

POSITIONING FOR GROWTH IN THE NIGERIAN INSURANCE SECTOR

INTRODUCTION

The apex regulator of the insurance sector, National Insurance Commission (“NAICOM”) in 2019 issued directives for the increase in the minimum paid-up share capital requirement for all classes of insurance companies in Nigeria¹. The effective date for compliance with the recapitalisation was initially extended from 30 June 2020 to 31 December 2020² and has recently been revised into two phases due to the impact of the COVID-19 pandemic. The first phase requires a partial compliance of 50% for insurance and 60% for reinsurance companies respectively by 31 December 2020. However, the second phase and deadline for full compliance is due by 30 September 2021³.

This article explores the (i) impact of external factors on insurance companies’ ability to meet the recapitalization requirement; (ii) options available to insurance companies to meet the recapitalisation requirements and expanding their businesses; and (iii) factors to consider in implementing the options.

THE IMPACT OF THE COVID-19 PANDEMIC ON RECAPITALIZATION PLANS

Following the deadline for submission of recapitalisation plans in August 2019, NAICOM has since confirmed receipt of plans from 47 insurers and 2 reinsurers, with 26 companies having received ‘no objection’ to their recapitalisation plans⁴. Thus, it is expected that most companies have set their recapitalization plans in motion. However, with the disruptions caused by the COVID-19 pandemic and the containment measures in Nigeria, it would be insurmountable to ascertain the degree these disruptions may have on the recapitalization efforts of insurers. Consequently, insurers need to re-assess their recapitalization contingencies for a more informed business continuity strategy.

There are overwhelming indications of a possible global economic recession as a consequence of the COVID-19 pandemic, with economic growth in Sub Saharan Africa predicted to plummet from 2.4% in 2019 to -5.1% in 2020⁵. These predictions would undoubtedly affect investor sentiment and could result in lower investment activity in the short term. As most insurers plan to raise capital through share premium, capitalisation of retained earnings, initial public offerings, rights issues and private placement⁶ (“Options”); a slowdown in investment activity will adversely impact the effectiveness of some of these Options in meeting the recapitalisation deadline.

1 NAICOM, ‘Minimum Paid-up Share Capital Policy for Insurance and Reinsurance Companies in Nigeria’ 20 May 2019 (Circular No: NAICOM/DPR/CIR/25/2019)

2 NAICOM, ‘Minimum Paid-up Share Capital Policy for Insurance and Reinsurance Companies in Nigeria’ 30 December 2019 (Circular No: NAICOM/DPR/CIR/25-03/2019)

3 NAICOM, ‘Segmentation of Minimum Paid Up Share Capital Requirement for Insurance Companies in Nigeria’ 3 June 2020 (Circular No: NAICOM/DPR/CIR/25-04/2020)

4 NAICOM, ‘Update on recapitalisation of insurers and reinsurers’ 23 September 2019 <<http://naicom.gov.ng/index.php/news-events-2/246-update-on-recapitalization-of-insurers-and-reinsurers>> accessed on 26 June 2020

5 Calderon, Cesar; Kambou, Gerard; Zebaze Djiofack, Calvin; Korman, Vjdan; Kubota, Megumi; Cantu Canales, Catalina. 2020. Africa’s Pulse, No. 21, Spring 2020: An Analysis of Issues Shaping Africa’s Economic Future. World Bank, Washington, DC. © World Bank. <https://openknowledge.worldbank.org/handle/10986/33541> License: CC BY 3.0 IGO.

6 NIPC, ‘Recapitalisation: six insurance companies set to merge’ 8 January 2020 <<https://nipc.gov.ng/2020/01/08/recapitalisation-six-insurance-companies-set-to-merge/>> accessed on 26 June 2020

Furthermore, the current volatility in the global financial markets accompanied by the possible impact of statistics shared over reported and continued death tolls, affected populations and businesses with insurance notwithstanding will affect general insurers and life insurers from an earnings and solvency standpoint. This is due to the nature of assets and liabilities held by insurance companies that are susceptible to market volatility. The current economic outlook requires that insurance companies reassess their investment portfolios and exposures; and depending on the relevant regulatory recapitalization requirements, raise additional capital.



AVAILABLE OPTIONS

In light of the challenges the ongoing pandemic presents, recognising some key variables that could influence the choice or options to be made by insurance companies are crucial. Such variables include the amount of capital required, the company's financial health, internal by-laws, regulatory framework, processes involved and timeline. With barely six (6) months left to the deadline for the first phase, set for 31 December 2020, affected insurance companies realistically have a short timeframe left to meet the partial recapitalization obligation.

Since NAICOM has barred insurance companies from borrowing to meet the recapitalization requirement⁷, the Options realistically available are primarily equity focused. This may mean more mergers and acquisition activity in response to the time constraints for the recapitalisation and due to the potential liquidity stress faced by others. Whilst NAICOM has confirmed at least 6 companies already exploring mergers⁸, this may also very well be the case for several other companies to remain on track to meet the recapitalization. Furthermore, internal options such as rights issues, share premium and capitalisation of retained earnings may be better suited to meet the first phase due to the possibility of lower investment activity.

Exploring any of these Options would require NAICOM's approval to the extent not already contemplated in the approved recapitalisation plan for that company. This is because the deadline for submitting plans has lapsed and NAICOM has since communicated its decision on the plans received to companies. Thus, any changes to the pre-approved plan would require NAICOM's approval. NAICOM also intends to carry out a capital verification exercise at the end of the recapitalization to ensure that companies are in line with the plans submitted and approved⁹.

⁷ Pius, Agboola, 'Recapitalization Roadmap: Implementation, Expectation and Benefits' (NAICOM presentation at the seminal for insurance correspondents 3 August 2019) <http://naicom.gov.ng/docs/publications/RECAPITALIZATION%20ROADMAP.pdf> accessed 28 June 2020

⁸ Business Day, 'NAICOM confirms 3 mergers in insurance industry recapitalisation' <<https://businessday.ng/exclusives/article/naicom-confirms-3-mergers-in-insurance-industry-recapitalisation/>> accessed on 26 June 2020

⁹ Punch, 'No Insurance Firm Has Met Recapitalisation Requirements-NAICOM.' <<https://punchng.com/no-insurance-firm-has-met-recapitalisation-requirements-naicom/?amp=11s>> accessed 8 April 2020

In ensuring the effectiveness of any of the Options, companies should aim to bolster investor and shareholder confidence. This could be improved by conducting a legal audit early enough to identify and resolve any potential issues that could impair/deter investors, whilst assuring seamless transactions to meet the revised deadline. The benefits of a legal audit are discussed further in the article.

STRATEGIC GROWTH PLAN

Whilst companies assure being on track to meet the recapitalisation requirements, which are short-term targets, it is important that they also consider their business opportunities in their long-term growth plans.

As the world gradually reopens for business post the widely global lockdown measures put in place to slow the spread of COVID-19 pandemic, insurance companies must strike a strategic balance that will sustain profit growth over the long term. Doing this is no easy feat, as economic and global forces (including the COVID-19 pandemic and the possibility of a second wave of spreading), unsettled numerous businesses including those in the insurance industry.

The concept of “business-as-usual” approach may falter in the face of the new way of life for individuals and businesses. With rising capital requirements, new regulatory burdens, record low interest rates, disruptive technology, and new competitors, it becomes imperative for insurers to grow their interest with the ever-changing trajectory of the industry. Some of these structural plans may include:

- a. Mergers, acquisitions and divestments to expand distribution, diversify product portfolios, or bolster capabilities.
- b. Developing the right products that meet the needs of the market, efficient and effective distribution of the products, creating awareness of the products and meeting expectations of customers. In doing this, insurance companies will maximise performance, increase market share and diversify its business. This will lead to more choices for customers and right pricing for insurance products, thereby leading to more growth and more income for the companies.
- c. Insurance companies have to aggressively leverage technology to improve their cost structure and establish deeper and stronger relationships with reinsurers and investors to further drive down associated costs. This is especially important in this growing era of smart devices, which will enable virtual claims processing for customers and also allow greater reach to existing customers in various parts of the country and the uninsured. This will inevitably contribute to increased revenue and reach for insurance companies.
- d. Insurance companies seeking greater financial flexibility should divest assets that require significant capital reserves.

LEGAL AUDIT

In assessing recapitalisation plans or implementing a strategic plan for growth, it is important for insurance companies to conduct a legal audit. This will assist to assess the extent or magnitude of exposure of the company and the potential impact it may have on both business continuity and taking on new transactions. This exercise will, for instance, pre-empt and address any issues that a due diligence conducted by a potential investor might present.

The legal audit is done by the company as a form of “Self-Assessment” on its own affairs and covers the review of its operations, to assure compliance with internal procedures as well as applicable laws and regulations. This will assist to identify gaps and best strategies to mitigating potential risks. The scope of the legal audit would typically be guided by the strategic objectives and plan, irrespective of whether an investment or restructuring or other capital raising method is adopted. A basic legal audit would generally include corporate governance, corporate and commercial contracts, labour, insurance, tax, regulatory compliance, and finance.

The benefits of conducting such legal audit include but are not limited to the following:

- a. anticipating the kind of issues that may arise during a potential investor’s due diligence and make informed decisions on how to address them during negotiations;
- b. regularising any outstanding compliance matters that may delay the transaction;
- c. revealing any contractual restriction which may impair the company’s ability to implement the transaction, such as change of control restrictions under material contracts or finance documents and obtaining the requisite consent or waiver.
- d. collating documents that may be relevant to the transaction for setting up a data room;
- e. collating information relevant to prepare marketing materials for the transaction;
- f. indicating any necessary corporate and regulatory approvals that may be required for the transaction;
- g. ascertaining the parameters around the pricing for the transaction;
- h. assessing the viability of the recapitalisation or strategic growth plan;
- i. planning a timetable for the transaction to ensure it completes within projected timeline.

Furthermore, the legal audit will also reveal the financial health of the company and the potential dilution of control that could result from an increase in share capital to accommodate an equity capital raise.



REGULATORY CONSIDERATIONS

Many regulatory agencies play a role in regulating the operations and activities of the insurance industry in Nigeria. For the purposes of recapitalisation, some of these regulators include NAICOM, the Securities and Exchange Commission (**SEC**) and the Nigerian Stock Exchange (**NSE**) - if a public company, the Financial Reporting Council of Nigeria (**FRC**), the Corporate Affairs Commission (**CAC**).

With each regulator having its own peculiar requirements for a recapitalisation exercise, it is important for companies to have a clear timetable of how they want to proceed with the capital raising to stay on track with the NAICOM deadline as well as any agreed timeline they may have set for the transaction.

Other than regulatory approval for the recapitalisation, other aspects of the capital raise may be subject to regulatory approval. For instance, for equity investment, if the investment will involve ownership of up to 25% of shares in an insurance company, NAICOM's prior approval will be required¹⁰. In addition, if the investor is a non-Nigerian individual/entity, the company will have to consider regulatory compliance with regulators such as the Nigerian Investment and Promotion Commission (**NIPC**), which requires companies with foreign participation to register with the NIPC before commencing business¹¹.

Furthermore, as investors typically require board positions for their investment, NAICOM would need to vet and approve such nominees prior to their appointment to the board¹². Where the investor is proposing a foreigner as its board representative, a business permit¹³ as well as an expatriate quota from the Ministry of Interior may be required.

For companies exploring a merger to meet the recapitalization requirement, it is important to keep in mind the amount of regulatory compliance matters involved which may impact on the timeline for completion. For such companies, in addition to NAICOM's no objection, the Federal Inland Revenue Service approval would be required as to any tax that may be due and payable¹⁴; the approval of the Federal Competition and Consumer Protection Commission (**FCCPC**)¹⁵; as well as the sanction of the Federal High Court of the merger scheme.¹⁶

¹⁰ NAICOM, 'Market Conduct and Business Practice Guidelines for Insurance Institutions', Paragraph 5.5.0(b) <<http://naicom.com.gov.ng/docs/regulations/Market%20Conduct%2-Guidelines.pdf>> accessed on 26 June 2020

¹¹ Nigerian Investment and Promotion Commission Act, s.20

¹² NAICOM, 'Market Conduct and Business Practice Guidelines for Insurance Institutions', Paragraph 5.5.0(d) <<http://naicom.com.gov.ng/docs/regulations/Market%20Conduct%2-Guidelines.pdf>> accessed on 26 June 2020. See also the Insurance Act 2003, s. 14(2)

¹³ The Nigerian Immigration Act 2015, s 8 (1) (a) & (b) 14

¹⁴ The Companies Income Tax Act (Amendment) 2007, s. 25 (12)

¹⁵ The Federal Competition and Consumer Protection Commission Act 2019, ss. 92(4) and 93

¹⁶ The Investment and Securities Act 2007, s 100 (3)

In addition, upon meeting the recapitalization requirements, insurance companies are required to make the statutory deposit of 10% of its updated paid up share capital with the Central Bank of Nigeria (CBN)¹⁷, and failure to do so would constitute a ground for cancellation of the certificate of registration of the defaulting insurance company.¹⁸

Compliance with different regulatory requirements, may have a significant impact on the ability of companies to meet the recapitalisation deadline, if not managed effectively. This is particularly significant, considering the disruptions to regulators work measures in response to the COVID-19 directives in place, which may further delay expected timelines for obtaining such approvals. It is thus important for companies to consider these factors as they implement their recapitalisation plans. Informal engagements should also be explored to guide timelines and expedite any approvals requirements.

CORPORATE CONSIDERATIONS

Other than the regulatory requirements, insurance companies would also need to consider how certain corporate processes may affect the timeline for implementing the company's recapitalisation plan.

Depending on the type of company, the constitutional documents and the Companies and Allied Matters Act CAP C20 LFN 2004 (CAMA), it is important to consider the timeline for convening the relevant meetings, quorum and the votes required to approve the transaction as well as any potential objections that may delay the transaction.

A general meeting of the members of a company (annual or extraordinary) typically requires a minimum notice period of 21 days, unless a shorter notice period is agreed to by (i) all the members (for annual general meetings) or (ii) majority of the members together holding not less than 95% of the issued share capital of the company (for any other meeting)¹⁹. Thus, it is important to keep this requirement in mind when preparing transaction timetables as notice of every business to be conducted at such meetings has to be given in order for it to be considered at the meeting.²⁰

For private companies, the need for convening a physical meeting can be dispensed with by using the written resolution procedure. This requires all the members of the company entitled to attend and vote at a general meeting to sign the written resolution²¹. Thus, approval has to be unanimous.

The board of directors of both private and public companies can cut down on the time constraints for convening a physical board meeting to approve the resolutions by using a written resolution procedure. This requires all the directors eligible to receive the notice of the meeting to sign the written resolution²². Thus, this also has to be unanimous.

For companies who cannot avoid convening such meeting(s), and considering the measures being implemented to deal with COVID-19, it will be pragmatic to explore alternative ways for holding meetings, such as via virtual platforms, and ensuring the company's articles contain provisions to permit these measures.²³

¹⁷ paragraph 5 of the NAICOM Circular

¹⁸ Insurance Act 2003, s.19(6)

¹⁹ the Companies and Allied Matters Act Cap C20, LFN 2004, s.217(1)(2)

²⁰ the Companies and Allied Matters Act Cap C20, LFN 2004, s.218(3)

²¹ the Companies and Allied Matters Act Cap C20, LFN 2004, s.234

²² the Companies and Allied Matters Act Cap C20, LFN 2004, s.263(8)

²³ the CAC has implemented a circular containing guidelines for convening and holding AGM for public meetings <https://www.cac.gov.ng/3956-2/>

It is also important to consider whether there are any restrictions in the articles of association that could impact on the transaction such as pre-emption rights, which may need to be disapplied; restrictions on the ways the company can raise capital or whether it has sufficient authorised share capital to undertake such capital raise. As some of these matters may need to be addressed prior to the transaction, this may require various meetings to approve.

Where a reduction of capital is contemplated to address any accumulated losses or liabilities the company may have prior to exploring the capital raising, the procedure and timeline required would also need to be considered. A special resolution is required to approve a reduction of capital²⁴, which means at least 75% of the persons present and eligible to vote at such meeting approved the reduction. In addition, a court sanction for the reduction would also be required and when considering the average time frame for cases in courts, this could also impact on the timeline for the transaction.

Where an increase to the authorised share capital may be required to accommodate the capital raise, meetings would need to be organized to approve the increase in share capital as well as the proposed capital raise option elected. This would require an ordinary resolution passed by a simple majority of the persons present at a general meeting of the company. Furthermore, where a company has increased its share capital it is required to, within 15 days of the passing of the resolution authorising the increase, give notice of increase to the CAC²⁵. In order for the increase to take effect, the company has to ensure that:

- a. within six (6) months of giving notice of the increase to the CAC, not less than 25% of the share capital including the increase has been issued; and
- b. the directors have delivered to the CAC a statutory declaration verifying that fact.²⁶

Thus, it is important for companies considering an increase to their authorised share capital to accommodate a capital raise, to ensure that it is increased by a proportion that covers the aforementioned 25% minimum issue.



²⁴ the Companies and Allied Matters Act Cap C20, LFN 2004, s.106
²⁵ the Companies and Allied Matters Act Cap C20, LFN 2004, s.102 (1)(2)
²⁶ the Companies and Allied Matters Act Cap C20, LFN 2004, s.103

Conclusion

As a result of several global factors affecting the financial markets and businesses, including the impact of the COVID-19 pandemic, it is important for insurance companies to take adequate steps to position their businesses for growth and opportunities in an increasingly changing market.

Furthermore, NAICOM's extension of the effective date for the recapitalization is a welcome development and will provide insurance companies with opportunities to reassess, adjust and implement their recapitalization plan to meet the revised recapitalisation deadline.

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