

Regulation, Innovation and Business Growth

IICC 2019 National Insurance Conference

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Outline

- 1** Definitions
- 2** Characterizing Regulation, Innovation and Business Growth
- 3** Putting the Tripod Together
- 4** Regulation, Innovation and Business Growth in Nigeria
- 5** The Tripod in the Global and Domestic Insurance Industries
- 6** Recommendations to NAICOM

Background: Definitions

Defining the Three Broad Concepts

Regulation

- “A regulation is a binding legal norm created by a state organ that intends to shape the conduct of individuals and firms. The state organ, the regulator, may be any legislative, executive administrative or judicial body that has the legal power to create a binding norm”
- “The need for regulation arises because of the existence of imperfection or ‘poisons’. Yet, regulation may have ‘poisonous effects’ when misused”

Innovation

- Generically, “a new method, idea, product...”
- “The process of translating an idea or invention into a good or service that creates value, for which customers will pay” – *Business Dictionary*
- Innovation may also express itself in process improvement

Business Growth

- “The process of improving *some* measure of an enterprise’s success” – *Business Dictionary*

Characterizing Regulation

The Purpose of Regulation

In All Market Systems:

- The correction of market failures or the remediation of externalities, where true costs and benefits are not reflected in prices –
 - Asymmetric (non-transparent) Economic Information
- The maximization of **defined social benefits**, beyond the logic of maximized utility for consumers, and maximized profits for producers –
 - Consumer & worker safety
 - Fair distribution of net benefits
- “To **reduce entry barriers**, ‘level the playing field,’ encourage greater **competition** and **innovation**...” - *Committee for Economic Development of The [US] Conference Board, 2017*

The Purpose of Regulation

In Emerging/Developing Markets:

The Development of Markets

Midwifing the emergence of market structures that underlie the development of key industries, which are often nascent in these countries

The Essence of Good Regulation

- To function in an increasingly interdependent global economy, the regulatory has to reflect ***global best standards and practices***
- The underlying global imperative for global best practices are called “**Good Regulatory Practices**”

*“GRP refers to internationally recognized processes and procedures that can be used to **improve the quality and cost-effectiveness of domestic regulations**”*

– Kent Shigetomi

Office of the U.S. Trade Representative

[undated]

The Essence of Good Regulation

The OECD's [2012] 12 Pillars/Recommendations for Good Regulatory Practice

- Integrated “whole-of-government” approach to pursuing and assessing regulatory quality
 - “Open govt. principles” - transparency & (stakeholder) participation in regulatory process
 - Mechanisms & institutions actively overseeing regulatory principles and goals
 - Regulatory Impact Assessment, especially at formulation stage of new regulation to establish rationale and necessity
 - Systematic Programme Review of significant regulation vis-à-vis policy goals
 - Accountability: Regular reporting on performance of regulatory policy and implementing agencies
- Consistent policy establishing role & functions of regulators - ensuring objectivity & impartiality
 - Ensuring Effectiveness of Systems that review legality & procedural fairness of regulation
 - Risk Assessment, Management & Communication strategies to regulation formulation, design & implementation
 - Promote Regulatory Coherence across supranational, national and subnational levels of govt; as well as across cross-cutting regulatory issues/agencies
 - Develop Regulatory Management Capacity
 - Consideration to International Standards & Cooperation

Characterizing Innovation

Conceptualizing Innovation

A rudimentary, generic perspective

**Recognize
Problem**



**Apply
Innovation**



**Determine
Solution**

**Commercialize
solution
[Product
Development]**

**Deploy
solution to
non-
commercial
use**

Conceptualizing Innovation

- Basically, innovation entails the discovery, broadening and/or application of knowledge in solving recognized or perceived problems
- Formally, it takes expression in organized *Research & Development*, which may serve commercial or non-commercial ends
- Generally, innovation may take more tangible forms – leading to the emergence of new physically appreciable *Technology* – or less tangible forms, of the kind that take expression in the *Creative Industries*, for example, but can still carry massive commercial power

Conceptualizing Innovation

Per Schumpeter (1942), innovation, especially in the commercial context, broadly entails

- The introduction of a new product(s)
- The introduction of new methods/processes of production – may or may not be based on new scientific findings
- Opening up new markets
- Employing new supply sources
- New approaches to competition – i.e. to gaining the competitive edge

3 models of the Innovation Process

Model 1: Science-push model

- Innovation begins with independently inspired scientific research, leading to new product, service or process, which, in later stages of product development, manufacturing and marketing, is successfully sold

Model 2: Market-pull model

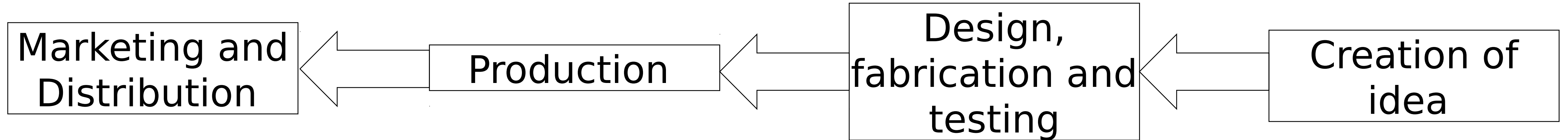
- Innovation and discovery is inspired by the findings made through market research and intelligence. Perspectives and perspectives derived from target markets induce product development

Model 3: Doubling model

- Recognizes the interdependency between the pulse of the market in inspiring research and development, and the ability of independent research which leads to product development to stimulate demand for new products

3 models of the Innovation Process

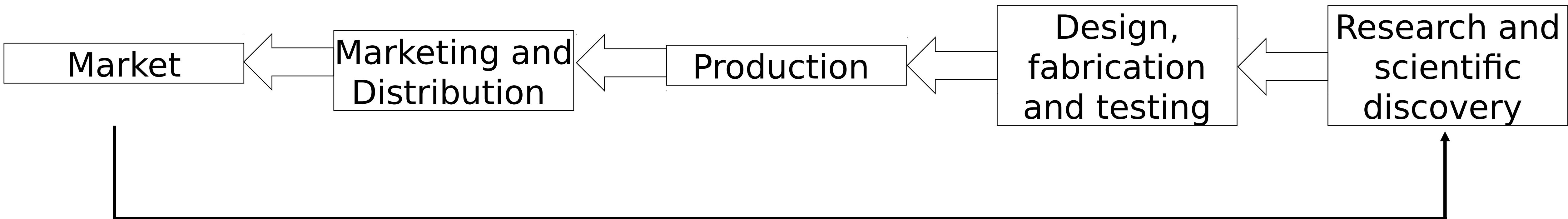
Model 1: Science-push model



Model 2: Market-pull model



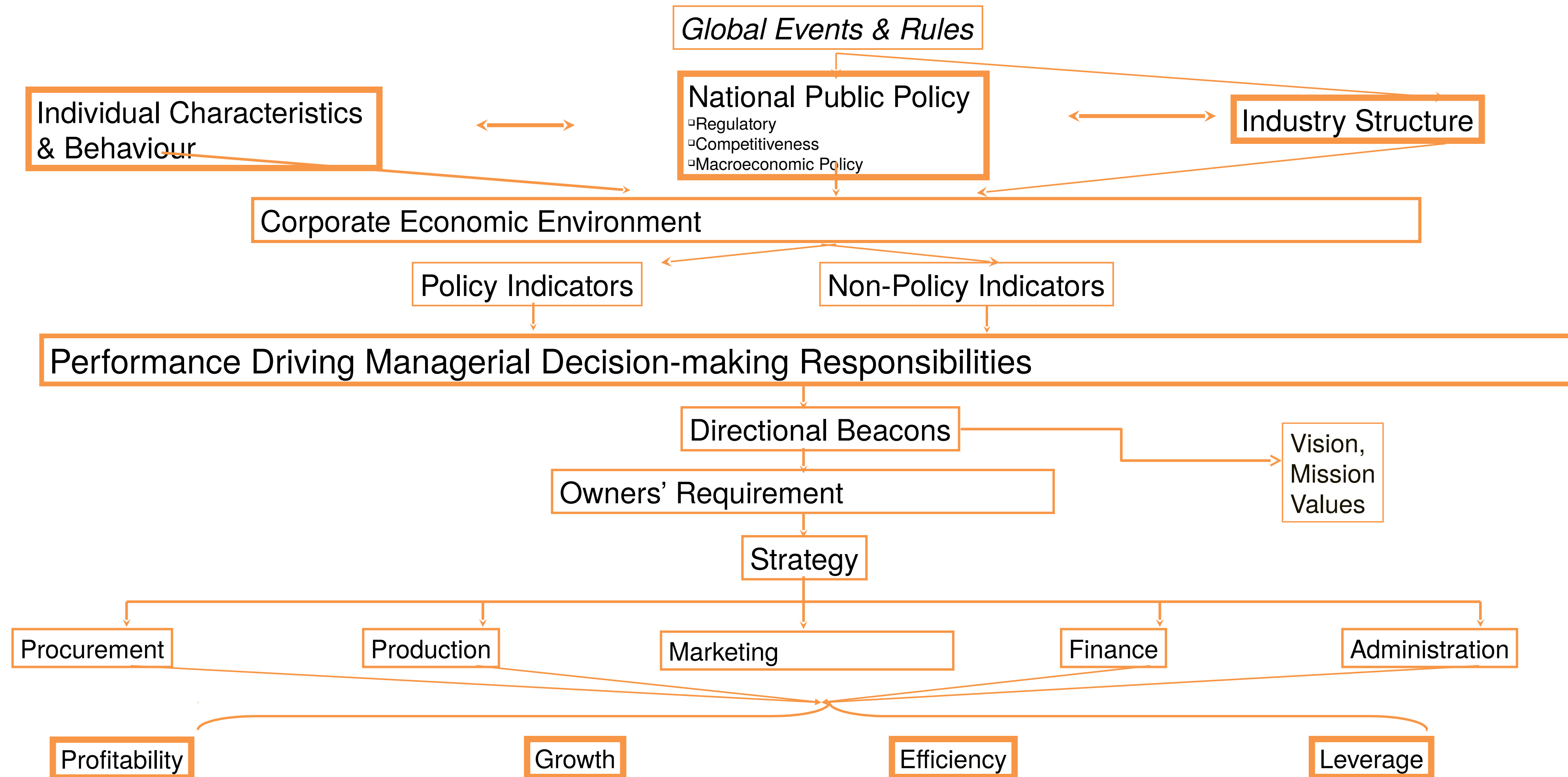
Model 3: Doubling model



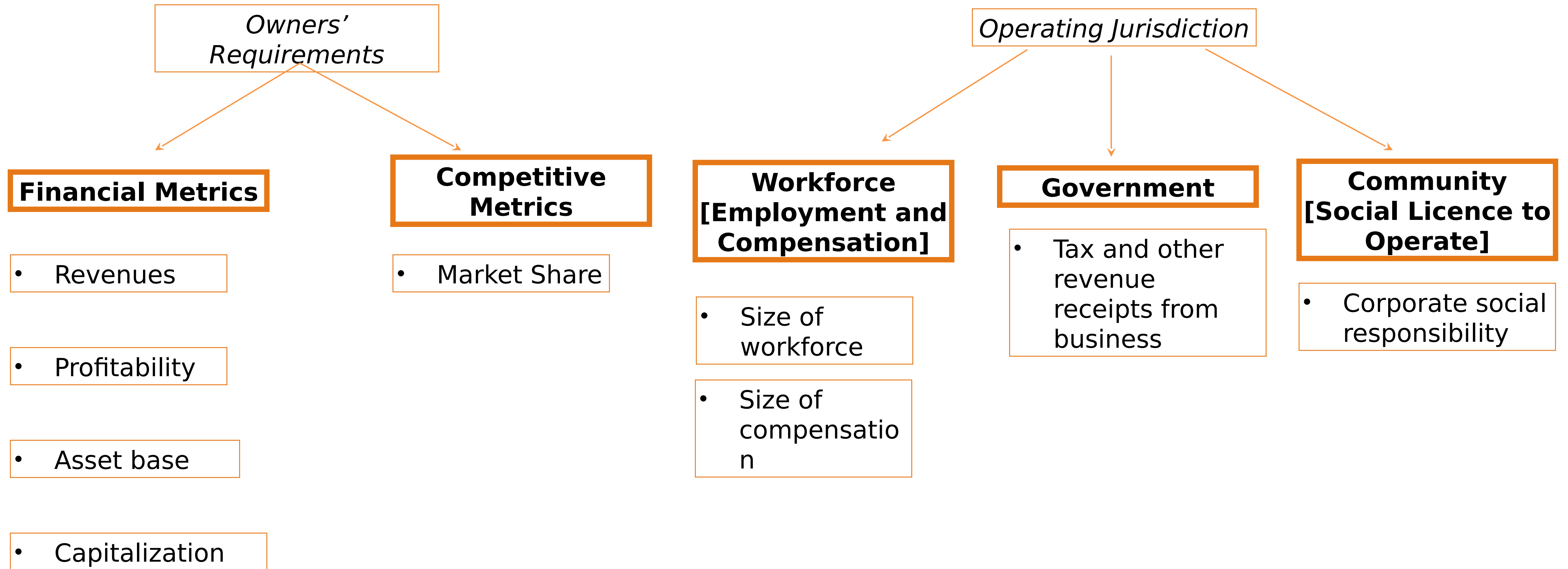
Characterizing Business Growth

What Drives Businesses?

The Stakeholders in a Business' Internal and External Environment



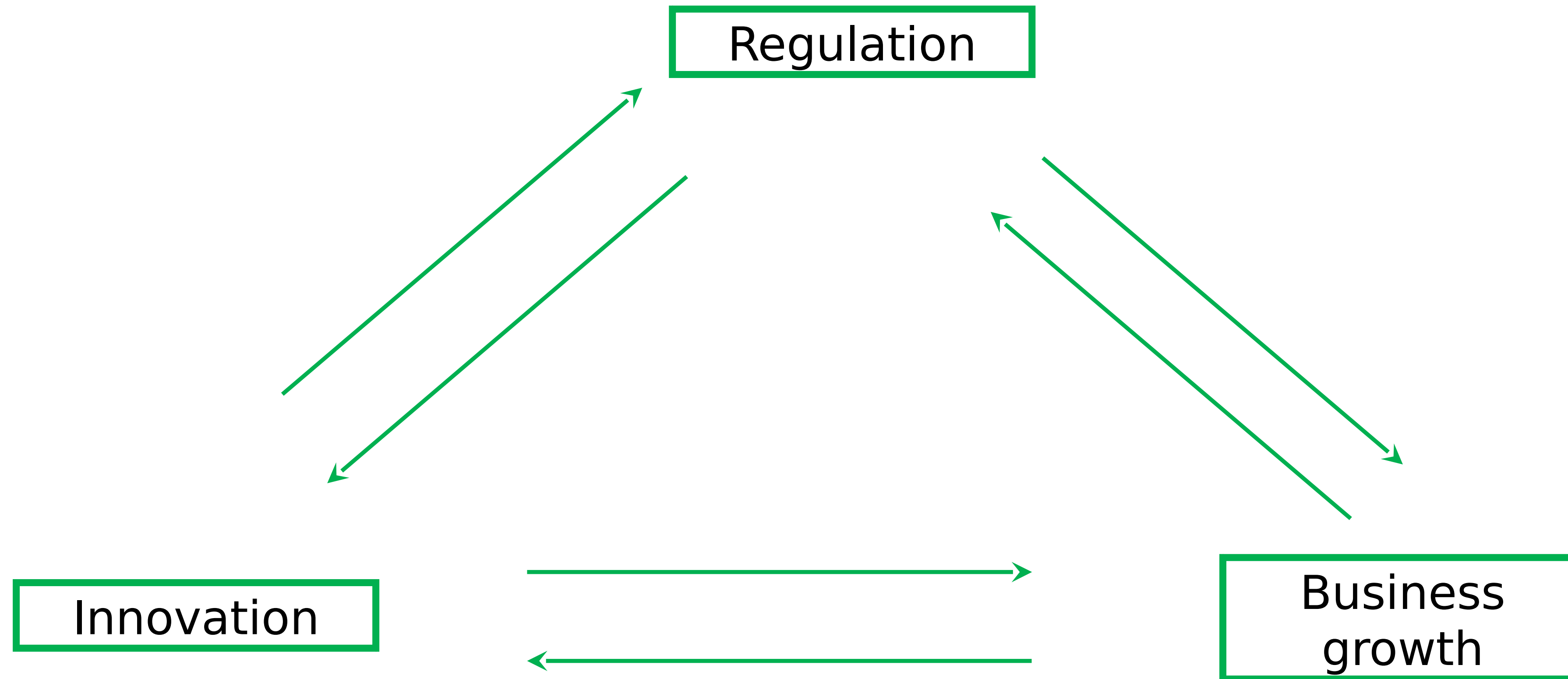
A generic, holistic view of Business Growth



- A holistic way to look at business growth is to accommodate the various stakeholders which interests in the business can be expressed quantitatively. The generic framework may exclude *industry-specific measures of financial performance* like **premium growth** in the case of the Insurance industry

Putting The Tripod Together

The Tripod



Unpacking the Nexus: Between Regulation and Innovation

- Regulation places a *compliance burden* on firms, causing the diversion of resources away from investment in innovation towards compliance efforts
- On the flipside, where regulations do not lead to the shutdown of a business, meeting regulatory obligations may induce innovation of two kinds:
 - ***Circumventive innovation*** – possible where scope of regulation is narrow enough to allowing firms to escape regulatory constraints by innovating alternatives outside the scope of the regulation
 - ***Compliance innovation*** – broad-scope regulation; the resulting product or process innovations remain within the scope of the regulation

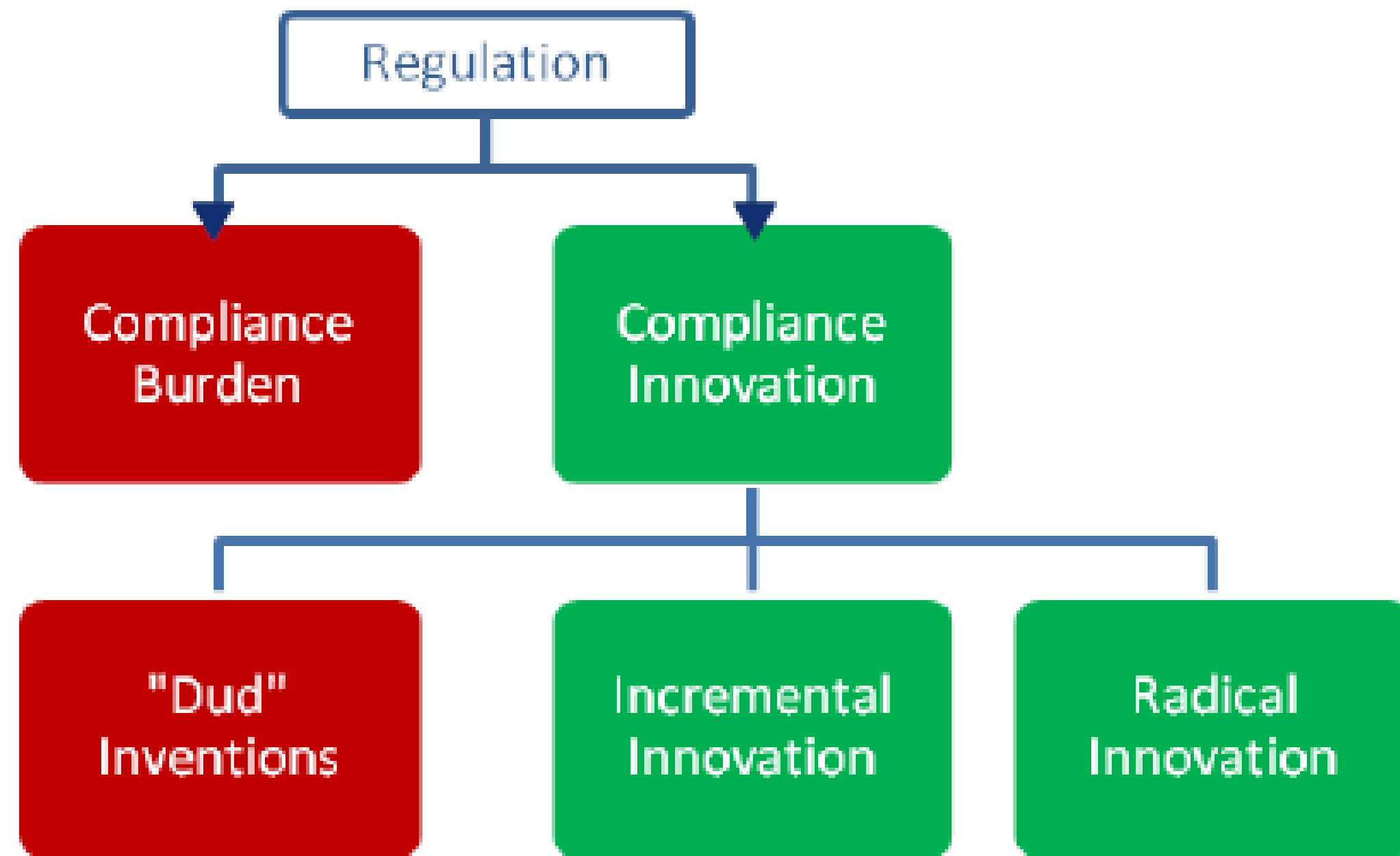
- **Stewart (2010)**

Unpacking the Nexus: Between Regulation and Innovation

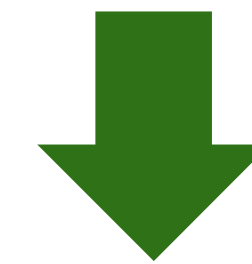
- In seeking to innovate within the bounds of compliance, firms could be led to produce innovation which could be of three types:
 - *Incremental innovation* – marginal but significant improvements in existing products and processes that enable compliance with regulatory requirements
 - *Radical innovation* – the necessity of compliance to far-reaching regulatory requirements inspires innovation of the sort that replaces existing products and processes
 - *“Dud” inventions* – attempts to innovate in a radical manner could lead to invention of little to no ascertainable

- Stewart (2010)

Unpacking the Nexus: Between Regulation and Innovation



Optimal Regulation-Innovation Relationship Scenario



“Regulations that are most effective at stimulating innovation will tend to require compliance innovation and, at the same time, will minimize the compliance burden and mitigate the risks of producing “dud” inventions”

- Stewart (2010)

Unpacking the Nexus: Between Regulation and Business Growth

- There is the fundamental question – does regulation help or hurt business growth?
It can do both
 - There are regulations that propel innovation and support business growth...
 - ...And there are regulatory practices that, even if necessary, may impede innovation, consequently business growth
- In developing markets, where sectors/industries are nascent and need to be propelled to grow, a critical balance between **operational control** and **market development** thrusts, with greater priority given to the latter
- A major leg to market development is for regulators to induce conditions that drive **product innovation** in the industries they regulate

Unpacking the Nexus: Between Innovation and Business Growth

From a macroeconomic perspective:

- The Solow-Swan growth long-run economic growth model identifies the following three drivers of economic
 - Capital accumulation
 - Population, or more to the point, labour force growth
 - Productivity growth, driven by technical/technological progress – this is where **innovation** is critical!!!

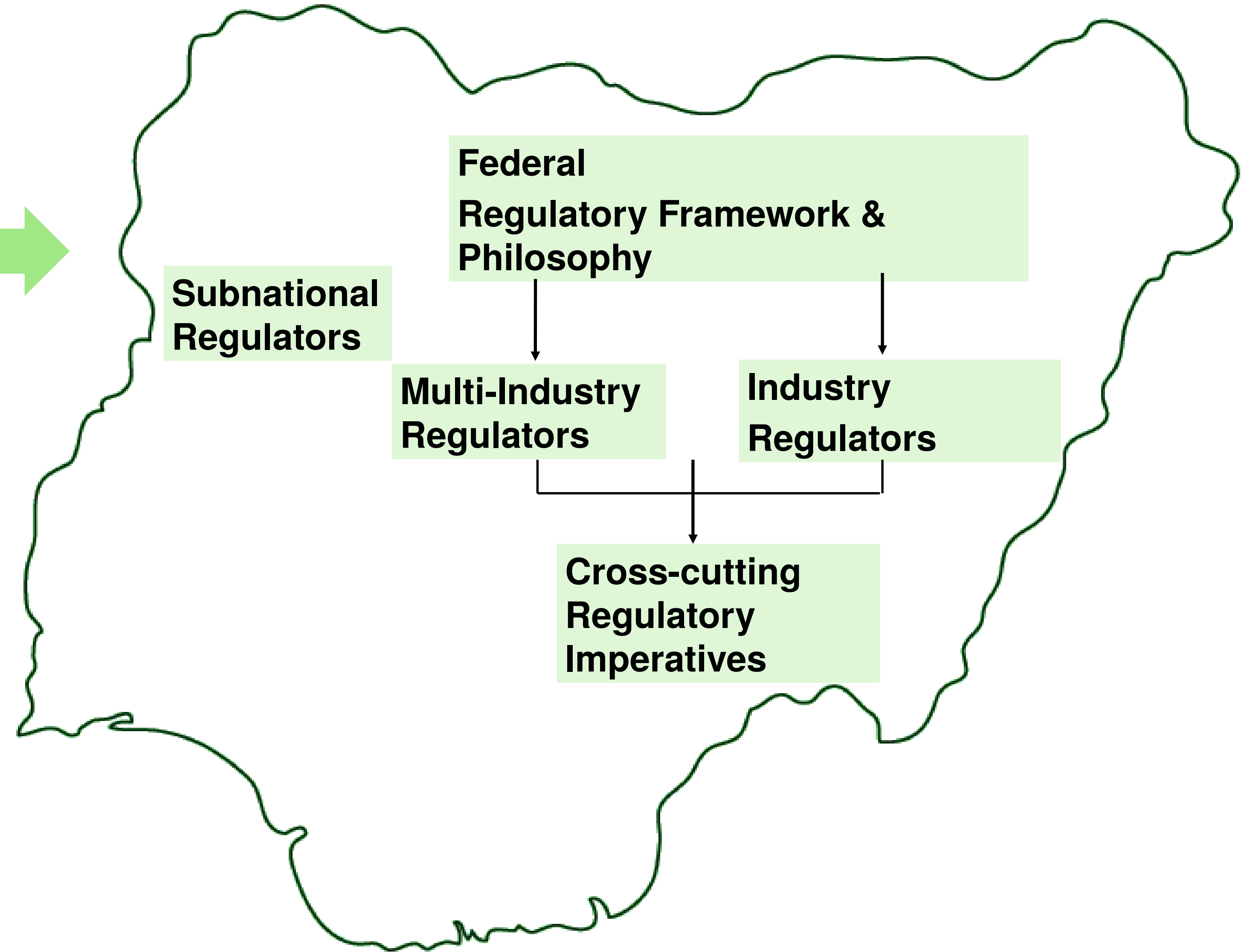
Drilling down to corporate conditions:

- At the corporate level, the logic is broadly the same:
 - Under a set of given conditions – given size of investable capital resources, workforce (and capabilities), environmental and market conditions – innovation is the prime mover that drives business growth
- New products, processes, ideas, access to new market, etc. – all of which are the essential elements of innovation – are the essential drivers of business expansion

Regulation in Nigeria

The Structure of Regulation in Nigeria

Global Regulatory Rules, Standards, Conventions, Best Practices



Characterizing Nigeria's Regulatory Framework

- At the top is the enabling legislation, which embodies governance codes and underlying institutional arrangements that drive the thrust of regulatory policy
- But Nigeria's underlying regulatory philosophy does not lurch decisively in clearly defined direction
- Which has led to divergent trends:
 - We continue to witness regulatory activism, coupled with a strong enforcer mindset and punitive disposition among regulators
 - Nonetheless, antitrust and competition engenderment reform is ongoing, amid a raft of business environment legislation which seek to separate regulatory entities from commercial entities (like SOEs) where both functions have been merged

Characterizing Nigeria's Regulatory Framework

- Nigeria is a “regulation taker” – domestic regulators try to domestic international standards, conventions and best practices, often with a view to making international economic and financial relations viable for domestic players
- Whilst industry regulators are expected to be the repository for data and statistics for their respective industries, based on sector/industry surveillance, few live up to this, and then inadequately
- Regulators need to deepen their capacity for market development in order to replicate successful, pro-market industry reform narratives – in Telecoms, Banking, etc.

The Insurance Industry Regulator - NAICOM

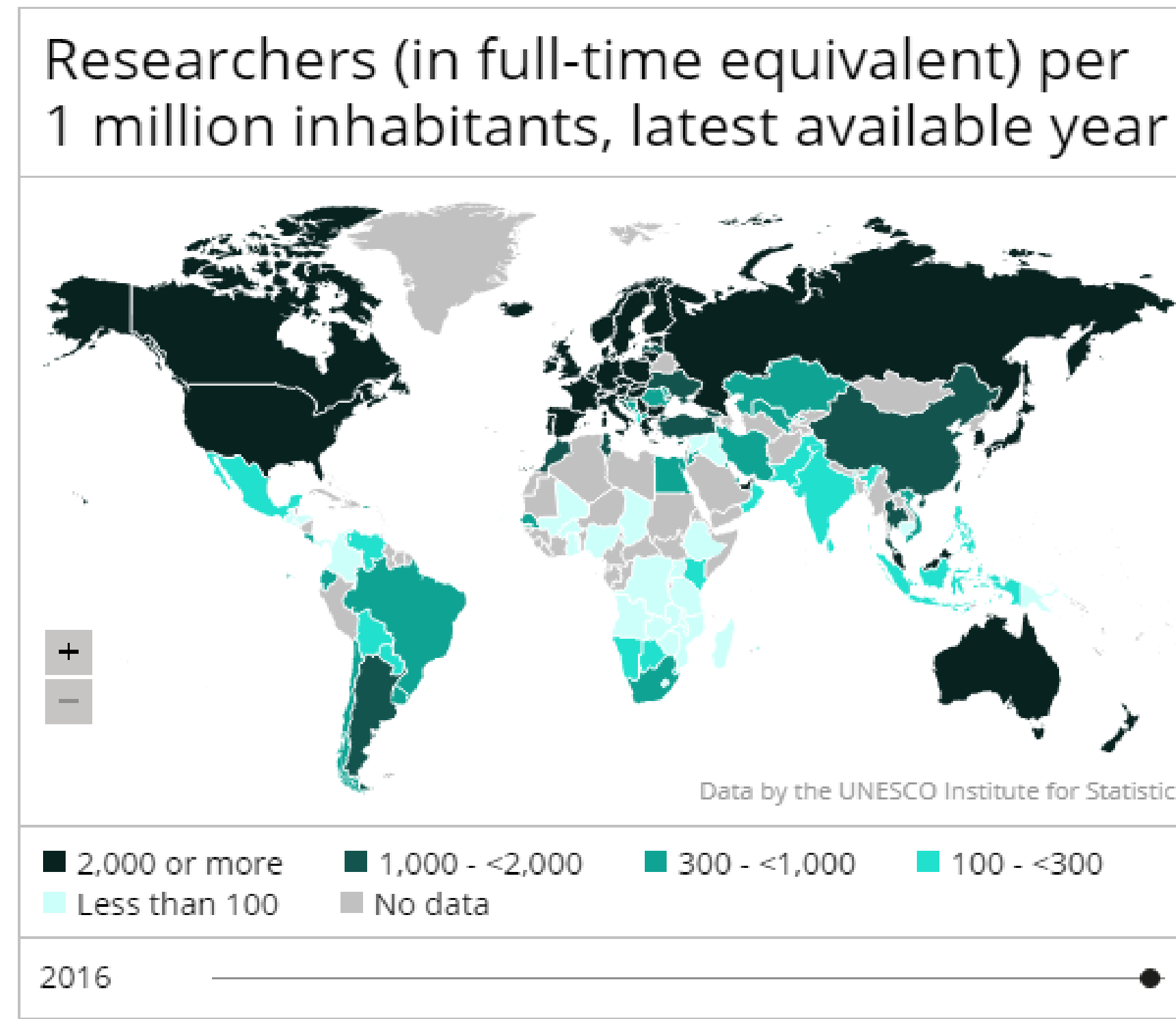
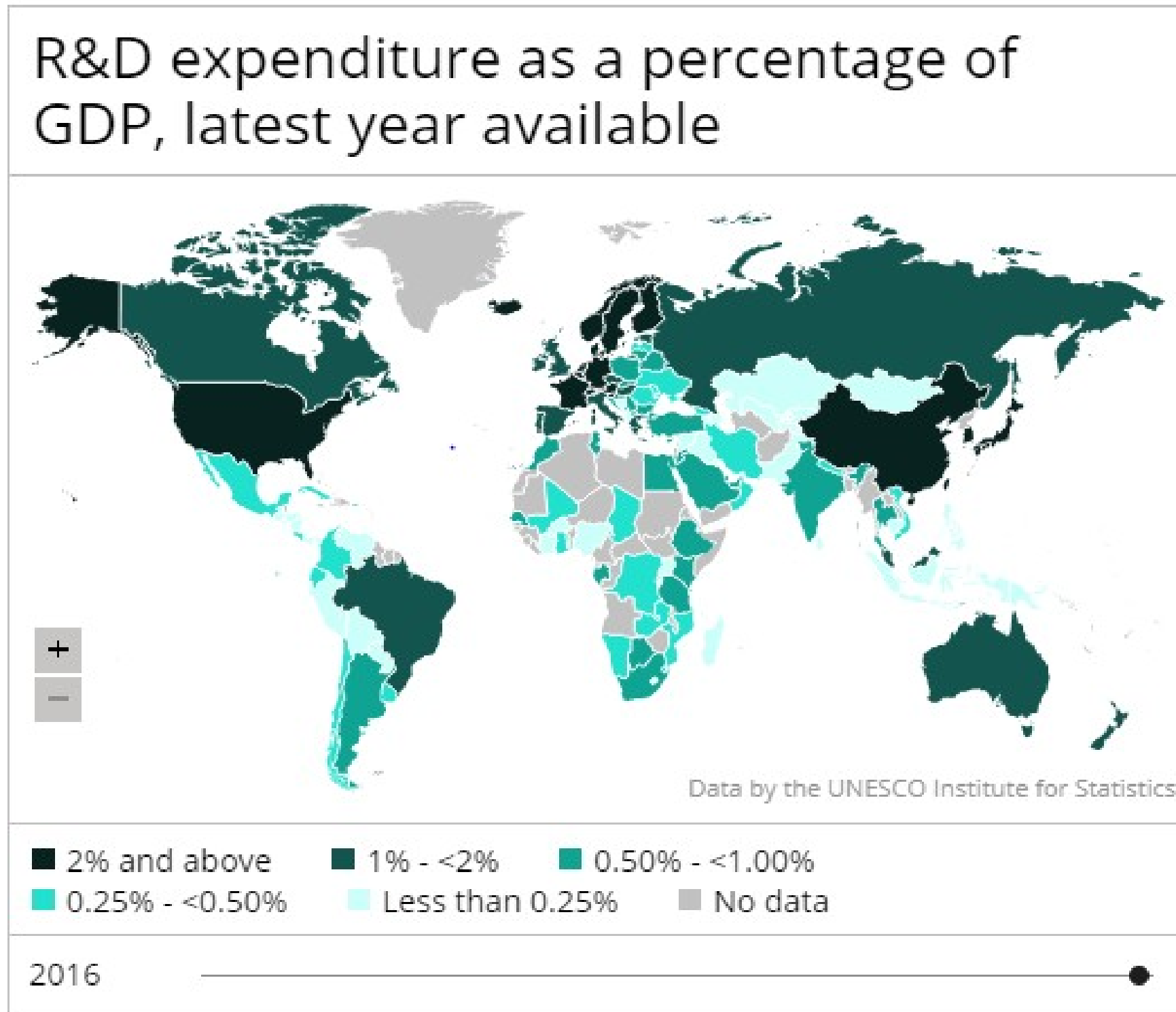
NAICOM Service Charter

- SOP for Insurance Industry conduct, incl. conditions, warranties for all business classes
- Some measure of price control – premium rates approval
- Insurer of strategic government assets
- Cross-border (re)insurance transactions regulation, involving Nigerian parties
- Advisor – to the FG on insurance-related matters
- Consumer protection – of policyholders, beneficiaries, third parties
- Insurance industry data and statistics repository
- Cross-cutting regulatory issues management and liaison with other regulators on insurance-related issues, including commitments by Nigeria
- Insurance education and sensitization drive

Innovation in Nigeria

Characteristics of the Nigerian Innovation Ecosystem

- *Very Low Research & Development intensity*



***Research and Development (R&D) intensity** is a measure of society's investments in research, expressed as R&D (public and private) as a proportion of GDP

R&D Intensity for Nigeria
0.22%

R&D Researchers per capita (1m inhabitants)
39

**Nigeria's recorded R&D intensity of 0.22% (2007 est.) is significantly lower than Sub-Saharan Africa average (0.5%) as well as the Lower-Middle Income average of 0.6%*

Characteristics of the Nigerian Innovation Ecosystem

- *“Adoption” and “adaptation” rather than “creation”*
- Within the global economic and innovation ecosystem, Nigeria is situated far away from the frontier of technological advancement
- Nigerian enterprises create largely services-based commercial value by plugging into existing global technology value chains, midstream or downstream

Characteristics of the Nigerian Innovation Ecosystem

- *Soft Innovation*
- There's a justified buzz around the vibrancy of Nigeria's *creative industries* – Entertainment [Music and Film], Literature, Arts and Crafts, Fashion. Combined, these industries amount in value-added terms to ₦1.5trn (US\$5bn), accounting for 1.2% of GDP, a still small portion of the economy
- Within the ICT space, Nigeria has emergent *techpreneurial ecosystem* comprising start-up hubs, although as emphasized earlier, most innovation is services-skewed – Financial Services (FinTech), Health, Education, eCommerce – but also Agriculture
- R&D and innovation that drives industrialization [fabrications] is still severely lacking

Business Growth in Nigeria

Business Growth in Nigeria: The Issues

- Nigeria's baseline demographic qualities of a large and youthful population present hallmarks of attractiveness to business concerns, namely –
 - A large market
 - A large labour force
- However, generally, business growth in Nigeria is undermined by longstanding environmental challenges:
 - Limitations to purchasing power, which vitiate the advantages of a large demography where market size is concerned
 - The dearth of infrastructure – especially Power and Transport
 - Human capital deficiencies – a large labour force without commensurate skills and capacity
 - Unhelpful regulatory structures and practices
 - Access to and cost of capital

Regulation, Innovation and Growth in the Global Insurance Industry

Trends in global (re)insurance regulation

The emergent regulatory environment in the global insurance industry is primed around regulatory responses to the significant role underwriters played in the global financial crisis of 2007-2009, and the risk management imperatives arising therefrom, as well as the disruptive rise of technology and the role of data

Wave of accounting changes for insurers

- Insurers are beginning to implement standards IFRS 9 Financial Instruments – effective 2018 and IFRS 17 Insurance Contracts – effective 2021 (a recent change allows conditional deferment of IFRS 9 until 2021)

Preparing for a data-intensive and connected world

- Proliferation of technology and a holistic approach to risk management have encouraged insurers and regulators to dedicate increasing attention to developing effective risk management practices for cyber and data security

Enhanced capital and risk disclosures

- Due to enhanced risk management practices introduced globally by new capital/supervisory regimes, besides quantitative disclosures, insurers have started disclosing qualitative information around business performance, governance, risk profile, solvency, valuation methodology and capital management

Ernst and Young (2018)

Trends in global (re)insurance innovation

Contemporary trends in innovation in the global insurance industry, especially at the Innovation Frontier, include:

- Closing empirically derived ‘protection gaps’ in traditional volume and high-growth product segments – life, property [catastrophe and non-catastrophe]
- Harnessing technology to push the boundaries of insurability – *new insurable products*
 - As corporates become richer in *intangible assets* such as intellectual property, networks, data and client relationships, businesses increasingly seek cover for previously uninsured exposures

Trends in global (re)insurance innovation

Contemporary trends in innovation in the global insurance industry, especially at the Innovation Frontier, include:

- Data and analytics-driven 'parametric' insurance solutions
 - Earnings and cash flow losses due to business interruption
 - Cyber-related losses
 - Product recall
 - Weather-related losses
 - Energy price risks

Situating Nigeria in the global Insurance Innovation Ecosystem - An Underdeveloped Insurance market

However, Nigeria remains an underdeveloped insurance market, nowhere near the industry's global innovation frontier

Insurance Penetration for Nigeria	Insurance Penetration - Africa average	Insurance Penetration - Global average
0.3%	2.8%	6.3%

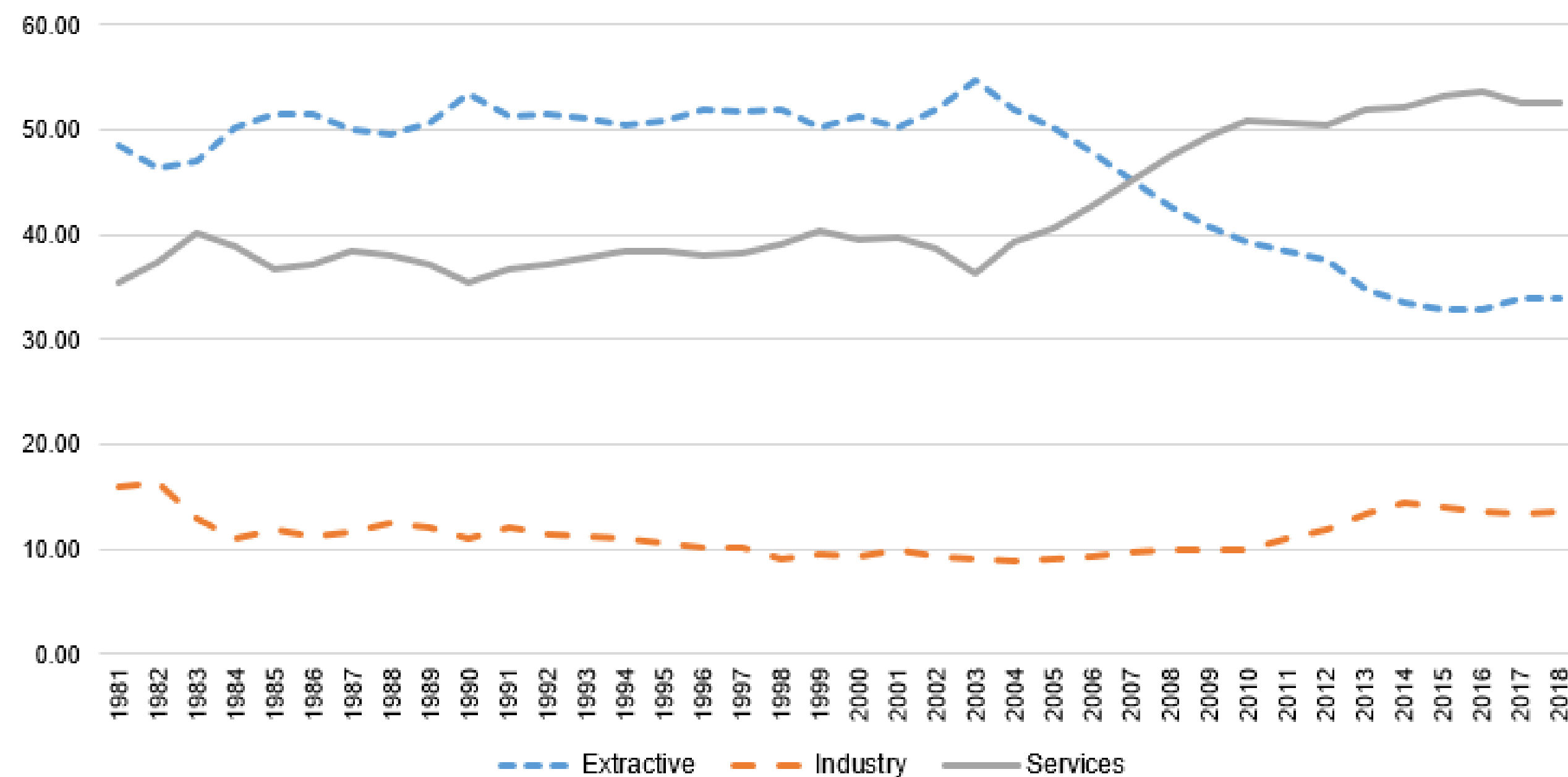
African and Global average insurance penetration* rates are 9x and 20x that of Nigeria, Africa's largest economy, respectively

- Given its status as an underdeveloped insurance market, product innovation in Nigeria continues to revolve around maximizing traditional commodity offerings [life, property, health, travel] but with emerging interest in inclusionary product offerings like agri-insurance, microinsurance
- However, penetration levels remain low on the consumer side, even for a lower-middle income country like Nigeria, possibly due to income concentration

Situating Nigeria in the global Insurance Innovation Ecosystem - A Significant Constraint

Nigeria's premature deindustrialization constrains insurance industry innovation

STRUCTURAL EVOLUTION OF THE ECONOMY, % of REAL GDP

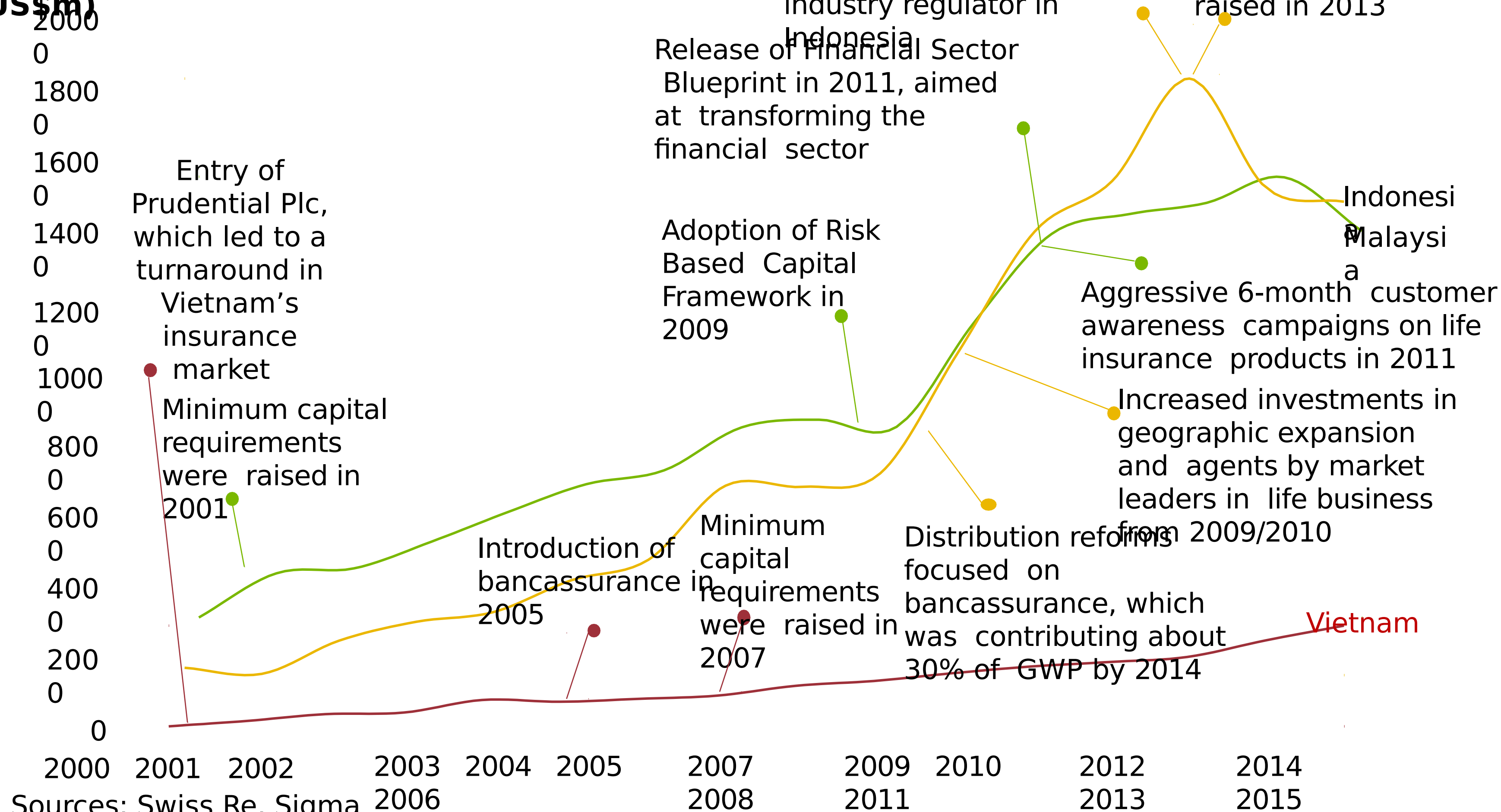


- Nigeria's premature deindustrialization – which has consigned the development of the industrial sectors – limits the scope for insurance industry growth and product innovation, especially in the area of *production insurance*

- Maritime and Aviation sector value chains not sufficiently domesticated; Rail sector not developed – so *transport infrastructure-related insurance innovation* is constrained too!

Comparators: The Insurance Industry Growth Experience of Strong Markets in South East Asia

Gross Written Premiums (US\$m)



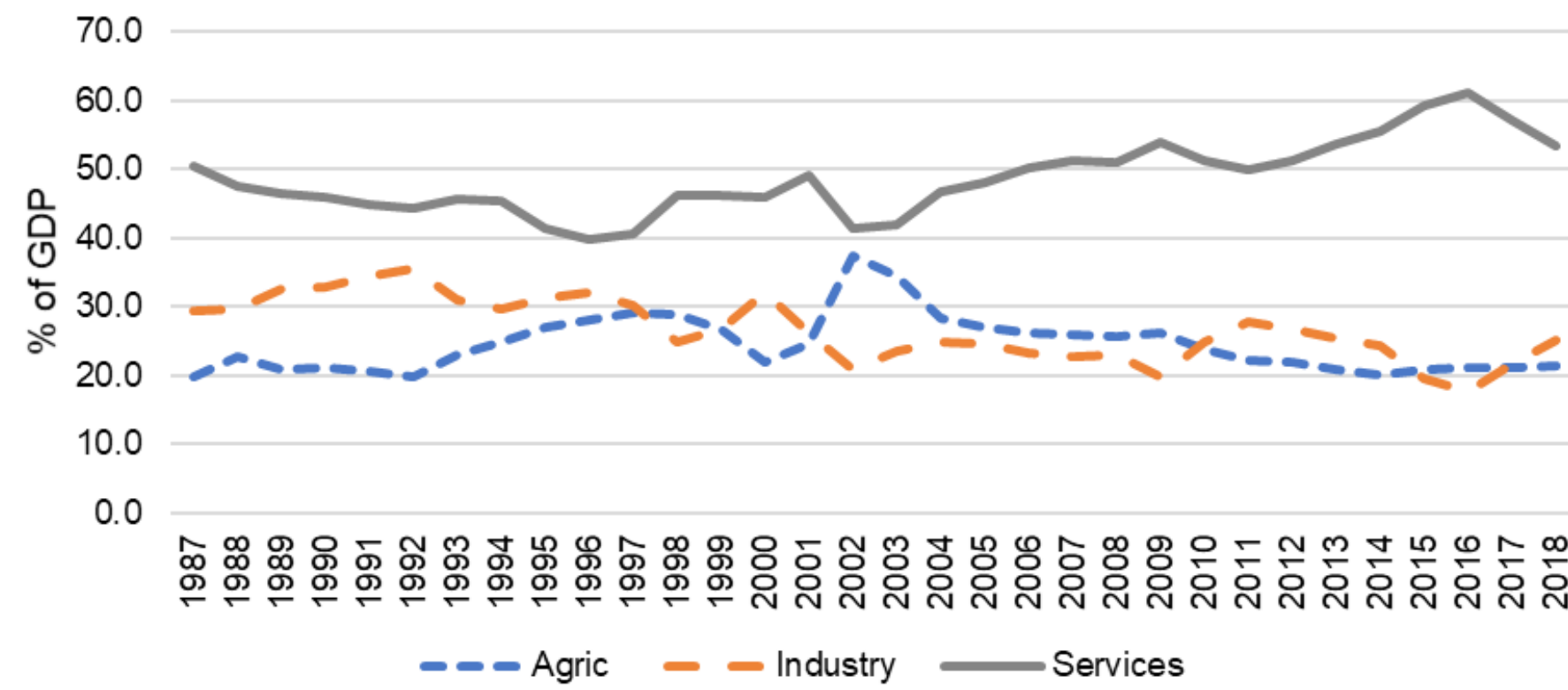
Sources: Swiss Re, Sigma reports

- **Indonesia recorded growth of 26% CAGR between 2009 and 2013, experiencing a steep decline between 2013 and 2014**
- **Growth rate for Malaysia within the same period (2009 - 2013) was an estimated 14.5%**
- **Vietnam experienced steady growth over the fifteen-year review, growing at 10% CAGR between 2009 -**

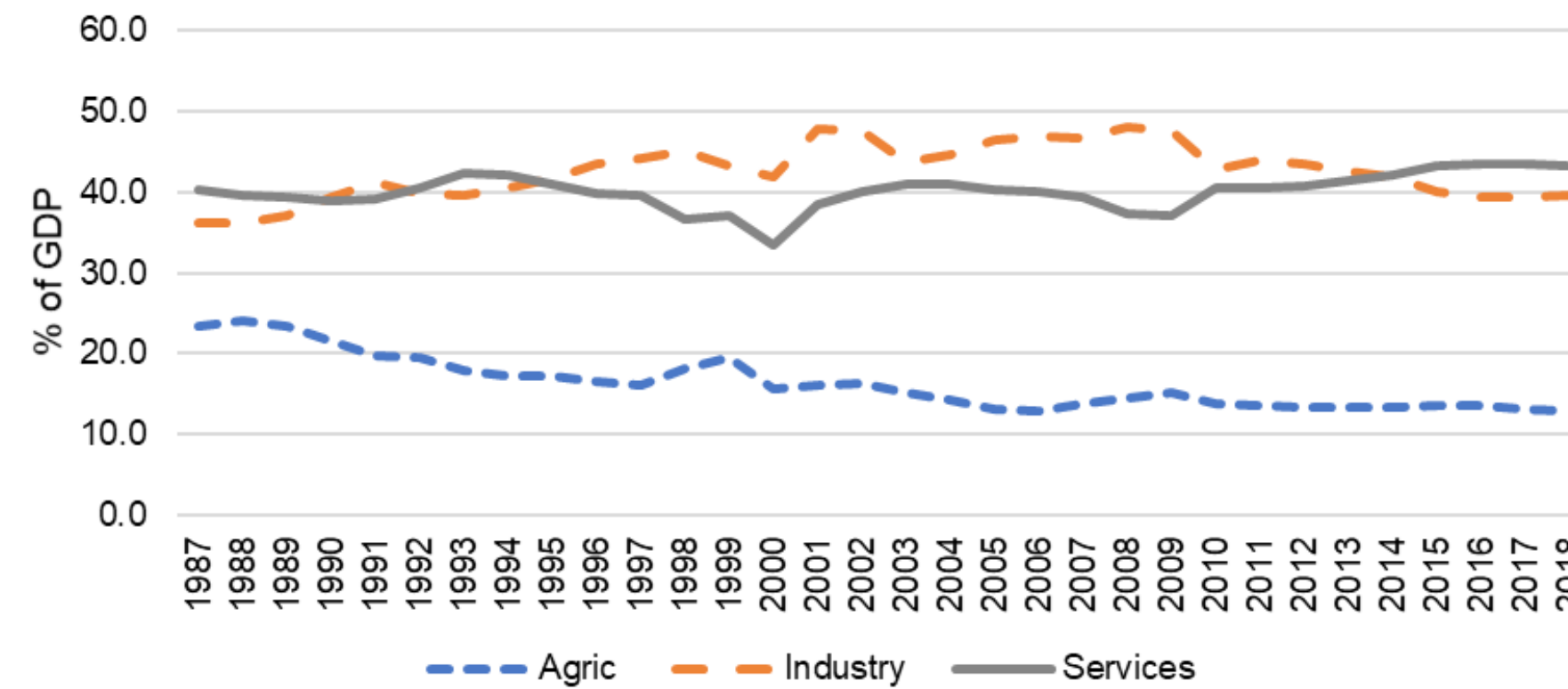
How do the evolutions of the aforementioned comparators compare with Nigeria's?

Nigeria's premature deindustrialization constrains insurance industry innovation

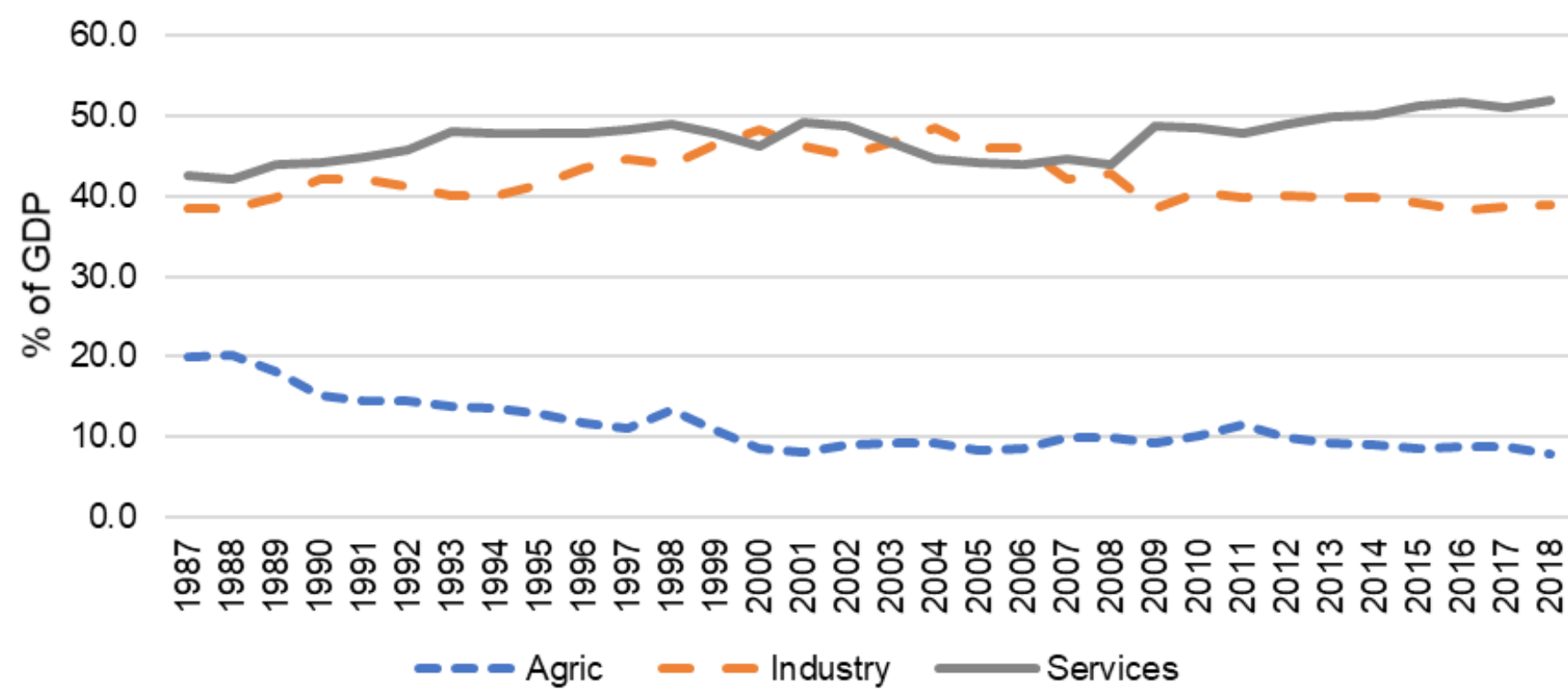
Nigeria



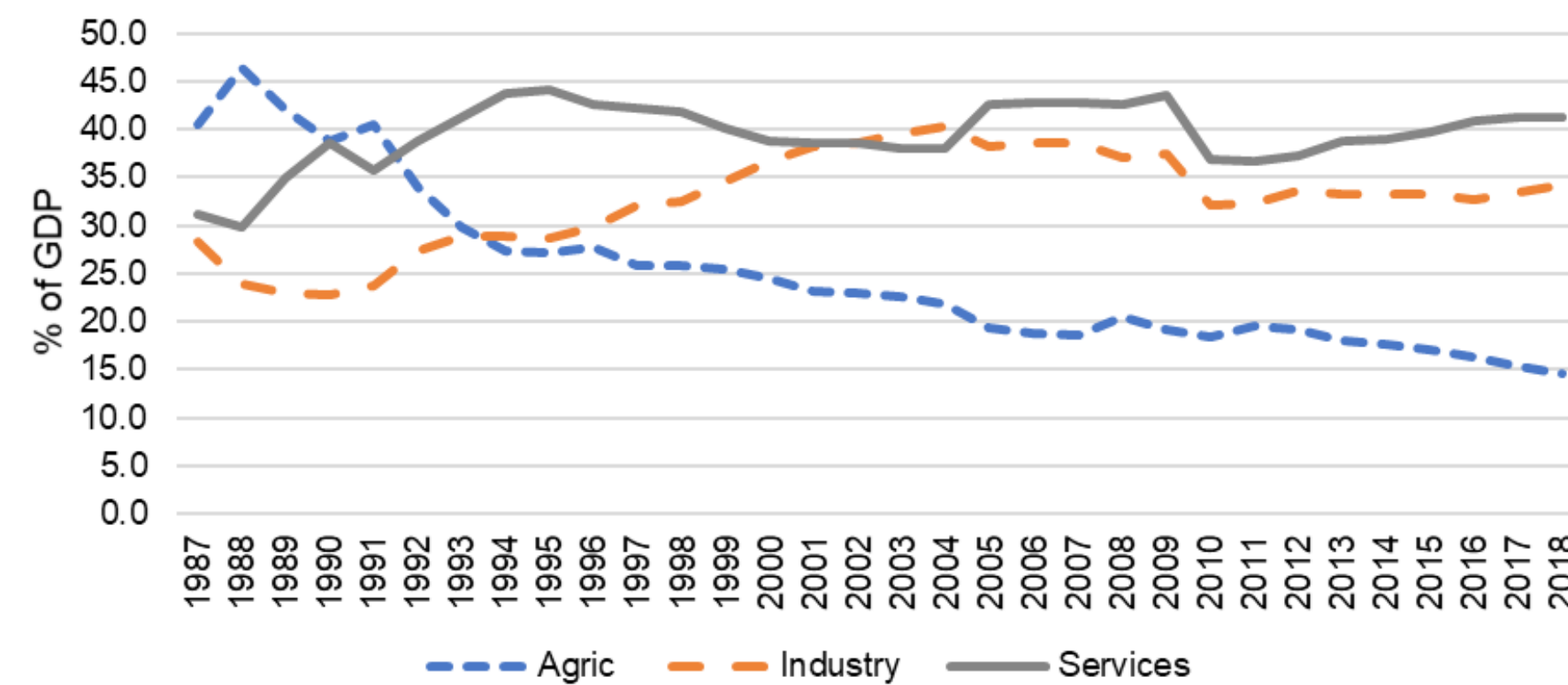
Indonesia



Malaysia



Vietnam

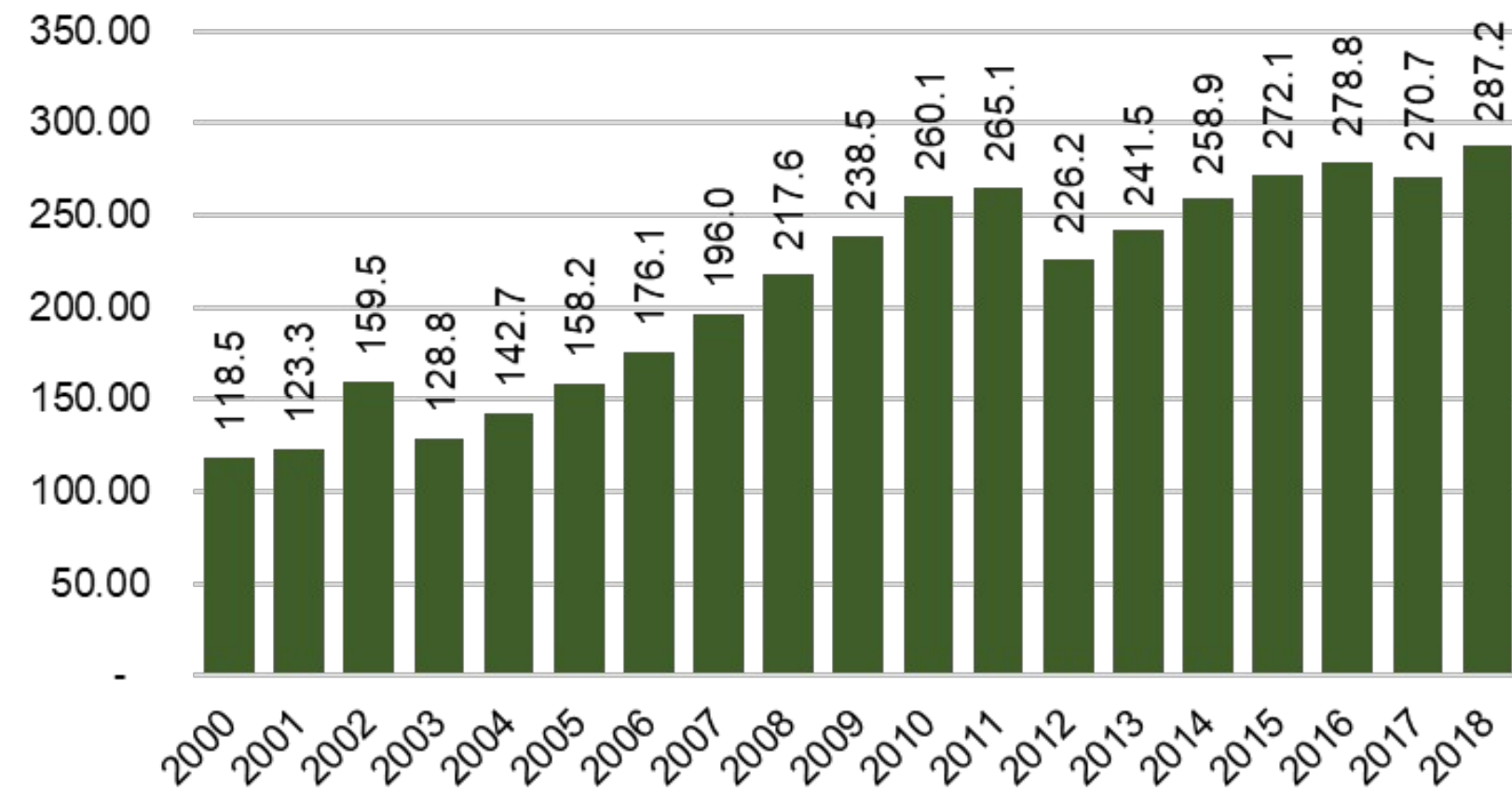


- *This rendition of the structure of economic evolution is different than the structure used for Nigeria in slide 42. In this rendition, extractive industries such as Solid Minerals and Oil & Gas [Petroleum] are considered Industrial sectors, in addition to Manufacturing and Construction

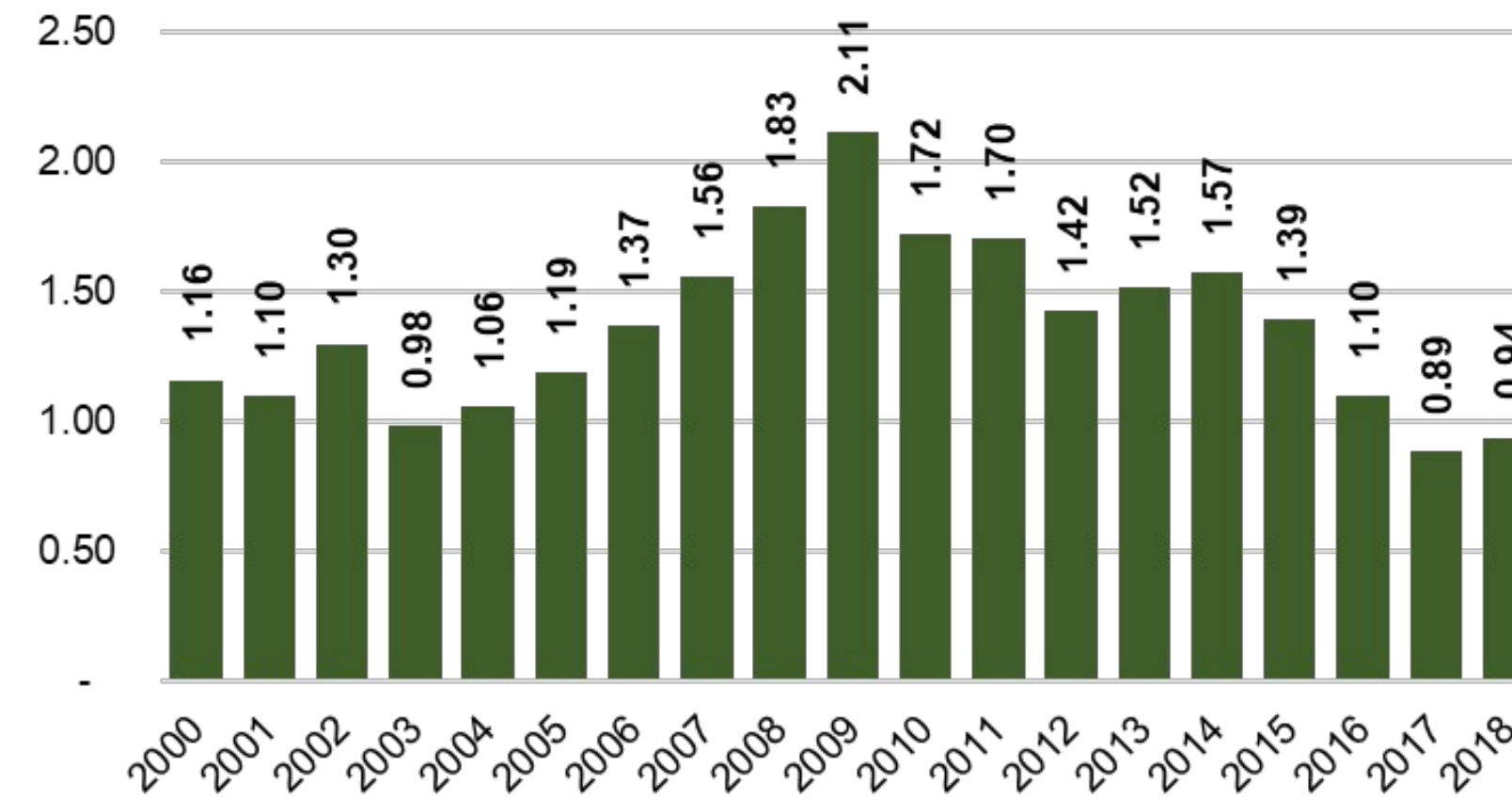
Regulation, Innovation and Growth in the Domestic Insurance Industry

Insurance Industry Characteristics

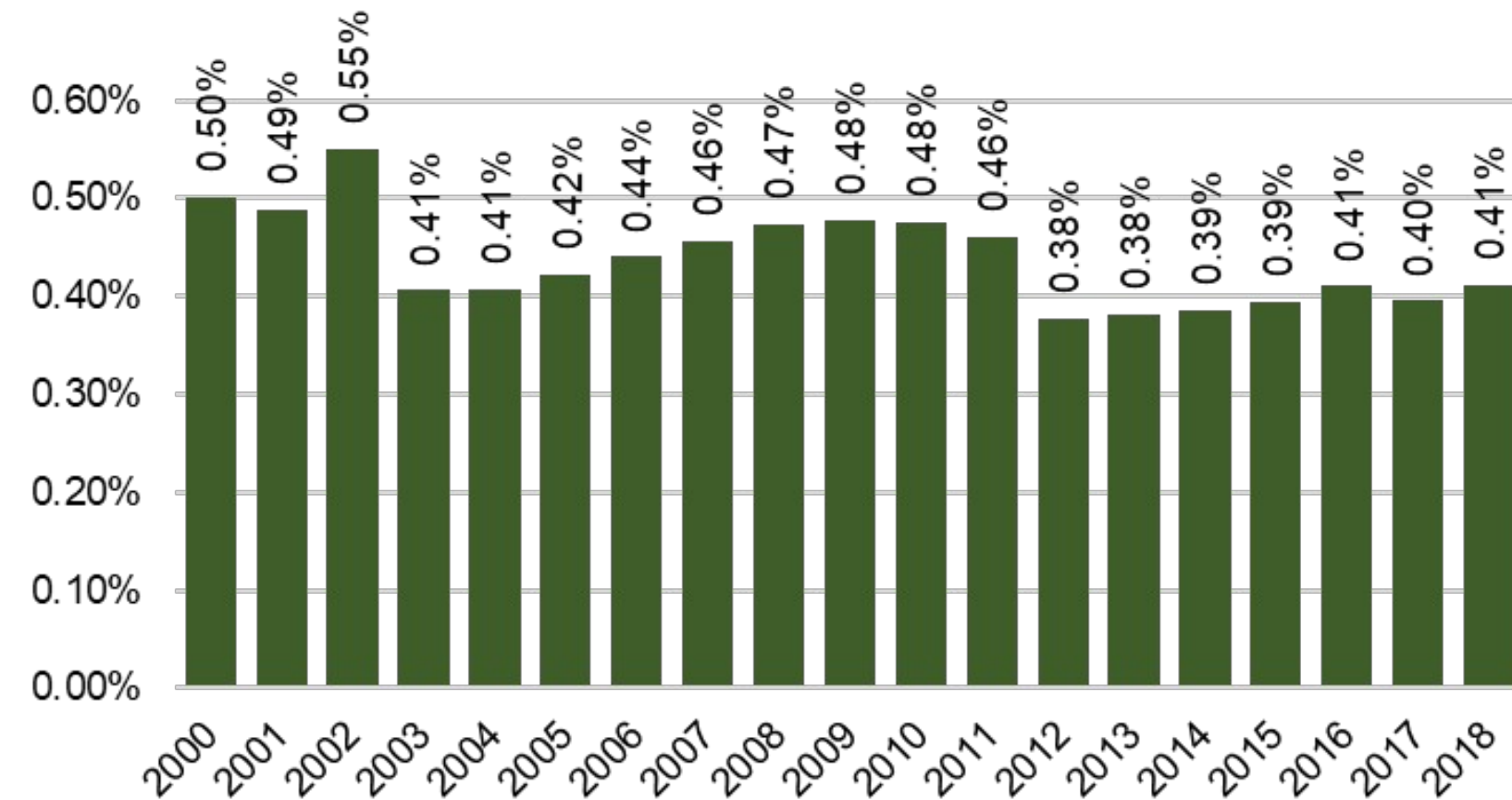
Insurance Sector GDP Size (N' Billion)



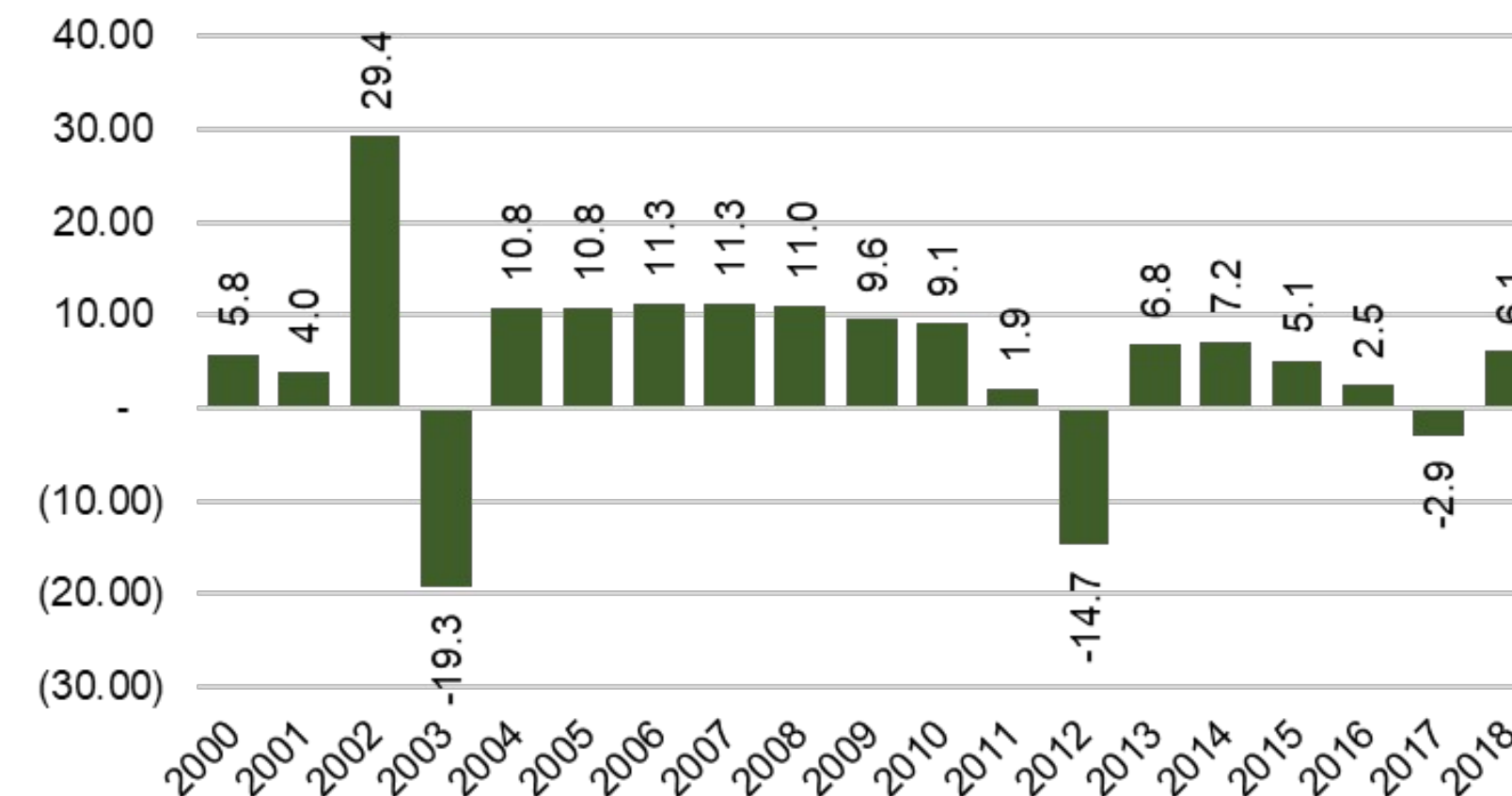
Insurance Sector GDP Size (US\$' Billion)



Insurance Contribution to GDP (%)



Insurance Sector Growth (% Y-o-Y)



- The Nigerian insurance industry is a small sector;
- about **US\$0.94bn** in size,
- less than half a percent of GDP,
- and a sector growing slower in recent years

The Insurance Industry Regulator: NAICOM - The Charter

NAICOM's service charter was set in 1997, under the NAICOM Act

Since then, NAICOM's mandate has evolved in accordance with the imperative of developing the sector to include:

- Insurance Industry Recapitalization
- Market deepening and development in order to address:
 - Still very low insurance penetration; heavy reliance on compulsory products, life, health, travel
 - Still narrow coverage of industrial verticals – production, maritime, agriculture,
 - Imperative of developing microinsurance

Imperatives of Innovation in the Nigerian Insurance Landscape

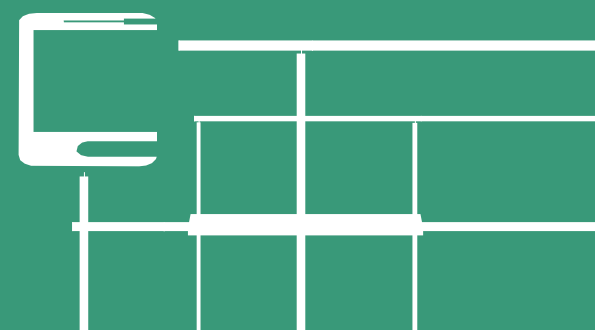
Changing customer trends and the large untapped market will necessitate the need for innovation to drive penetration...

Distribution



- Limited distribution channels in Nigeria, with brokers and agents contributing significant proportion of premiums leading to high reliance on these channels, which focus on the urban areas.
- Need for **distribution reforms** as current distribution regulations limits effective utilization of alternative distribution channels

Digital Transformation



- Currently lacking in the industry, this business priority requires an innovative business model that is focused on customer needs, emerging technologies and data.
- The insurance industry of the future will need to leverage a number of digital tools such as AI, Advanced Analytics, Robotics to be able to meet evolving customer needs.
- Digital transformation success is hinged on data which the operators should rely on the regulators to provide

Partnerships & Value Chain Collaboration



- With an increasing demand for innovative products and services from younger people, collaborations & partnerships across the value chain are becoming very important.
- Insurance service providers will need to collaborate and capture more market share. Leading insurance providers will need to invest in ancillary companies to consolidate their standing and scale to establish a better connect with their customers.
- The regulatory environment needs enable these changes to flourish.

The Regulation-Innovation-Business Growth nexus: Where are we in the Nigerian insurance space?

The Nature of Regulation:

Of the two imperative functions of regulation in developing markets - **Market Development** and **Operational Control**;

- The last 20 years of regulatory oversight in insurance have focused on the latter to the detriment of the much needed former
- The same problems that besotted the Insurance industry in the 1990s are still with us today and the products remain largely the same. On the other hand, banking and capital market operations have grown significantly and continue to do so
- In response to the lack of creativity and vision at the regulatory level, the government has wisely excised sectors such as health insurance and pension management and created new regulators - NHIS and PENCOS - unburdened by legislative structures that stymie industry growth. These two sectors have accordingly flourished while traditional insurance has stagnated

The Regulation-Innovation-Business Growth nexus: Where are we in the Nigerian insurance space?

Operational Pain points:

i. Product development

- There is limited product differentiation across the industry - poor research and development practices by insurance companies, heavy focus on mandatory policies and commercial lines.
- The product approval process is usually delayed for months, which hinders creativity.
- Insurance penetration rate in developing countries in SE Asia has grown on the back drop of product innovation. Regulators in these countries allow insurance companies launch/pilot products for a trial period of 1-2 years before seeking regulatory approval.

The Regulation-Innovation-Business Growth nexus: Where are we in the Nigerian insurance space?

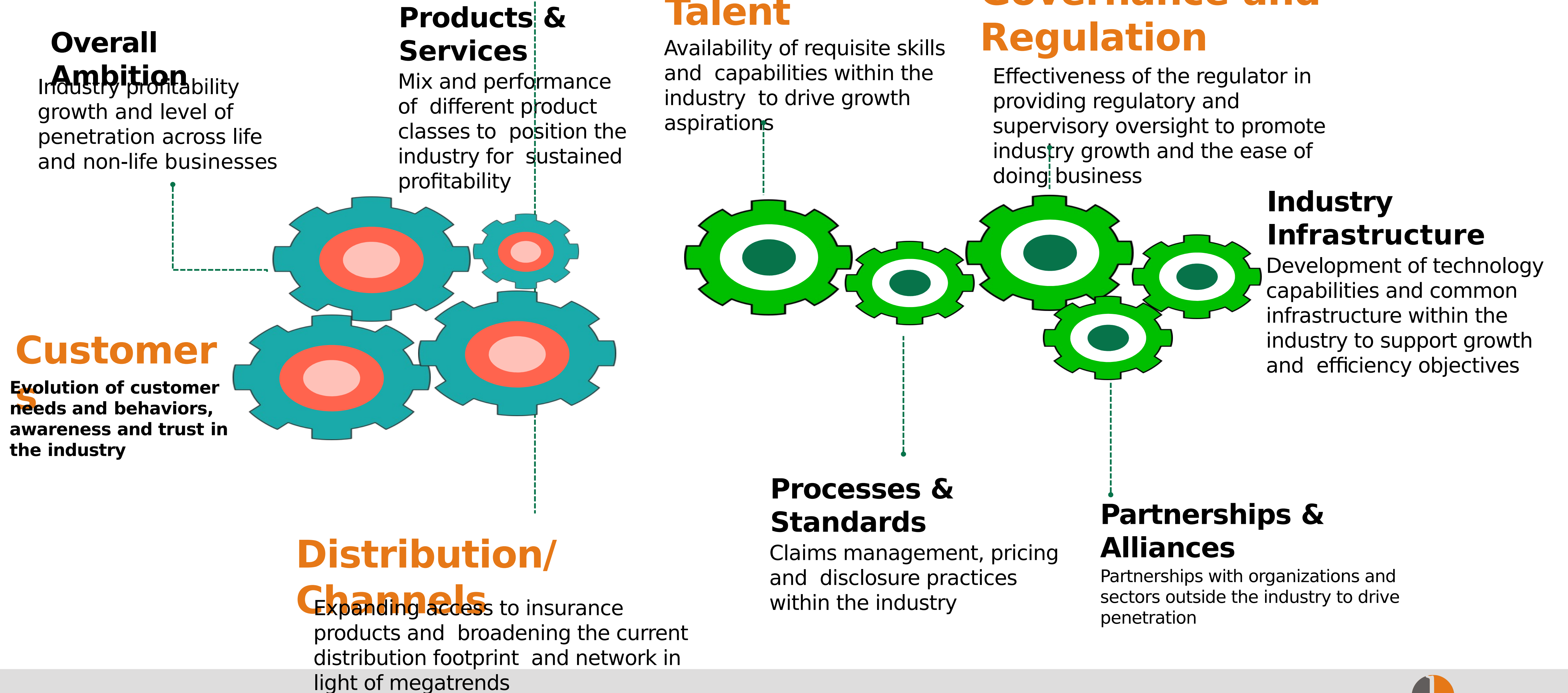
Operational Pain points:

ii. Capital Management

- **Statutory deposit:** Operating Insurance companies are required to deposit 10% of the Minimum Capital requirement for their respective class of insurance operation with CBN, while it is 50% for new insurance companies. With the new Minimum Capital Share requirement, this statutory deposit has now increased to N1.8bn for composite companies
- **NAICOM levy:** Insurance underwriters are required to pay the regulator 1% of Gross premium within 15 days from the date of receipt of the Approval In Principle of audited account

Recommendations for NAICOM

The Agenda for NAICOM: Nine levers to transform insurance



The Agenda for NAICOM: What have strong benchmark insurance growth markets in South-East Asia done?

Customer education initiatives

Stimulation of consumer demand for insurance through various customer awareness initiatives

Deregulation of Pricing Structure

Liberalisation of non-life insurance tariffs to address rising claims expenses

Bancassurance distribution model

Bancassurance is an increasingly important distribution channel, with insurers and banks seeking JV arrangements rather than a commission model



Major presence of foreign market players

Entrance of foreign insurance companies that partner with local insurers, a key driver of growth in benchmark markets. Foreign players bring strong skills and expertise as well as product innovation that drives market

Collaboration between Insurance Companies and Universities

Partnerships between insurers and Universities to provide scholarships and promote the actuarial profession

Stricter capital requirements and industry consolidation

Higher minimum capital requirements to drive market consolidation, eliminating smaller and under-capitalised insurers. This encourages mergers and acquisitions between foreign and domestic players in raising

Thank You

Regulation, Innovation and Business Growth



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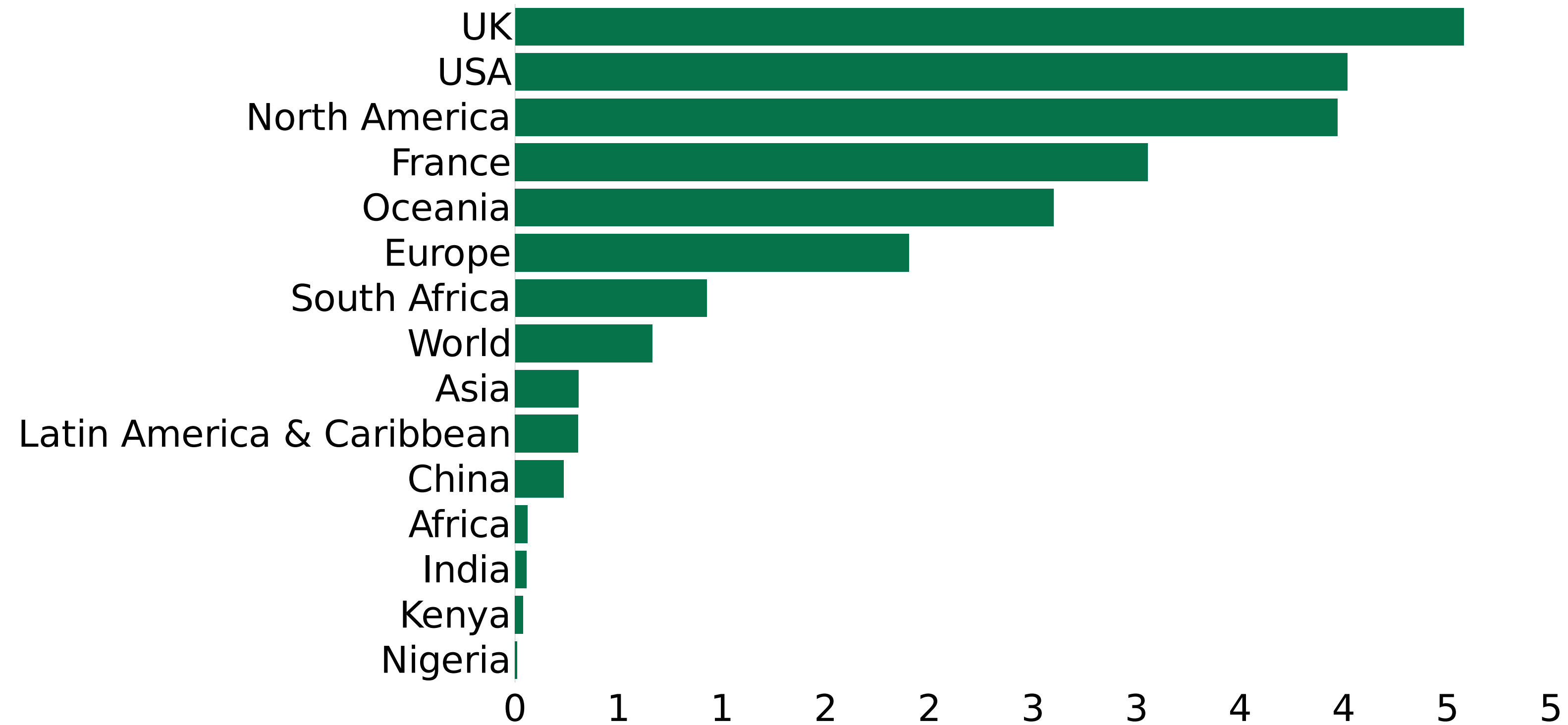
Insurance Penetration levels

Country	Total GWP (\$'mn)	Penetration (%)	Life Penetration (%)	Non-Life Penetration (%)	Density (\$)
South Africa	41,962	14.2	11.5	2.7	925
Morocco	3,561	3.5	1.4	2.1	102
Egypt	2,130	0.7	0.3	0.4	24
Nigeria	1,790	0.3	0.1	0.2	10
Kenya	1,784	2.7	1	1.7	39
Algeria	1,159	0.8	0.1	0.7	40
Angola	788	0.8	0	0.8	52
Namibia	783	7.2	5	2.2	396
Tunisia	824	2	0.4	1.6	80
Mauritius	776	6.5	4.5	1.9	613
United States	1,352,385	7.2	3	4.2	4,017
United Kingdom	304,208	10.2	7.6	2.6	4,823
France	237,644	9.3	6.1	3.2	3,902
Africa	60,709	2.8	1.9	0.9	61
Global	4,732,188	6.3	3.5	2.8	662

*GPW = Gross Written Premium; Source: SwissRe Sigma3_2017

Insurance Density levels

2016 Insurance density (\$'000)



** Insurance density is a per capita metric, computed as total insurance premium divided by the population.*

Source: SwissRe Sigma3_2017