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# *African Insurance Organisation Study on the Transfer of Insurance Premiums Offshore*

*September 2016*



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## ***Context***

This report must be read in its entirety. Individual sections of this report could be misleading if considered in isolation from each other. We have performed the work assigned and have prepared this report in conformity with its intended utilisation by a person(s) technically competent in the areas addressed. Members of PwC staff are available to explain and/or amplify any matter represented herein, and it is assumed that the user of this report will seek such explanation and/or amplification about any matter in question.

# ***Executive Summary***

## ***1. Overview***

The African Insurance Organisation ('AIO' or 'the Organisation') seeks to establish how much the African insurance sector loses through insurance and reinsurance premiums being placed with foreign insurance markets outside the continent. The AIO has appointed PricewaterhouseCoopers ('PwC') to conduct the research in three phases, namely:

- Phase 1: Desktop research and literature review;
- Phase 2: Detailed survey questionnaire to all AIO members; and
- Phase 3: Face to face interviews with selected industry participants.

The research aims to primarily establish:

- Why transfer of premiums offshore is an issue;
- The characteristics of African insurance markets that result in the transfer of premiums offshore;
- The quantum of insurance premiums transferred outside of Africa, with a focus on Africa's largest insurance markets and those markets experiencing high levels of Foreign Direct Investment;
- The key reasons put forward for the transfer of premiums offshore;
- The key interventions to encourage local retention and reduce offshore transfers; and,
- Strategic considerations for implementing the identified interventions.

## ***2. Quantifying insurance premium flight***

### ***Overview***

The extent of offshore premium transfer has been investigated under two broad categorisations, namely:

- Type 1: Offshore premium transfers - after the initial insurance placement in country (where the risk originates) with a local insurer; and,
- Type 2: Offshore premium transfer - due to risks being insured directly offshore.

In most countries, legislation requires all domestic risks (i.e. risks which arise in country) to be insured (in the first instance) by a locally registered insurance company. In most cases, direct offshore insurance of domestic risks may only occur with approval from the local insurance regulator.

As a result, the primary source of offshore premium transfer is expected to be the category above titled "Offshore premium transfers after the initial insurance placement in country with a local insurer". This may however not always be the case due to unapproved sources of direct offshore insurance resulting in larger than expected insurance premiums being transferred offshore.

Therefore, at a high level, the mechanisms under which premiums are transferred offshore are outlined below.

- Type 1: Offshore premium transfers - after the initial insurance placement in country (where the risk originates) with a local insurer through one of the below:

- Cross border reinsurance (i.e. direct offshore transfer of reinsurance premiums);
  - Inter-group reinsurance; or,
  - Reinsurance with a local reinsurer but subsequent retrocession to a foreign reinsurer.
- Type 2: Offshore premium transfer – due to risks being insured directly offshore through one of the below:
    - Direct offshore insurance with a foreign insurance company;
    - Direct offshore insurance with a foreign reinsurance company; or,
    - No formal insurance paid for by the local risk-taking entity, however, profits are paid to (usually through dividends) foreign companies and a portion of the profits are used to provide for insurance with a foreign insurance entity.

As an independent validation of the gross written premiums (GWP) figures used for the countries included in this report, the Swiss Re Sigma report "World insurance in 2013: steering towards recovery" has been used. This report has been used to support the quantum of the premiums used in our report, and has been validated against regulator submissions and BMI reports on African insurance premiums. The report is publicly available from the Swiss Re website ([http://media.swissre.com/documents/sigma3\\_2014\\_en.pdf](http://media.swissre.com/documents/sigma3_2014_en.pdf)), and has been used by Africa Re in the compilation of their "African Insurance Regulation Directory" from May 2015.

Estimates from the Swiss Re Sigma report places the total size of gross written premium (GWP) in Africa at \$72bn in 2013. This is split into \$50bn of life insurance premiums and \$22bn of non-life premiums. Where the Swiss Re Sigma report did not have the required premium figures, the Africa Re Insurance Regulation Directory was used.

The following table indicates the breakdown of premiums across the major African countries.

**Table 2.1 – African Country Insurance Premiums in 2013**

Country	Population ('m)	GDP (USD 'bn)	GWP - Life ('m)	GWP - Non-Life ('m)
South Africa	53	366	44,556	9,565
Morocco	32	104	1,023	2,157
Ghana	25	48	168	269
Egypt	79	272	773	1,051
Uganda	35	21	20	140
Tanzania	49	33	30	260
Kenya	44	53	439	1,000
Nigeria	174	522	403	1,406
Angola	22	124	50	948
Mauritius	1	12	463	212
<b>Total</b>	<b>515</b>	<b>1,556</b>	<b>47,925</b>	<b>17,008</b>
<b>Africa Total</b>	<b>1,111</b>	<b>2,390</b>	<b>49,939</b>	<b>22,485</b>

Table 2.2 below summarises the split between life and non-life sectors where appropriate data were available.

**Table 2.2: Life and non-life insurance total gross written premium in 2013**

Country	Life insurance		Non-life insurance	
	Gross Premiums Written (USD m)	Net Premiums Written (USD m)	Gross Premiums Written (USD m)	Net Premiums Written (USD m)
Angola	50	17	948	531
Egypt	773	742	1,051	493
Ghana	168	168	269	199
Kenya	439	411	1,000	690
Mauritius	463	359	212	129
South Africa	44,556	34,515	9,565	7,336
Tanzania	30	30	260	130
Zimbabwe	269	264	209	110

***Type 1: Offshore premium transfers - after the initial insurance placement in country with a local insurer***

The following tables estimate the insurance premiums that remain in the key African countries and, by implication, the level of expatriation. It is important to consider that some level of offshore transfer occurs through direct placements of the risks overseas and is not captured in tables 2.3 and 2.4 below, but is rather estimated separately thereafter. These tables include figures that were developed by the regulators of these countries, and were confirmed in our discussions with these regulators.

**Table 2.3: Life insurance transfers**

Country	Life transfer (\$m)	Total life premiums (\$m)	Proportion of African life market
South Africa	1,146	44,556	89%
Morocco	69	1,023	2%
Egypt	56	773	2%
Nigeria	26	403	1%
Kenya	2	439	1%
<b>Total</b>	<b>1,299</b>	<b>47,194</b>	<b>95%</b>

**Table 2.4: Non-life insurance transfers**

<b>Country</b>	<b>Non-life transfer (\$m)</b>	<b>Total non-life premiums (\$m)</b>	<b>Proportion of African non-life market</b>
South Africa	1,800	9,565	43%
Morocco	147	2,157	10%
Egypt	480	1,051	5%
Nigeria	291	1,406	6%
Kenya	275	1,000	4%
<b>Total</b>	<b>2,993</b>	<b>15,179</b>	<b>68%</b>

The tables above are then used in order to estimate the size of the offshore premium transfer for the remainder of the continent.

### Mid-range estimate (type 1)

Extrapolating the above figures to give an Africa-wide premium transfer estimate gives the total life insurance transfer offshore as \$1.37bn, and the total non-life insurance transfer offshore as \$4.4bn.

The 2013 mid-range estimate of the total premium transfer from Africa is therefore in the region of \$5.8bn.

This result would depend on other countries displaying a similar split between life and non-life insurance, as well as similar levels of sophistication in their local reinsurance markets such that retention levels are similar. It is therefore set as the middle estimate of the extent of offshore premium transfer. The reason for this scenario being selected as the mid-range estimate is as follows:

- The majority of the insurance markets have been included in the above estimation, and it would not be expected that there would be significant changes to the experience for the remainder of the market.

To provide for a more updated quantification for the 2015 calendar year, the results above have been increased by an average African GDP growth rate of 4.2% per annum, as projected by the OECD.

The mid-range estimate of offshore premium transfer due to type 1 transfers is therefore approximately \$6.3bn for the 2015 calendar year.

### Lower range estimate (type 1)

To provide a lower range estimate of the quantum of offshore premium transfers we have followed the above methodology with an adjustment for the extent of offshore premium transfer allowed for those countries where we have not received the exact quantification from the regulator (as shown in tables 2.3 and 2.4).

In summary:

- For the top 5 African countries we have the exact estimates from the regulators - these will be relatively unchanged except for the insurance industry growth adjustment from 2013 to 2015.

- For the remaining countries, these make up 5% and 32% of the life and non-life markets respectively.

We then assume half of the average transfer rate applicable to the mid-range estimate. The reason half the average transfer rate is selected is because this equates to applying the second lowest transfer rate from the 'known' top 5 countries to all other countries. The lowest country transfer rate was excluded as this is viewed as an outlier in the African market.

The above determines the premiums that are transferred offshore from those countries where country specific offshore transfer information is not available.

The average transfer rate for the life market is 2.75%, implying that 2.75% of the life insurance premiums are transferred offshore. Assuming that half of this transfer rate is appropriate for the remaining life insurance premiums, the additional transfer of life insurance premiums is then \$34m. The total life insurance transfer is therefore \$1,333m.

For the non-life market, the average transfer rate is 19.7%, implying 19.7% of non-life premiums are transferred offshore. Applying half of the above assumption (9.86%) to the remaining non-life premiums implies that the additional non-life insurance premium transfer offshore is \$704m. Thus the total non-life premiums transferred offshore are \$3,697m.

The above results in a lower range estimate for type 1 of \$5.03bn for the 2013 calendar year.

To provide for a more updated quantification for the 2015 calendar year, the results above have been increased by an average African real GDP growth rate of 4.2% per annum.

The lower range estimate of offshore premium transfer due to type 1 transfers is therefore \$5.46bn for the 2015 calendar year.

### Upper range estimate (type 1)

To provide an upper range estimate of the quantum of offshore premium transfers we have followed the above methodology with an adjustment for the extent of offshore premium transfer allowed for in countries where we have not received the exact quantification from the regulator.

In summary:

- For the top 5 African countries we have the exact estimates from the regulators - these will be relatively unchanged except for the insurance industry growth adjustment from 2013 to 2015.
- For the remaining countries, these make up 5% and 32% of the life and non-life markets respectively.

We then assume that the average retention rate for the countries that have data available is applied to these countries and that 100% of reinsurance premiums are transferred offshore (i.e. 100% of the reinsurance premiums that would be suggested by the retention ratio). These countries are those included in table 2.2 above. This determines the premiums that are transferred offshore from those countries where country specific offshore transfer information is not available as an upper range estimate.

The average retention rate for the life market is 85%, implying that 15% of the life insurance premiums are reinsured. If we assume that 15% of the remaining African life insurance premiums are

placed offshore, this leads to the additional transfer of life insurance premiums being \$384m. The total life insurance transfer is therefore \$1,683m.

For the non-life market, the retention rate is 61%, implying 39% of non-life premiums are reinsured. Applying the above assumption to the remaining non-life premiums implies that the additional non-life insurance premium transfer offshore is \$2,803m. Thus the total non-life premiums transferred offshore are \$5,796m.

The above results in an upper range estimate for type 1 of \$7.48bn for the 2013 calendar year.

To provide for a more updated quantification for the 2015 calendar year, the results above have been increased by an average African real GDP growth rate of 4.2% per annum.

The upper range estimate of offshore premium transfer due to type 1 transfers is therefore \$8.12bn for the 2015 calendar year.

### ***Type 2: Offshore premium transfer - due to risks being insured directly offshore***

The methodology for estimating the range of type 2 offshore premium transfers is outlined below.

#### **Estimation methodology: Key points to note**

In most countries that have been surveyed or interviewed, and certainly the largest African insurance markets, regulators have stated that type 2 offshore transfer does not occur without their knowledge and approval and the effect thereof is largely included in their submitted quantifications of type 1 offshore premium transfers.

For prudence, and based on industry feedback, we may assume the above does not always hold. However, what has been identified is that where type 2 or direct offshore insurance does occur, it primarily occurs as a result of large FDI deals where the insurance is pre-arranged with a global partner.

Note that whilst a similar prearrangement may occur for Global Insurance programmes, these programmes and the effect thereof are already captured in regulators' type 1 numbers and/or occurs via a reinsurance mechanism and are still therefore captured in our initial analysis on type 1 transfers.

Where self-insurance is used by investors, there is no loss of premiums offshore. The local economy then benefits through not having to cover the cost of insurance premiums related to the project. Premium outflow in respect of exports and imports of goods relates to risks that arise offshore, and thus do not pertain to the offshore transfer of insurance premiums. Both domestic and offshore insurers participate in these risks.

#### **Estimation methodology: Overview**

- Using BMI data supported by PwC research and other independent data sources we have, in USD the total per country of Foreign Direct Investment per year;
- The total FDI for Africa was \$654bn in 2012 (according to BMI and World Bank data) – note that this includes a large quantum of transactional data relating to asset/investment cashflows on stock and bond exchanges which are unrelated to insurance transactions;
- The total extent of FDI for Capital Projects and Infrastructure for Africa is then sourced from the BMI and PwC research reports and data;

- The base estimate of Capital Projects and Infrastructure related FDI for Africa is \$40bn per annum in 2014 which is projected to increase to \$180bn per annum in 2025;
- As an upper bound, we have assumed a large proportion of the FDI deals done in Africa are insured directly offshore.

As an aside, the assumption of 'all deals' being insured directly offshore is an overestimation as we are aware of large projects which are insured in country in various African countries. For example, the V&A Waterfront in Cape Town, South Africa, which is a multi-billion Rand shopping complex, is insured locally.

- On average, insurance premiums for these deals are 0.1% to 1% of the capital expenditure. These figures have been validated through discussions with engineering experts experienced in the placement of insurance for capital projects, as well as reinsurers that are responsible for large reinsurance programs of this nature. The nature of the calculation does however allow for independent re-calculation of the result with other estimates of the premium rate.
- Based on Capital Project and insurance specialists' feedback the average insurance premium as a percentage of capital expenditure is 0.15% (see detail later in the report).
- Applying a conservative estimate to the proportion of projects insured offshore as well as a low estimate of the premium as a percentage of the capital expenditure provides the lower range estimate.
- Applying a high estimate to the proportion of projects insured offshore as well as a high estimate of the premium as a percentage of the capital expenditure provides the upper range estimate.

The estimation results are shown below.

### Lower range estimate (type 2)

The 2014 PwC Capital Projects and Infrastructure report estimates \$40bn of capital projects FDI for 2014.

- We assume the size of foreign funded capital projects in 2015 will be \$46bn (i.e. 15% growth)
- We assume 50% of foreign funded projects are insured offshore
- We assume a 0.10% rate for premium as a percentage of the capital expenditure - this is a low estimate when compared to the average rate of 0.15%

The lower range of offshore premium transfer due to type 2 transfers is therefore \$0.023bn (i.e. \$23m) for the 2015 calendar year.

### Upper range estimate (type 2)

The 2014 PwC Capital Projects and Infrastructure report estimates \$40bn of capital projects FDI for 2014.

- We assume the size of foreign funded capital projects in 2015 will be \$50bn (i.e. 25% growth)
- We assume 100% of foreign funded projects are insured offshore – this is an overly high estimate
- We assume a 0.5% rate for premium as a percentage of the capital expenditure - this is a high estimate when compared to the average rate of 0.15%

The upper range of offshore premium transfer due to type 2 transfers is therefore \$0.25bn (i.e. \$250m) for the 2015 calendar year.

The number is not as significant as expected, although regulators have confirmed that they do not expect there to be an ‘unregulated’ insurance market that is large in size.

### ***Total African offshore premium transfer***

The summary of the above two analyses results in an estimate of the total offshore premium transfer for Africa (both types 1 and 2 offshore transfers) estimated in the range of \$5.5bn to \$8.4bn; this is shown in the table below.

**Table 2.5: Summary of African offshore premium transfer (2015)**

<b>Estimation Range (\$m)</b>	<b>Type 1 transfer</b>	<b>Type 2 Transfers</b>	<b>Total Transfers</b>
Lower range estimate	5,461	23	5,485
Mid-range estimate	6,263	137	6,400
Upper range estimate	8,120	250	8,370

### ***Excluding South Africa***

As a means of understanding the impact of excluding the South African experience, the above analysis has been repeated but without the South African premium information being included. The results of this exercise are given in the table below.

**Table 2.6: Summary of African offshore premium transfer excl. South Africa (2015)**

<b>Estimation Range (\$m)</b>	<b>Type 1 transfer</b>	<b>Type 2 Transfers</b>	<b>Total Transfers</b>
Lower range estimate	2,541	23	2,564
Mid-range estimate	3,257	137	3,394
Upper range estimate	5,071	250	5,321

### ***Reasonability assessment of the offshore transfer results***

To assess the potential differences between the local market’s expectations of offshore transfers and the offshore transfers estimated above we have, for the countries where regulatory statistics were not available, received estimates from market players in each country to compare to our results.

### ***Comparison to Illicit Financials Flows report***

In 2015, a report jointly issued by the United Nations and the African Union aimed to put an estimate on the value of Illicit Financial Flows (IFF) being lost by Africa. This put the value of the total annual transfer of funds at \$60bn. This was recently updated to a value of between \$80bn - \$90bn in 2016. This value included numerous sources, of which insurance premiums were not identified separately. These flows included laundering criminal proceeds, corruption, tax abuse and market abuse, and thus are applicable to industries that go beyond only insurance. It was said that two thirds of this total was due to commercial companies, and one third to criminal activities.

We would thus anticipate the value of this flow of funds to exceed that of our estimate, and significantly so. This report can be used as a means of benchmarking our evaluation of the African insurance industry and the size of premiums transferred offshore. Given that the proportion of IFFs compared to the total African GDP of \$2.4trn is 3.8%, our estimate of the offshore transfer of 11.6% of

the African insurance market appears reasonable. The report also showed that the estimation of these illicit flows is a complex and difficult exercise, which was experienced during the course of our work.

### ***Worst Case Scenario***

In order to give an ultimate “worst case scenario”, an estimate of the true upper limit of the transfer of premiums was calculated. This was done by assuming that the full premiums of the countries whose transfer is unknown are transferred offshore. The table below gives this worst case scenario.

**Table 2.7: Worst case scenario**

<b>(\$m)</b>	<b>Life</b>	<b>Non-Life</b>	<b>Total Transfers</b>
2013	3,791	10,136	13,927
2015	4,117	11,005	15,122

This can be seen as the ceiling of premium transfer, and would reflect 19% of total African gross written premiums.

### ***3. Importance of retaining premiums in Africa***

The AIO has identified the expatriation of premiums as a potential cause inhibiting the growth of African insurance markets. There is recognition that some transfer of premiums offshore is necessary in the conduct of insurance business. By its nature, insurance relies on the concept of spreading risks. Global placements of insurance and reinsurance can achieve the spreading of risks across various geographies thereby reducing concentration risk on the African continent.

However some of the transfer of premiums offshore is deemed unnecessary where African underwriters are deprived of the opportunity to underwrite certain risks where local capacity exists. In some instances this is as a result of reasons unrelated to core insurance principles. Increased retention could, over time, help grow the African insurance markets.

#### ***Necessary transfer of premiums offshore***

The necessary transfer of premiums offshore occurs where the local market is restricted and when:

- there is limited capacity to underwrite the risks locally;
- certain risks fall outside risk appetite parameters of local underwriters; or
- there is a need to diversify in order to prevent the concentration of risks in local markets.

Other considerations for the transfer of premiums offshore may include:

- better premiums or pricing;
- improved security and a willingness and ability to pay claims by foreign underwriters; or
- improved service and customer experience.

#### ***Unnecessary transfer of premiums offshore***

Transfer of premiums offshore is unnecessary if the risks could have been underwritten locally but are not due to reasons unrelated to insurance. Examples include:

- profit transfer arrangements in multi-national groups where ‘expenses’ are described as insurance;

- pure fronting arrangements where local companies are set up solely as a channel for premiums to foreign countries;
- instructions or policy under a global programme of a foreign direct investor;
- premium subsidisation under global arrangements;
- instruction or policy of sponsor including Government, cell captive, foreign direct investor or contractor; and,
- where there is no desire to promote the local insurance industry by the insured.

Unnecessary expatriation of premiums potentially costs the African economies in the following areas:

- reduced income tax base for local countries;
- reduced investment or developmental funds from insurance savings;
- pressure on limited foreign exchange reserves and depreciation of the local currency;
- reduced jobs and enterprise creation;
- reduced opportunity to create local insurance skills;
- reduced ability to grow local economies; and,
- reduced ability to protect African policyholders if insurance outside of the approved regulatory framework prevails.

The potential for growth in the African economy, and consequently its insurance market, is significant. Unnecessary transfer of premiums offshore, if unchecked, may constrain that growth. There is a case that it still needs to be protected by way of positive interventions in order to nurture its growth, whilst being mindful of commitments to free trade and World Trade Organisation protocols.

#### ***4. African premium retention frameworks***

Regulators in most African countries have indicated their awareness of the risk of unnecessary transfer of premiums offshore. African countries have adopted premium retention frameworks that aim to ensure that only necessary offshore premium transfer occurs. Typical frameworks aim to cover the following at a minimum:

- the requirement that all domestic insurance business be conducted with locally licenced insurers;
- the requirement that reinsurance arrangements and plans be approved by the regulator;
- the exhaustion of local capacity before any insurance or reinsurance can be placed offshore;
- compulsory cessions to insurance pools, national reinsurers or a regional reinsurer where it exists; and,
- 5% cessions on all treaty business to Africa Re are also applied where a country is a signatory to this accord.

Based on our research, unnecessary transfer of premiums still prevails in spite of the above, where:

- legislation is bluntly not complied with;
- legislation is incomplete, not understood or not supported by clear guidelines on implementation;
- legislation is adhered to by the letter, but not in spirit, of the law;
- multiple respondents are of the view that mechanisms have been developed to avoid various parts of legislation;
- regulatory enforcement of existing legislation is re-active only, limited or delayed resulting in non-adherence being unidentified and/or unaddressed; or ,
- significant local effort is exerted but unnecessary transfer of premiums still occurs.

Examples of mechanisms that market participants perceive to be applied include:

- unnecessary or complex policy wordings for otherwise standard insurance cover which result in the local market declining to cover risks for which local capacity, skill and security exists;
- unnecessary stipulation of stringent credit rating requirements;
- strategic or simply short timing of the offer to the local market (often only for the purposes of satisfying regulatory requirements around exhausting local capacity) resulting in the local market being unable to quote in time;
- unnecessary aggregation of complex and vanilla risks in a manner that excludes the local market; and,
- insurance premiums being negotiated away when foreign direct investment deals are concluded, sometimes in violation of the insurance laws of the country.

## ***5. Reasons put forward for transfer of premiums offshore***

A key objective of our research is the identification of the reasons put forward for the transfer of premiums offshore. The following nine key themes emerged consistently in our research, interviews and survey responses.

- the lack of local capacity amongst local underwriters;
- the lack of adequate security from local underwriters;
- the role of global programmes;
- the role of intra-group operations;
- the lack of technical skill;
- the lack of suitable products in local markets;
- the role of relationships;
- price considerations; and,
- the lack of awareness of the existence of some of the above factors.

The influences of the above generic insurance/economic factors are amplified by the capitalist/free-market approach generally adopted by market participants in Africa. Section 7 of this report provides a detailed analysis of these themes and how the influence and effect of these factors vary in different countries.

Example sub-themes put forward include the effect of:

- Regulatory incentives/disincentives;
- FDI (Foreign Direct Investment) covenants;
- Group or parental reinsurance programmes;
- Global insurance policies/programmes;
- Financial/commission and other incentives for offshore transfer;
- Insufficient marketing effort by local insurers;
- Reduced willingness and ability to pay claims by local insurers;
- Intermediary leverage;
- Competitiveness – ‘if I do not ‘front’ there is a risk my competitor will’; and,
- Specialist covers and policy wording.

It is important to note that the reasons that influence the transfer of premiums offshore vary by country and that the impact/effect of the above factors in each African country will vary accordingly. Furthermore, we were unable to validate the range of perceptions given the scope of our engagement and the practical considerations of validating such perceptions.

Where logical however, some of these perceptions were used to inform the range of possible interventions which are addressed in the following section. We would recommend that these perceptions be validated by some of the AIO’s key bodies as part of any implementation plan in the relevant insurance markets.

## 6. Strategic considerations for interventions

### Overview

The impact of any interventions should be assessed with consideration to the following four key factors:

- the risks to financial system stability;
- the cost of insurance to society, including the impact on the local competitive landscape;
- the benefits of insurance to society; and,
- the time needed to achieve anticipated benefits.

The following table summarises the key considerations for each intervention type:

**Table 6.1 Types of market intervention**

Intervention	Relative direct/implementation cost	Relative benefit	Relative financial stability risk	Timeline for implementation
Market conduct	Low	Low	Medium	Short
Market development	Medium	High	Low	Long
Prudential supervision	Medium	High	Low	Medium
Supervisory restriction	High	High	High	Long

### Market conduct

The lowest cost type of intervention is market conduct which refers to actions taken by local purchasers of insurance and reinsurance to insure or invest locally. This is achieved mainly through increasing awareness of local ability and encouragement to support local or regional insurance or reinsurance participants. The AIO and its key bodies are expected to drive this awareness activity, considering any further detailed investigations required to validate the perceptions which have informed our recommendations.

Awareness extends to key local stakeholders who include Ministers of Finance across the various governments and the related regulatory authorities. International stakeholders include the International Association of Supervisors, UNCTAD, the World Bank, ILO and GIZ.

The direct cost associated with this relates to active marketing and lobbying in the industry. The relative benefit is rated as low, based on industry’s view of the success of other similar initiatives. This

results mainly from the view that without significant additional or direct incentive, the purchasers of insurance/reinsurance would only marginally adjust their current purchasing decisions.

Relative financial stability risk is medium to reflect that, based on current African insurer strength and low levels of capitalisation, supporting locally would introduce additional financial risk.

The timeline for the implementation of this approach would be short as it would primarily relate to activities over the next year and in the run up to changes in the reinsurance programme at the next annual renewal.

### ***Market development***

The second-lowest cost type of intervention, but with the highest time to implement and achieve, is 'market development' which refers to actions taken by governments, insurers and reinsurers to develop financial strength and sophistication in order to attract more insurance risk and to retain more of it locally.

The direct cost associated with this relates to fast-tracking the capitalisation, profitability and quality of the local insurance industry. The relative benefit is rated as high, since based on economic considerations primarily, additional premium flows would be retained locally. This approach is expected to yield the greatest benefits since economic considerations are the primary drivers for offshore premium transfers.

Relative financial stability risk is low to reflect that, based on justifiable risk-based decision-making, local well-developed insurers would be selected without a significant increase in relative financial risk.

The relative disadvantage of this approach is the very long timeline for implementation and the need for short-term measures to ensure the success of this long-term goal. The intervention may be prone to postponement well beyond expectations.

### ***Prudential supervision***

Prudential supervision is the third-lowest cost type intervention and refers to the development of a well-resourced and more active regulator. This type of intervention excludes development of additional legislation or regulation to limit offshore premium transfers but rather refers to more engagement by regulators with the local insurance industry. This includes:

- active regulator review of insurance/reinsurance arrangements;
- active regulator discussions with insurers regarding placement decisions;
- ad hoc reporting to explain placement decisions; and,
- collation, analysis and reporting of relevant statistics.

The direct costs associated with this intervention, which are rated medium, relate to:

- improving regulatory capacity to regularly monitor insurance and reinsurance activities;
- improving regulatory skills; and,
- the cost associated with industry providing additional time to explain business decisions to the regulator.

### ***Supervisory restriction***

Finally the direct cost associated with supervisory restriction is rated the highest. This is an indication of the extensive effort to design and promulgate new legislation and the cost of compliance by

industry. New and aligned regulation may need to be calibrated regionally and in time, continentally, for the market interventions to be effective.

The timeline to implement the supervisory restriction is rated as long, owing to the time required to approve and implement new regulation, as well as the timeframe taken for insurers to respond to this approach.

This approach comes at the highest cost but could, if implemented correctly, be the most effective. The risks of this approach relate to the extent to which:

- the regulator is seen as requiring riskier actions to be taken by the insurer;
- the corresponding impact on policyholder protection; and,
- the potential impact on the cost of insurance to society.

## ***7. Recommendations - interventions to curb premium flight***

### ***Overview***

In principle, many of the factors that lead to unjustified reliance on offshore underwriting of risks can be resolved at three primary levels:

- **Supervisory**, being through the International Association of Insurance Supervisors (IAIS), Association of African Insurance Supervisory Authorities (AAISA) and the various National Insurance Supervisors who are able to implement intervention mainly via policy formulation, implementation and monitoring.
- **Underwriters**, both applicable to insurance and reinsurance, including their national, regional and continental associations and forums. Intervention will be mainly via capacity building and increases in risk appetite; and,
- **Policyholders**, including intermediaries who often act in the interest of the policyholder. Intervention will mainly involve increasing the will from multinationals, captives, financiers and government who are all key potential buyers of insurance to improve local, African retention.

The AIO will need to balance the advantages, disadvantages and risks involved in considering the various strategies for intervention. The degree of control and influence by the AIO and its members diminishes as the interventions move from supervisory to policyholder. It is therefore difficult to prescribe behaviour at a policyholder level.

### ***Intervention types***

The intervention types have been grouped according to four key themes, namely:

- the market conduct required to reduce the unnecessary transfer of premiums offshore;
- the market development measures that can be implemented;
- the prudential supervisory measures that can be implemented; and,
- supervisory restrictions and incentives.

Market conduct refers to actions taken by local purchasers of insurance and reinsurance when insuring or investing locally. Market development requires a focussed effort by both industry and policy makers. In our experience, the successful interventions to directly develop the market have

arisen through strong engagement between both parties. The last two types of interventions suggested are at a supervisory level.

When deciding on interventions, the cost and benefit of such a change must be considered carefully, with an economic impact study being a potential method of evaluating what the net impact on the economy as a whole would be from enacting a change to curb offshore insurance placement.

### ***Market conduct***

Examples of market conduct interventions include:

- reciprocal inter and intra-African exchange of business;
- AIO partnerships;
- standard policy wordings;
- consolidation of reinsurance purchases;
- reinsurance optimisation;
- international partnerships;
- industry intervention through associations;
- enhancing management capacity; and,
- efficient capital allocation.

### ***Market development***

Examples of market development interventions include:

- promotion of fewer but stronger insurance companies;
- affirmative action leading to localisation requirements;
- policy of government insurances;
- government led strategies to grow the insurance sector;
- market disclosure of reinsurance arrangements;
- building of regional capacity; and,
- education and skills enhancement.

### ***Prudential supervisory***

Examples of prudential supervision include:

- risk based capital structures;
- evaluation of the application of ratings;
- strengthening of the structural insurance framework;
- analysis of earnings;
- analysis of asset quality;
- analysis of capital adequacy;
- analysis of actuarial reserves; and,
- tightening of licence renewal process.

### ***Supervisory restriction and incentives***

Examples of supervisory restriction include:

- directives to insure locally;

- ‘exhaustion of local capacity’ legislation;
- promotion of mechanisms for co-insurance;
- allowance of direct inward reinsurance by insurers;
- prohibition of reinsurance outside the local market;
- compulsory reinsurance cessions;
- injunction of subsidiaries in global programmes;
- localisation requirements for management and shareholding; and,
- Regulatory capital and/or tax advantages to local retention.

## **8. Conclusions**

Retention of insurance premiums in Africa should be viewed in the context of Africa’s development story and strategy. The end goal of any intervention would be to strengthen the local insurance industry and create an industry that is viable in the long run. An approach which sets Africa on the development path to achieving insurers that can insure Africa’s risks in a financially independent manner should be promoted.

The primary aim of the intervention must be the long term creation of strong insurance markets underpinned by resilient and efficient domestic insurance and reinsurance institutions. It is only strong African underwriters that can capitalise on the rapidly growing demand for insurance services in Africa and reduce the transfer of insurance premiums offshore.

We recommend that each country, based on the assessment of necessary and unnecessary offshore transfers, develops a programme in conjunction with local and regional market players to:

- Strengthen their local market;
- Remove loopholes in existing regulation;
- Promote and incentivise local market retention; and,
- Manage the appropriate outcomes through regulation.

The above can be achieved by adopting a programme that simultaneously addresses the following four strategic pillars, which have been described in section 7 above:

- Market development
- Market conduct
- Prudential supervision
- Supervisory restrictions