM frameworks for their annuity portfolios, including data quality issues, model risk, and the evolving regulatory landscape.

5.2 ALM at a Glance

Asset-Liability Management (ALM) at insurers is one of the most difficult functions to provide a standard structure for, given its complexity, involvement of multiple areas of the firm, and the dependence of its effectiveness on its culture, businesses, risk management, capital management, and shareholder value generation. For a number of reasons, as touched upon in this report, ALM is getting more attention, and most insurers are making changes in relation to their ALM.

Primary Responsibilities

ALM can be viewed as encompassing four key elements: Liability modeling & management, asset modeling & management, ALM reporting, and hedging. Traditionally, liability modeling has been the domain of actuaries, while asset modeling and management has fallen under the purview of investment teams. However, various ownership structures exist. A notable trend involves a rethinking of the reporting function, with a focus on:

- Uniform Metrics: Implementing consistent metrics across all lines of business for better comparability and analysis.
- Consolidated Tools: Utilising integrated platforms and tools for improved data management and reporting efficiency.
- Enhanced Controls and Oversight: Strengthening governance and oversight mechanisms to ensure data accuracy and the integrity of the reporting process.
- "One Source of Truth": Establishing a central data repository ("one source of truth") to improve data quality, reduce inconsistencies, and enhance the efficiency of data-driven decision-making.

This shift towards more integrated and data-driven reporting aims to provide a more comprehensive and insightful view of the insurer's overall risk profile and performance.

While primary decision-making responsibility around ALM often resides with Investments, it's crucial to recognise that no single department has exclusive ownership. At most companies, decision-making involves a committee-based approach, often through an Asset-Liability Committee (ALCO) (or similar) structure.

However, the extent of committee involvement versus individual decision-making responsibilities varies significantly.

ALM Models and Systems
Insurance companies in Nigeria and Africa at large are more likely to use vendor systems for Liabilities rather than for Asset. This is generally because of the complexity involved in the liability valuation relative to the asset and the complexity of the accounting requirement for measurement of the insurance liabilities. For assets projections, the use of spreadsheet is common due to plain vanilla nature of the assets. While most insurers still rely on excel based spreadsheet for their ALM process, this approach presents limitations in terms of scalability, data management, inability to perform complex stochastic simulation and integration with liability projection solution.

Automation around ALM processes is currently low to moderate, but there is a clear trend towards increased automation. In the next two to three years, more insurance companies will likely seek to implement appropriate automation and controls around ALM. This is driven by several factors: the connection between ALM results and financial reporting, the sensitivity of risk management programs to ALM parameters and projection results, and the increasing regulatory requirements (both current and anticipated).

ALM Metrics and Reporting
Insurance companies primarily report Asset Liability Management (ALM) metrics like maturity analysis, duration, credit quality, and asset allocation, typically benchmarked against industry standards. However, the use of more advanced metrics like convexity, higher-order sensitivities (including hedging Greeks), Value-at-Risk (VaR), and Return on Capital (ROC) varies depending on factors like product type, risk exposure, and the sophistication of the ALM program. The insurance market in Nigeria and Africa are not deep in hedging instrument for the purpose of managing its liability, hence the absence of sophisticated metrics.

The frequency of ALM reporting is typically monthly or quarterly, with a trend towards more frequent reporting for some companies.

5.3 Key Provision of NAICOM Circular

Statutory responsibility for ALM	The circular requires for all Insurance Companies intending to continue to write annuity business to have at least one fully qualified actuary in-house who shall take statutory responsibility for the monthly Assets-Liability Matching (ALM) analysis and implementation of its adoption by the investment team of the Company.
Content of ALM Report	The ALM report shall at a minimum contain the following: • The Annualised Net Cash flow (Matching Asset cash flows less Liability cash flows) analysis over the projected life of the portfolio, highlighting points of negative net cash flows. It should be noted that the matching assets are fixed income assets and so exclude property and equities. • The Weighted Average Duration of the Asset and Liability cash flows with comments on the implications. • Weighted Average Convexity of the Asset and Liability cash flows with comments on the implications. • Clear recommendations to the investment team for a rebalancing of the asset portfolio; and • Comparison of the situation in the previous report and the current report, with comments on what has changed with reasons.
ALCO Meeting	The Management and Board of the Company shall ensure regular but at least monthly Asset/Liability Committee (ALCO) meeting between the Actuarial and Investment functions of the Company to address the following: i. Discuss the implementation of the previous ALM report. If any recommendation from the report was not executed, state clearly why it was not implemented. ii. Discuss the latest ALM report and agree on an implementation plan; and iii. Submission of the minutes of the meeting to the Management and Board of the Company

5.4 Challenge and Opportunities

Navigating the complexities of competing accounting regimes and the ever-changing regulatory landscape presents significant challenges for insurers. These challenges encompass a wide range of issues, from operational concerns such as the need for robust data infrastructure and computing power to strategic considerations such as adapting business models to achieve profitability in the face of rising capital requirements.

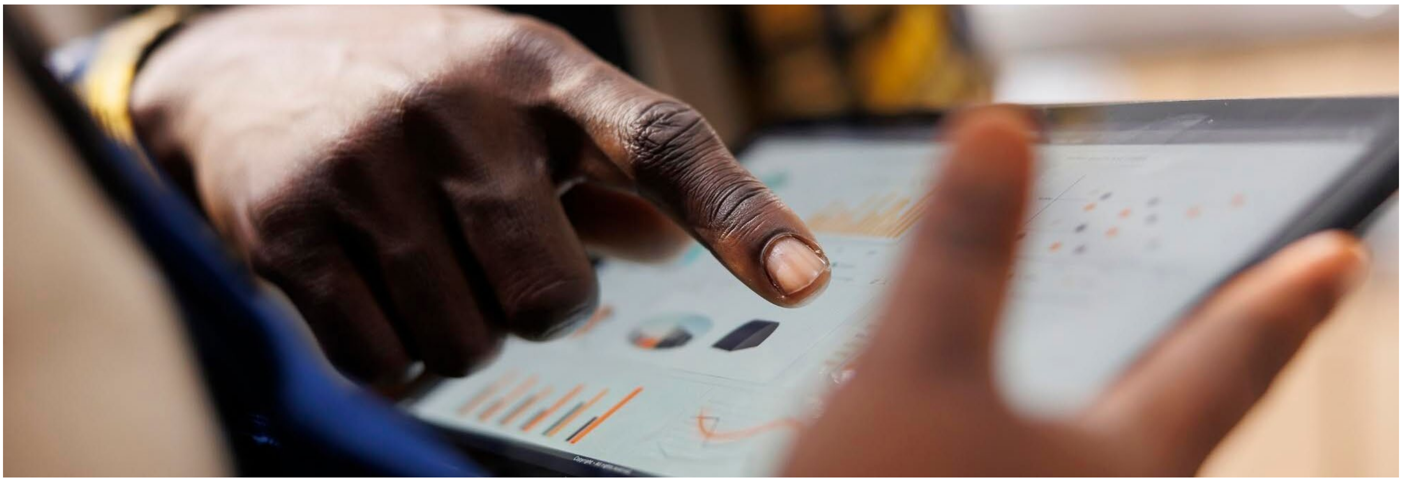
Talent: A critical factor for successful ALM operations lies in attracting and retaining the right talent. This extends beyond the ALM function itself, encompassing individuals within Finance, Capital Management, Product Development, Investments, and Enterprise Risk Management (ERM). The current talent market, however, struggles to keep pace with the growing demand for individuals with the necessary skills and leadership qualities to effectively manage these complex challenges.

Operating Model: The landscape of ALM operating models within the insurance industry is undergoing significant transformation. Factors such as the complexity of current accounting standards (IFRS 17), advancements in actuarial system, and heightened stakeholder expectations for robust risk management are driving this evolution. Key trends include the establishment of dedicated ALM functions, particularly within larger organizations, a sharper focus on separating duties to enhance governance, and a greater emphasis on coordinated decision-making across key areas like pricing, valuation, and ALM.

ALM Solution: The current reliance on spreadsheets and legacy systems for Asset-Liability Management (ALM) within many insurance companies may not be sufficient to address the complexities of the modern insurance landscape. These systems often lack the flexibility and sophistication to support dynamic financial analysis, real-time rebalancing, and robust scenario generation. Furthermore, integrating these systems with capital models and other key risk management functions can be challenging. To remain competitive, insurance companies must explore and implement more advanced ALM platforms that leverage technology and data analytics to enhance decision-making, optimise asset allocation, and effectively manage the evolving risks associated with climate change, interest rate fluctuations, and other market uncertainties. This may involve leveraging investments made in actuarial systems for IFRS 17 implementation to support more sophisticated ALM capabilities.

5.5 Ways Deloitte can help

- Deloitte Actuarial & Quantitative solution unit is very active with regard to ALM advisory services for insurance companies and other financial services firms in the Nigeria and wider Africa market..
- We have assisted firms in reviewing operating models; reviewing and enhancing policies and procedures; considering staffing concerns and providing expert support; establishing appropriate dashboards, reporting, metrics, and triggers; setting strategy; and connecting pricing and product development processes to ongoing management of liabilities.
- Many other service offerings are available, especially connecting the strategy and operations of the firm to the ALM and addressing capital and risk management inefficiencies.



Beyond IFRS 17 Compliance: Navigating the future of finance and Actuarial function

The successful implementation of IFRS 17 marks a significant milestone for the insurance industry in Nigeria. However, the journey of financial excellence extends beyond mere compliance. Building upon the valuable insights gained from our recent Deloitte IFRS 17 webinar held in September 2024 with keynote speech from our global IFRS 17 leaders and Industry panelist – which included top insurance executives and representatives from the regulator,, this paper will explore key considerations for insurers as they move beyond implementation phase to business as usual (BAU).

6.1 IFRS 17 Post Implementation Focus

Data Quality Optimisation

IFRS 17 is a data driven standard and the requirement have given finance teams access to a lot more data than they used to have. Now, finance and actuarial teams are working together to improve how they use this data. The goal is that the data will be accurate and easy to access – facilitating better decision-making.

Reskilling and Training.

The successful implementation of IFRS 17 required significant investment in training and upskilling of staff. Many insurers relied heavily on external consultants to bridge the knowledge gap and ensure successful implementation. However, with the ongoing challenges of brain drain and skilled workforce emigration ("the JAPA syndrome"), insurers must prioritise continuous training and development of their internal staff. This will ensure that in-house expertise in IFRS 17 is maintained and enhanced, enabling the company to adapt to evolving regulatory requirements and leverage IFRS 17 data for strategic decision-making.

Month-End Close

Many insurers have prioritized meeting the initial compliance requirements of IFRS 17, leading to some operational inefficiencies. Now that the initial implementation phase is largely complete, these insurers can shift their focus towards optimising their processes. This includes streamlining month-end close procedures to reduce the time and resources required to generate accurate and timely financial reports.

Process Optimization

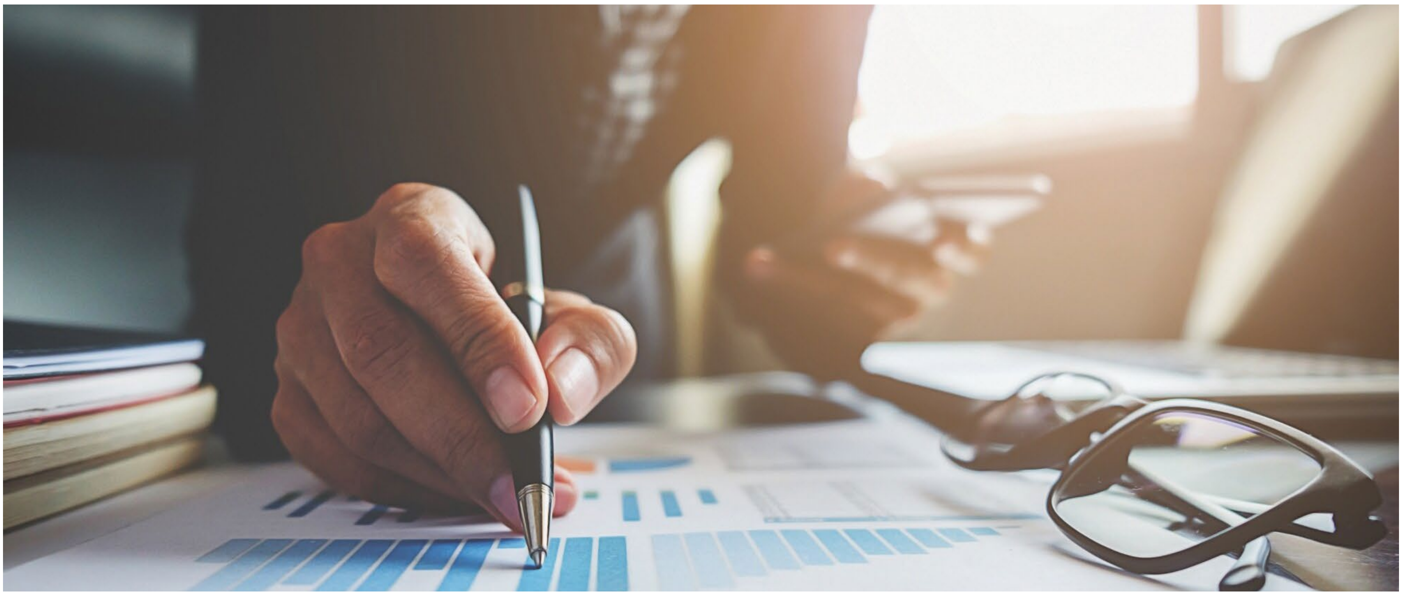
Beyond streamlining the month-end closing process, finance departments are now looking to optimise other key areas of their operations. By leveraging new technologies and data analytics, they aim to improve efficiency across various functions. This includes streamlining processes such as accounts receivable (AR), accounts payable (AP), purchase orders (PO), and resource allocation.

Finance and Actuarial Transformation

Finance and Actuarial leaders are moving beyond operational efficiency and are now focusing on strategic transformation. This involves leveraging technology like AI and automation to streamline processes, re-engineering work structures to enhance collaboration and agility, and developing a skilled workforce equipped to navigate the evolving business landscape. By focusing on these key elements – technology, processes, and people – finance and actuarial functions can build more sustainable and resilient operating models that drive long-term success beyond compliance.

Leveraging IFRS 17 Metrics to Drive the Business

As insurers begin to produce new financial reports under IFRS 17, it will be critical for insurers to understand the new figures themselves and across their different internal team members, executive and board. We have not seen yet a widespread movement to embed IFRS 17 metrics in the way to drive the business (e.g., to take decisions on product mix) but we are expecting to see this more and more in the upcoming months.



6.2 Insurance Finance Trends Post IFRS 17

The implementation of IFRS 17 ushered in a new era for the insurance industry, marking a significant shift in financial reporting, actuarial and risk management practices. While the initial focus was on ensuring compliance with the new standard, insurers are now exploring the broader implications of IFRS 17 and its potential to drive strategic decision-making across the organisation

Finance Transformation Through Cloud

There remains many Insurance clients that need to transition from their legacy ERP systems to the Cloud, empowering organisations with comprehensive finance capabilities within a modern finance architecture, facilitating the adoption of industry best practices. Enterprise providers are looking to solutions like SAP S4/Hana and Oracle Cloud, with a large focus on enabling data and reporting.
Through a Finance transformation, insurers can tackle issues like process inefficiencies and siloed data systems and business units.

Actuarial Transformation

Actuarial transformation will leverage new breakthrough technology (e.g., GPU) and modernised finance and risk architecture and ecosystems. Actuarial Transformation will need to embrace core actuarial technology, broader finance and other technology (e.g., Cloud, GPUs), AI, and modern reporting / visualization solutions. Actuarial Transformation will lay out new approaches for the actuarial operating model across teams, roles & responsibilities, governance, processes and automation.

Financial Planning and Analysis (FP&A) Transformation

Post IFRS 17 reflections have led insurers to shift their mindset on FP&A. Many are beginning to see FP&A as an integration with the entire insurance value chain. There is a trend of breaking down existing silos and adopting a unified FP&A model to improve decision-making and gain holistic insights.
The objective would be to adapt FP&A practices to align with the current and future needs and goals driven by the business and managed by Finance. Key changes driving this include ESG reporting and M&A activity.

Innovation Agenda

CFOs are working with IT and helping C-Suite leaders make informed decisions on whether or how to integrate innovations like Generative AI or Machine Learning into their strategy and operations. GenAI is on the agenda of pretty much every CFO around the world, with a couple of use cases in production notably around Modelling and Data quality, but we are still in very early days.

Insurers are setting up innovation teams to find the right balance between what technology can bring, how to harness it in a sustainable way, and how to involve the Business into the future operating models.

Climate Change and Insurance Business

7.1 Introduction

Natural catastrophes driven by extreme environmental conditions have been a recurring feature in recent years, and 2024 was no exception. Extreme floods and droughts were particularly prevalent in Nigeria, impacting various parts of the country throughout the past year. These events, particularly the devastating floods in northern Nigeria, had a significant impact on agriculture, contributing to growing food insecurity. Looking ahead, 2025 is likely to witness similar challenges, emphasising the increasing vulnerability of Nigeria to the impacts of climate change.

Climate change is one of the most important issues of our generation and future generation. It refers to long-term shifts in the earth's climate occurring over multi-decadal periods. Such changes include rising atmospheric temperatures, increasing sea levels, and more frequent extreme-weather events. While natural climate variations occur, human activities such as the burning of fossil fuels and deforestation have significantly accelerated these changes. According to the United Nations (UN), Nigeria experiences a high rate of deforestation, losing approximately 3.7% of its forest cover annually. This environmental degradation exacerbates the impacts of climate change, contributing to increased vulnerability to extreme weather events such as floods and droughts.

In this paper, we describe the main hazards associated with climate change that affect Nigeria in particular, and we provide an overview of the types of risks we face as a result, including physical, litigation, and transition risks. We then focus on how climate change affects the insurance business and how risk professionals and actuaries can play a key role in improving climate resilience.

7.2 Climate risk

Climate change is causing catastrophic problems around the world. A warmer temperatures, rising sea levels, and intense storms are happening more frequently. While some of this is natural, humans have made it worse by burning fossil fuels and eliminating forests.

Climate change affects everyone, but some people are more at risk. For example, children, older people, and people who are already sick are more likely to be harmed. People who live in certain geographical locations, those who live in the north of Nigeria or in small communities, are also more at risk. It's important that everyone – individuals, governments, and businesses – work together to understand and reduce the dangers of climate change.

Some of these hazards include:

- Increase in frequency and intensity of flood
- Increase in frequency and intensity of droughts.
- Rise in sea and lake levels
- Rise in temperatures
- Shifts in ecosystems

This environmental degradation exacerbates the impacts of climate change, contributing to increased vulnerability to extreme weather events such as floods and droughts.

7.3 Primary Hazards in Nigeria

Some of the primary hazards in Nigeria include;

Increase in frequency and intensity of floods

Climate change is causing significant disruptions in Nigeria. The release of greenhouse gases into the atmosphere is warming the planet, leading to more frequent and severe weather events. For example, in 2024 some cities in Nigeria experienced devastating floods, impacting millions of people and causing significant economic damage. This aligns with global trends, as the World Bank reports that water-related disasters have accounted for a significant portion of natural disaster-related deaths worldwide in recent decades. These events underscore the urgent need for action to mitigate climate change and adapt to its inevitable impacts.

Increase in frequency and intensity of droughts

Droughts have become increasingly frequent and severe in Nigeria, exacerbated by climate change. Rising global temperatures and altered rainfall patterns have led to prolonged dry spells, impacting agriculture, water resources, and livelihoods of those living in the Northern regions of Nigeria. These droughts result in crop failures, livestock losses, and diminished access to water, leading to food insecurity, malnutrition, and increased vulnerability to diseases. Climate change is intensifying these challenges, creating a pressing need for sustainable agricultural practices, improved water management strategies, and robust social safety nets to mitigate the impacts of drought on vulnerable populations in Nigeria.

Rising sea level

Rising sea levels are a major concern for coastal cities like Lagos, while heavy rains are causing severe flooding in many parts of Nigeria, including the north. These floods can spread diseases, damage homes and road infrastructure, and disrupt people's lives and business.

Extreme weather

Climate change is making the weather in Nigeria more unpredictable. We're seeing longer dry spells followed by very heavy rains. This is causing problems like severe droughts in the north and devastating floods in many parts of the country. These events damage crops, homes, and roads, and can even spread diseases. This has an impact on people's lives and the overall well-being of the country.

7.4 Climate risk types and Impact on Insurance Business

Climate change is making extreme weather events like floods and droughts more common. This is a big problem for insurance companies. For example, more floods result in more claims related to damage to homes and businesses. Also, the shift away from fossil fuels could impact their investments (see the Transition risk section below). To remain successful, insurance companies need to understand their risk profile and adjust their business model and processes accordingly.

Physical risk

Physical risk is the result of hazards that are usually subdivided into acute and chronic hazards. Acute physical risks are event-driven and refer to extreme climatic incidents such as hurricanes, wildfires, and floods. Chronic physical risks, by contrast, are long-term changes in climate patterns, such as sustained higher temperatures, rising sea levels, and shifts in precipitation patterns. Insurers are taking steps to address the growing physical risks associated with climate change. These steps include:

- Modifying their products: They are carefully considering climate risks when designing and pricing insurance policies. For example, they may adjust coverage in areas prone to natural disasters or offer discounts to policyholders who take steps to mitigate climate risks, such as installing solar panels or improving energy efficiency.
- Using advanced modeling: They are using sophisticated catastrophe models to better understand the potential impact of climate change on their portfolios. This helps them assess and price risks more accurately.
- Collaborating with governments: They are working with governments and other stakeholders to develop and implement climate-resilient policies and standards.

By taking these steps, insurers can better manage their own risks while also playing a role in helping their customers and communities adapt to the challenges of climate change.

Transition risk

The transition to a low-carbon economy poses significant financial risks for insurers. Transition risk arise from the need for companies to adapt to new policies, technologies, and market realities to meet climate change mitigation and adaptation goals. Transition risk may lead to financial losses, such as devaluation of fossil fuel-related investments (stranded assets), increased operational costs to comply with new regulations, and potential liabilities arising from inadequate climate risk management.

While most Insurers in Nigeria are still mostly in the introductory phases of assessing transition risk—for example, contemplating how to integrate this variable into financial condition assessment, stress testing and broader risk management. Some insurers in advanced countries have taken some steps further in addressing this risk in a way that include:

- Reviewing their investments, shifting towards more sustainable, longer-term options and reducing exposure to carbon-intensive industries.
- Re-evaluating their underwriting practices, considering how climate change may impact the risks they insure.
- Engaging with their customers, helping them understand and adapt to the changing climate by offering products and services that support a low-carbon transition.

Liability risk

Liability risk occurs when firm suffer financial consequences after being held legally responsible. Liability risk is the exposure to litigation and/or regulatory consequences as a result of failing to comply with climate-related requirements and legislation. Insurers are still in the nascent stages of addressing climate-related liability risk, for some are Integrating this risk into the organization's Own Risk and Solvency Assessment (ORSA) report and processes (e.g., running internal stress tests and developing suitable scenarios), with an emphasis on expectations from regulators.

Impact on Insurance

Insurance companies are increasingly facing challenges due to more frequent and severe natural disasters caused by climate change. To stay in business, they need to carefully consider how climate change will impact their operations. This includes reviewing how they price insurance policies, assess and reserve for potential losses, and underwrite new policies. They also need to develop new products and strengthen their risk management strategies to address the growing risks associated with climate change.

Insurance products

Climate change is prompting insurance companies to re-evaluate the risks they are willing to cover. In some cases, insurers may choose to limit coverage in areas highly vulnerable to climate-related disasters, which could reduce choices for homeowners in those regions. Standard household insurance typically covers certain events like fires but usually excludes some weather-related like flood damage. To stay competitive, insurance companies need to adapt their products to meet the evolving needs of their customers. This might involve developing new insurance products that specifically cover climate-related risks, such as flood insurance or coverage for other extreme weather events.

It is equally important for the insurance industry, regulators, and government agencies to work together to ensure that affordable insurance coverage is available for all homeowners, especially those living in high-risk areas. This may involve exploring innovative solutions and public-private partnerships to address the growing challenges posed by climate change.

Risk management

Climate change presents significant risks for businesses, including insurance companies. To effectively manage these risks, it's crucial to have a strong system for assessing climate-related threats. This involves not just looking at the worst-case scenarios, but also considering a wide range of possible outcomes and how they could affect the company. This requires a robust framework that combines both qualitative and quantitative analyses, involving risk champions from different areas of the company. This framework will help insurers understand and manage climate risks more effectively.

Insurance companies need to understand how climate change affects their own business. They can't on general climate change reports or simply rely on climate scenarios provided by other organisation such as the intergovernmental Panel on Climate Change (IPCC). Instead, they need to develop their own models that consider their unique circumstances and the long-term impacts of climate change. This includes understanding how long it takes for physical risks to develop and how this might impact their business in the future.

To improve transparency and consistency in how companies report on climate-related risks, the Task Force on Climate-related Financial Disclosures (TCFD) has developed a framework that focuses on governance, strategy, risk management, and metrics. This framework aims to make climate risk considerations an integral part of a company's overall risk management strategy. Building upon the TCFD's work, the International Sustainability Standards Board (ISSB) has developed a set of global standards for climate-related disclosures aim to provide a more consistent and comparable picture of companies' climate-related risks and opportunities.

Pricing

By factoring climate change into their pricing, insurance companies can avoid a situation where only the riskiest customers buy insurance. For example, people living in flood-prone areas might be more likely to buy flood insurance, leaving the insurer with a pool of high-risk customers. The World Property and Casualty Insurance Report 2022 found that climate change is a major concern for insurance companies. Many insurance executives worry that climate change will hurt their profits due to more frequent and severe disasters like floods and wildfires. To deal with this, many insurers are rethinking their premium structure to cover the increased costs.

To prevent this, insurers need to use data and advanced modeling techniques to accurately assess climate risks and adjust their prices accordingly. Pricing actuaries should collect accurate, granular, and real-time data for use in scenario analyses, machine-learning based pricing, or stochastic modelling, and then use the insights they gain to encourage insurers and the insured to take risk-preventive actions and fortify their climate change resilience. CAT models are useful for quantifying climate-related risks, but it's important to note that not all data sources are equally informative.

Reserving

As climate change intensifies, extreme weather events like floods and droughts are becoming more frequent and severe. This makes it harder for insurance companies to accurately predict future losses, as past events may not accurately reflect the risks they now face. To address this, actuaries need to carefully review their assumptions about future losses. They should work closely with other departments, such as pricing and underwriting, to better understand and account for the increasing impact of climate change on insurance claims. This may involve exploring alternative reserving methods and incorporating climate change scenarios into their loss projections.

Reporting

Nigeria has committed to adopting the International Sustainability Standards Board (ISSB) standards, including IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related Disclosures), for all public interest entities, which includes insurance companies. These standards aim to provide investors with comprehensive information about an entity's sustainability-related risks and opportunities, covering areas such as governance, strategy, risk management, as well as metrics and targets. For insurance companies in Nigeria, this will mean disclosing how climate-related risks are integrated into underwriting decisions, the exposure of their investment portfolios to such risks, and the overall resilience of their business to climate change.

7.5 Conclusion

The impacts of climate change on people and various sectors of the global ecosystem can be interrelated and catastrophic. To effectively address climate change, insurers must first understand how it affects their own business. They need to assess how climate change impacts their operations, from increased claims due to extreme weather events to the potential devaluation of investments in fossil fuels. By proactively addressing these risks, insurers will not only protect their own businesses but also contribute to a more sustainable and resilient future for society.

Bringing Focus to 2025 and Beyond

With increased capital, insurers will be able to expand their risk appetite within the boundaries of their risk frameworks and regulatory guidance

Insurance companies need to stay on top of the evolving regulatory landscape to succeed. While global and national concerns may be uncertain, regulators will continue to prioritise consumer protection and the financial stability of the insurance industry. This means new rules and regulations will emerge, requiring insurers to adapt and innovate. By staying informed about these changes and incorporating them into their business practices, insurers can ensure they remain compliant and competitive in the ever-changing insurance market.

A revitalised and well-capitalised financial services industry can significantly boost the economy by facilitating enhance financial intermediation, wealth protection and job creation. The proposed recapitalisation exercise presents significant opportunities for Nigerian insurance companies. With increased capital, insurers will be able to expand their risk appetite within the boundaries of their risk frameworks and regulatory guidance. This allows them to be able to take on more risk and potentially increase their retention ratios for certain lines of business that were previously ceded to foreign reinsurers as there will be sufficient capital to absorb unexpected losses. This enhanced financial strength positions insurers to play a more significant role in supporting the Nigerian economy by providing broader coverage and contributing more effectively to national development.

Insurance companies need to be ready for the many new regulations that will come into effect this year. This means having strong systems in place to keep accurate records and monitor their compliance with these regulations. Regulators will also be working to ensure the safety and stability of the insurance industry. They will likely work with the industry and consumers to find the best way forward, considering the current economic and regulatory environment.

Key next steps for Insurance companies

1. Detailed impact assessment of the different regulatory directives and reforms. An effective assessment should be carried out to identify levers that can be pulled and gaps that need to be filled in light of the investments made to date. Findings from such an assessment exercise can then provide inputs into the operationalization roadmap and supporting business case.
2. Prepare for new levels of frequent and intense supervisory scrutiny which we expect will be sustained for the foreseeable future, with a particular focus on risk and governance.
3. Set up a team internally and / or engage experts on the subject matter to support with the development of an implementation plan that will clearly indicate the chosen option(s) for meeting the new capital requirements and various activities involved with the timelines.

Deloitte Services

Deloitte has an Insurance and Actuarial team based in Nigeria with a breadth of experience across valuation, risk and regulation.

Actuarial & Quantitative Solution Services

Actuarial Modelling & Transformation

We provide actuarial modelling expertise including:
- Development and enhancement of actuarial models
- Model reviews and validations

We support financial transformation initiatives including:
- IFRS 17 modelling support and implementation, including managed services offering on IFRS 17
- IFRS 9 Implementation
- modernisation of actuarial processes and infrastructure

We are skilled in, and make use of various software, including:
- Exemplar – our proprietary short-term insurance reserving software
- Prophet, IRIS, Moodys Risk Integrity , VBA, Python, R, SQL, IRIS
- In-house IFRS 17 and solvency-related tools
- Asset & Liability Modelling

Managed Actuarial Services

We provide managed actuarial services and statutory actuary roles

- Head of Actuarial Function (HAF)
- Statutory Valuation (IFRS 17, IAS 19)
- Financial condition report, Own Risk Solvency Assessment (ORSA) and Embedded Value valuation (EV)
- Actuarial business as usual (BAU) Operations
- Secondment of Actuarial staff
- Capacity Building

Risk, Solvency and Capital Management

We conduct, provide support or advise on:
- Risk identification, modelling and mitigation strategies, including stress & scenario testing
- Projections and valuations of technical provisions, calculations of solvency capital requirements and determination of eligible own funds
- Reinsurance optimisation /adequacy assessments
- Capital optimisation
- Climate risk management service–
  - Scenario modelling
  - Stress testing
  - Climate risk integration into broader ERM
  - Capacity building

Advice and support:
- Developing or reviewing insurance company policies
- Asset-liability management (ALM)
- Governance efficiency reviews
- Enterprise Risk Management (ERM) review and implementation

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