Positioning the Insurance Industry in West Africa for Global Competitiveness.

Insurance and reinsurance companies operating in West Africa have excellent growth opportunities but are typically exposed to heightened levels of economic, political and financial system risks. In recent years, these risks have been exacerbated by external shocks, such as the COVID-19 pandemic and the Russia-Ukraine conflict.

With global economic conditions expected to remain challenging in 2023, the creditworthiness of many African institutions is likely to be pressured. In turn, this could impact the financial strength of domestic (re)insurers.

Best's Credit Ratings

A Best Credit Rating (BCR) serves as a valuable, forward-looking opinion for consumers, insurance agents, financial advisors, banks and other financial institutions to support prudent decision-making. The ratings help the financial industry and consumers understand the financial strength and creditworthiness of insurance companies worldwide.

AM Best assigns various types of BCRs to a wide variety of insurance organisations, from single legal entity insurers to complex, multinational enterprises with diversified operations.

Best's Credit Rating Scale

Translation of Issuer Credit Ratings to Financial Strength Ratings

Long-Term ICR	FSR
aaa, aa+	A++
aa, aa-	A+
a+, a	A
a-	A-
bbb+, bbb	B++
bbb-	B+
bb+, bb	B
bb-	B-
b+, b	C++
b-	C+
ccc+, ccc	C
ccc-, cc	C-
c	D

AM Best Credit Rating Definitions

- **Best's Issuer Credit Rating (ICR):** An independent opinion of an entity's ability to meet its ongoing financial obligations, issued on either a long- or short-term basis
- **Best's Financial Strength Rating (FSR):** An independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations
- **Best's Issue Credit Rating (IR):** An independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation, issued on a long- or short-term basis
- **Best's National Scale Rating (NSR):** A relative measure of creditworthiness in a specific local jurisdiction that is issued on a long-term basis and derived exclusively by mapping the NSR from a corresponding global Issuer Credit Rating (ICR) using a transition chart

Best's Credit Rating Methodology

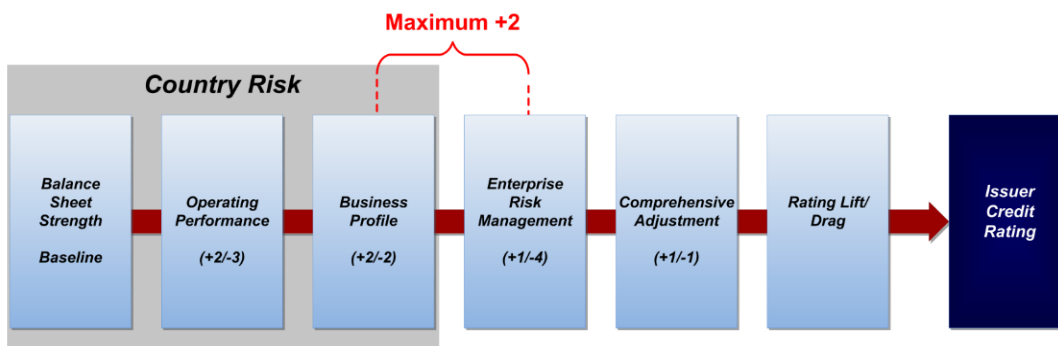
Best's Credit Rating Methodology (BCRM) provides a comprehensive explanation of AM Best's rating process. Key rating factors—including an insurer's balance sheet strength, operating performance, business profile and enterprise risk management (ERM)—are qualitatively and quantitatively evaluated during the rating process.

The foundational building blocks of AM Best's rating approach are outlined below.

AM Best's Rating Process

Exhibit 2

AM Best's Rating Process



Source: Best's Credit Rating Methodology

Balance Sheet Strength

AM Best's rating analysis is an interactive process that begins with an evaluation of the company's balance sheet strength. This evaluation results in a baseline balance sheet strength assessment and includes a three-part analysis focusing on the following areas:

1. The insurance rating unit (the (re)insurer)
2. The financial flexibility and risks associated with the insurer's holding company and/or ownership structure
3. The impact of country risk on the insurer's balance sheet strength

Best's Capital Adequacy Ratio

The measurement of the insurer's capital adequacy is key to the balance sheet assessment. AM Best uses its Best's Capital Adequacy Ratio (BCAR) to differentiate an insurer's balance sheet strength and determine whether its capitalisation is appropriate for its risk profile.

BCAR evaluates many of the insurer's balance sheet risks simultaneously, generates an estimate of the capital needed to support those risks at different confidence intervals and compares it with the insurer's available capital.

BCAR Assessment

VaR Confidence Level (%)	BCAR	BCAR Assessment
99.6	> 25 at 99.6	Strongest
99.6	> 10 at 99.6 & ≤ 25 at 99.6	Very Strong
99.5	> 0 at 99.5 & ≤ 10 at 99.6	Strong
99	> 0 at 99 & ≤ 0 at 99.5	Adequate
95	> 0 at 95 & ≤ 0 at 99	Weak
95	≤ 0 at 95	Very Weak

Country Risk

Country risk and its assessment are incorporated into the analysis of balance sheet strength, operating performance and business profile. AM Best defines country risk as the risk that country-specific factors will adversely affect an insurer's ability to meet its financial obligations.

Exhibit 4

AM Best – Overall Balance Sheet Strength Assessment

Overall Balance Sheet Strength Assessment

Combined Balance Sheet Assessment (Rating Unit/ Holding Company)	Country Risk Tier				
	CRT-1	**CRT-2**	**CRT-3**	**CRT-4**	**CRT-5**
Strongest	a+/a	a+/a	a/a-	a-/bbb+	bbb+/bbb
Very Strong	a/a-	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-
Strong	a-/bbb+	a-/bbb+	bbb+/bbb/bbb-	bbb/bbb-/bb+	bbb-/bb+/bb
Adequate	bbb+/bbb/bbb-	bbb+/bbb/bbb-	bbb-/bb+/bb	bb+/bb/bb-	bb/bb-/b+
Weak	bb+/bb/bb-	bb+/bb/bb-	bb-/b+/b	b+/b/b-	b/b-/ccc+
Very Weak	b+ and below	b+ and below	b- and below	ccc+ and below	ccc and below

Source: Best's Credit Rating Methodology

Operating Performance

The second building block of AM Best's rating process is operating performance. This analysis can result in an increase, decrease or no change to the baseline assessment. Possible adjustments range from +2 notches to -3 notches.

AM Best views operating performance as a leading indicator of future balance sheet strength and long-term financial stability. A company's profitability affects its ability to generate earnings, and profitable insurance operations are essential for a company to operate as a going concern.

In general, more diversity in earnings streams leads to greater stability in operating performance. AM Best's analysis of operating performance focuses on the stability, diversity and sustainability of the company's earnings sources and the interplay between earnings and liabilities.

Business Profile

Business profile is the third building block in AM Best's rating process evaluation. Business profile may ultimately affect an insurer's current and future operating performance and, in turn, its long-term financial strength and ability to meet its obligations to policyholders. Possible adjustments for business profile range from +2 notches to -2 notches.

The business profile review includes evaluation of the following factors:

- Market position
- Degree of competition
- Distribution channels
- Pricing sophistication and data quality
- Management quality
- Product and geographic location

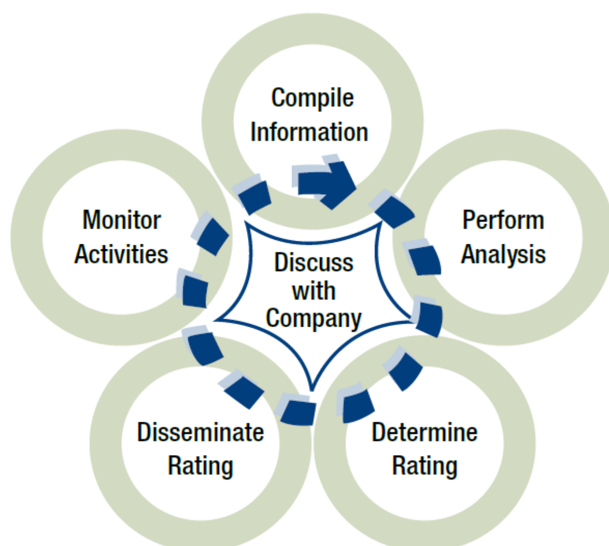
- Product risk
- Regulatory, event, market and country risks

Enterprise Risk Management
ERM is the fourth building block in the rating process. The impact of ERM on an insurer's rating is based on understanding the
development and implementation of an insurer's risk management framework as well as the insurer's risk management capability
relative to its risk profile. The framework and the risk evaluations include the following sub-assessments:

Framework Evaluation	Risk Evaluation	
• Risk identification and reporting	• Product and underwriting	• Liquidity and capital management
• Risk appetite and tolerance	• Reserving	• Investments
• Stress testing and non-modeled risks	• Concentration	• Legislative, regulatory, judicial and economic
• Risk management and controls	• Reinsurance	• Operational
• Governance and risk culture		

If a rating unit is practicing sound risk management and executing its strategy effectively, the results will be evident in successful performance over the long term. Possible adjustments for ERM range from +1 notch to -4 notches.
Companies with complex global business profiles have a need for a robust and comprehensive ERM program. In many cases, the complexities and demands of these companies' "Very Favorable" business profiles require an equally "Very Strong" ERM.
Acknowledging this interaction, and the limited impact that these two highly qualitative building blocks may have on credit strength, the combined impact between business profile and ERM will be restricted to a maximum of +2 notches. This calculation would only affect those companies that have both a "Very Favorable" business profile assessment and a "Very Strong" ERM assessment.
Comprehensive Adjustment
A comprehensive adjustment may be applied in the rating process when the company being reviewed has an uncommon strength or weakness that exceeds (or is less than) what has been captured through the rating process up to this point. A comprehensive adjustment can increase or decrease the assessment by a maximum of 1 notch. The vast majority of ratings will not require a comprehensive adjustment.
Rating Lift/Drag
In this step, the company's rating may be afforded lift (or drag) based on factors such as integration, strategic importance and contribution to the overall enterprise. The amount of lift or drag assigned depends on the specific circumstances of the insurer.
The Credit Rating Process
BCRs are initially determined and periodically updated through a defined rating committee process. The rating committee itself consists of analytical staff and is chaired by senior rating officers. The committee approach ensures rating consistency across different business segments and maintains the integrity of the rating process (see **Exhibit 7**).

Exhibit 7
AM Best's Interactive Rating Process



1 Compile Information
The assigned analyst collects public and proprietary financial information and data to develop a tailored meeting agenda.
2 Perform Analysis
AM Best incorporates a host of qualitative and quantitative measures to evaluate the organisation's financial health.
3 Determine Best's Credit Rating
The AM Best Rating Committee ensures rating consistency and maintains the integrity of the rating process and methodology.
4 Disseminate Best's Credit Rating
If the initial Best's Credit Rating is accepted, it is distributed via the AM Best website, press releases and a number of print and digital publications.
5 Monitor Best's Credit Rating
AM Best regularly monitors the rating by continually analyzing the organization's creditworthiness.

AM Best's Rating Process in Practice

Soaring commodity prices as a result of supply-chain disruptions and price shocks related to the Russia-Ukraine crisis have resulted in increased inflation and financial instability across Africa, particularly for those markets reliant on the import of fuel and other commodities such as grain and fertiliser. With global economic conditions expected to remain fragile through 2023, softer demand conditions may hamper growth and reduce government revenue, adding to the list of existing challenges faced by many African economies.
The majority of AM Best-rated (re)insurers operating in Africa maintain robust buffers in their risk-adjusted capitalisation, as measured by BCAR. Despite African (re)insurers incurring significantly greater capital requirements due to their higher risk investment portfolios.
High BCAR scores of African companies typically reflect low underwriting and asset leverage, particularly compared with counterparts in Europe and North America.

AM Best's Country Risk Tiers

Country risk is evaluated and factored into all AM Best ratings. As part of evaluating country risk, AM Best identifies the various factors within a country that may directly or indirectly affect a (re)insurance company.

Countries are placed into one of five tiers, ranging from Country Risk Tier 1 (CRT-1), denoting a stable environment with the least amount of risk, to Country Risk Tier 5 (CRT-5) for countries that pose the most risk and, therefore, the greatest challenge to a (re)insurer's financial stability, strength and performance.

AM Best closely monitors economic, political, and financial system risks in countries assigned a CRT assessment. In addition, AM Best undertakes stress tests to assess how a company can absorb the key risks in its operating environment and how its balance sheet can withstand these stresses. Emerging markets generally have higher levels of volatility and uncertainty, and particularly challenging macro-economic environments; hence, stress tests play a particularly important role in determining those ratings.

It is important to note that AM Best's determination of country risk is not directly comparable to a sovereign debt rating, which entails an evaluation of the ability and willingness of a government to service its debt obligations. Although country risk has a bearing on the overall rating assessment, particularly for a company operating in CRT-3 to 5 countries, there are (re)insurers with higher ratings than the sovereign rating; these have demonstrated that they can absorb and mitigate risks arising from their operating environment—a key consideration when evaluating the impact of country risk in the assessment.

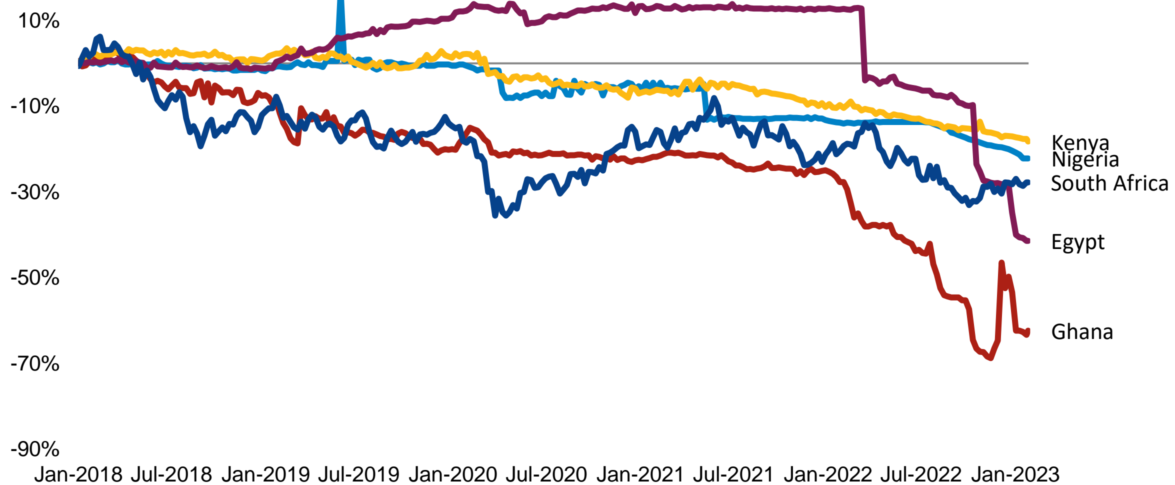
Country risk is an important component of the rating assessment for African (re)insurers, particularly given that they are mostly operating in CRT 4 and CRT 5 countries. Country risk is considered in three of the building block components: balance sheet strength, operating performance, and business profile. Under balance sheet strength, the baseline assessment is determined by analysing an array of balance sheet factors and applying a transition table (see **Exhibit 4**).

In general, over the last five years, many countries designated CRT-4 and CRT-5 have experienced heightened levels of economic, political and financial system risks. In recent years, these risks have been exacerbated by external shocks.

Exhibit 8

Devaluation of Selected African Currencies Against the US Dollar from Jan 2018 to Feb

(% using 1 Jan 2018 as the base reference rate)



Source: Yahoo Finance

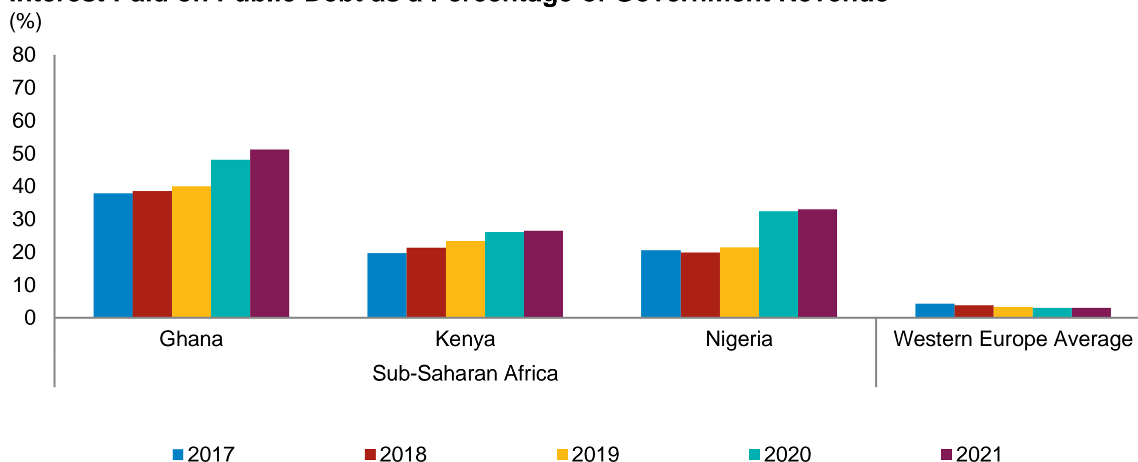
In response to the inflationary pressures, many central banks have raised interest rates, thus increasing borrowing costs. Compounding this has been the rapid devaluation of many emerging market currencies, which has increased the repayment burden of foreign-currency-denominated debt.

Exhibit 8 shows the devaluation of some major African currencies as an example. These issues have contributed to large capital outflows amid a ‘flight to security’, leaving those countries most affected with restricted access to external funding, which will make refinancing debt increasingly difficult.

Consequently, multiple African countries are facing a high and growing debt servicing burden (see **Exhibit 9**), which has in some cases led to sovereign default. This is not solely an issue within Africa, with emerging markets around the world encountering similar issues.

Exhibit 9

Interest Paid on Public Debt as a Percentage of Government Revenue



Source: International Monetary Fund

Four countries – all located in sub-Saharan Africa – have formally applied for debt restructuring support under the G20 common framework for debt treatment since 2021, with Ghana joining this list in 2023. Moreover, as per the IMF Debt Sustainability Analysis for low-income countries13% of these countries were classified as "in debt distress", with a further 41% at a "high risk of debt distress", up from 10% and 33%, respectively, in 2018.

Since the start of the COVID-19 pandemic, three countries in Africa have defaulted on their debt - Zambia in 2020, and Mali and Ghana in 2022.

As we move through 2023, AM Best expects the debt burden of many African countries to remain high, and possibly increase, as they balance the trade-off between tightening monetary policy to tackle high levels of inflation, with rising recessionary risk.

As the cost of servicing debt rises, there is increased risk that more countries will be forced to consider debt re-structuring or outright default, particularly if inflationary pressures persist longer than expected, leading to tougher financing conditions and difficulty in restoring access to much-needed foreign capital.

Balance Sheet Strength – Baseline Assessment

The balance sheet strength assessments of rated-(re)insurers operating in both mature and emerging markets generally tend to be concentrated within the Very Strong category. This partly reflects robust capital buffers, typically in excess of their internal target levels.

Risk-Adjusted Capitalisation – Best's Capital Adequacy Ratio (BCAR) Assessment

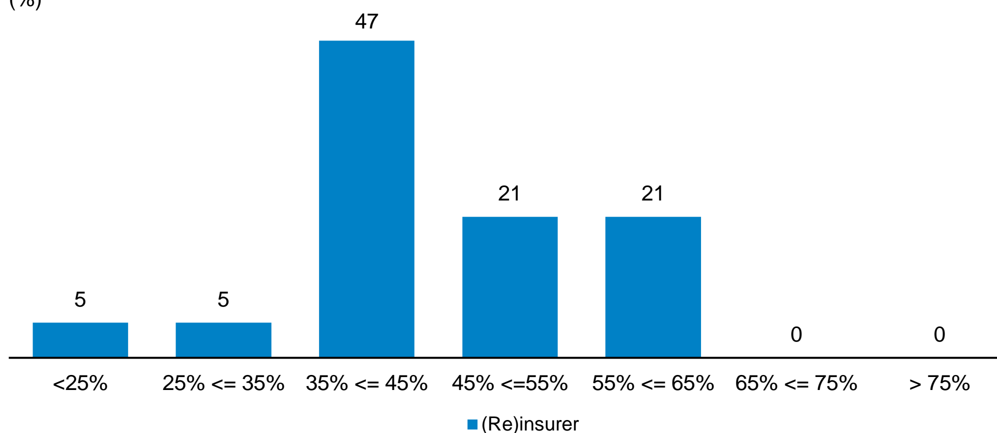
AM Best uses a proprietary capital adequacy model—Best's Capital Adequacy Ratio (BCAR)—to measure risk-adjusted capitalisation across several confidence levels. Risk-adjusted capitalisation is assessed as Strongest when the standard BCAR score is above 25% at the 99.6% value at risk (VaR) confidence level, and Very Strong when the BCAR score is between 10% and 25%. AM Best also assesses

stressed BCAR scores to provide insight into a company's balance sheet strength shortly after it experiences a catastrophic event.

For most African companies, investment risk tends to be the main driver of capital consumption. This is explained, as they invest in less mature financial markets with higher levels of credit risk.

Given the heightened volatility and uncertainty in many African financial markets, capital charges for investments are often greater within BCAR. In addition, many African companies tend to have narrower levels of asset allocation, and incur concentration and illiquidity charges in AM Best's capital model. Despite the elevated asset risk charges observed in emerging markets, all but one of the AM Best-rated rating units in Africa have BCAR scores at the Strongest level. It is common for African companies to have low levels of net underwriting leverage, which results in lower underwriting risk capital requirements compared with mature market ratings.

Exhibit 10
Africa – Distribution of AM Best BCAR Scores @99.6% VaR
(%)



Source: AM Best data and research

AM Best notes that most reinsurers have Strongest BCAR assessments, reflected by the significant capital buffers that reinsurers hold, which allows them to absorb large shock losses (see **Exhibit 10**). Most of the reinsurers have robust risk management capabilities and tools at their disposal in order to manage potential earnings and capital volatility in line with their risk appetites. On the other hand, most primary insurers tend to have more moderate risk underwriting profiles that reflect lower levels of volatility and tend not to hold large excess capital buffers.

Beyond BCAR – Other Drivers of Balance Sheet Strength

African Markets

There is a common misconception that the BCAR assessment is equivalent to a company's overall balance sheet assessment. This is not the case; while the BCAR is important to the analysis, there are also a number of other components that come into play.

While the risk-adjusted capitalisation of emerging market players is generally assessed as Strongest to Very Strong, other balance sheet components can weigh on an insurer's overall balance sheet strength. In particular, very high levels of reinsurance dependence is often a negative factor. While in most cases this risk is partly mitigated by the use of reinsurers of sound credit quality, there can be significant counter-party credit risk in the event of large losses. This is often amplified by the concentration among a single (or few) counterparties which exacerbates the potential impact that a reinsurance dispute could have on a (re)insurer's balance sheet.

Other offsetting factors include inadequate asset liability matching (ALM); particularly for companies operating in African countries where long-duration fixed income securities are sometimes scarce. Often companies are only able to invest in their domestic financial markets, which are frequently in the early stages of development.

Given the generally smaller size of economies in Africa, there are a limited number of banks and issuers for (re)insurers to invest in. This typically results in much more concentrated investment portfolios, often to the local sovereign or government-owned institutions, exposing (re)insurers to greater levels of concentration risk. Such concentration significantly increases the sensitivity of (re)insurers' balance sheet to default events.

Even when liquidity in the domestic market is good, a negative impact may arise from stress tests relating to large losses, or write-downs for many companies.

In addition, the financial flexibility of African companies is often weaker than mature market counterparts. Most emerging market companies do not issue hybrid debt and are reliant on their main shareholder(s) or private banks for financing—the latter of which is often on more onerous terms with much shorter maturities.

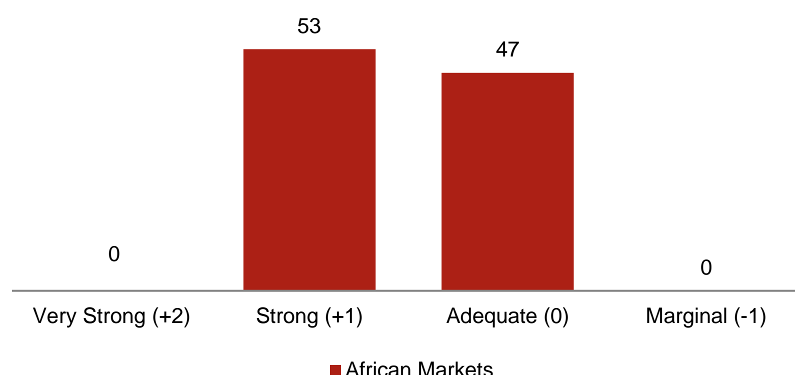
Operating Performance

Operating performance assessments for African companies centre around the Adequate to Strong categories (see **Exhibit 11**).

Exhibit 11

AM Best Operating Performance Assessments - Africa

(%)



A full listing of AM Best Operating Performance Assessment categories can be found on our website.
Source: AM Best data and research

The vast majority of Strong assessments are for companies that are market leaders, or (re)insurers with stable profiles that benefit mostly from diversified earnings sources and have consistently generated strong risk-adjusted returns for a long period, with a solid profit-generating pattern expected to continue.

Operating performance metrics of African companies need to be considered holistically. When taking into account returns in real terms, the performance may not be as good as the nominal figures imply. Furthermore, in certain territories, inflation and interest rates may be particularly high, leading to volatile operating environments and sometimes dependence on investment income to bolster earnings.

When assessing operating performance, companies' profiles and exposures can differ vastly. Companies heavily exposed to natural catastrophe perils or large single risks may have had exceptionally good results over a long period of time with very low standard deviation. However, following a large loss those same companies can experience a material spike in claims, wiping out many years of profits. This emphasises the importance of assessing operating performance over a longer period of time, along with a prospective view of market conditions.

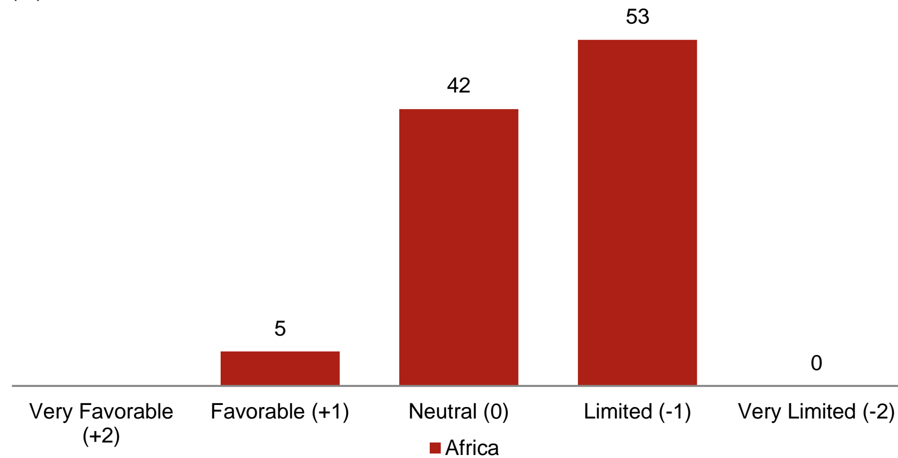
AM Best factors into its assessments the earnings profile from both investment and underwriting activities and the level of volatility over various time periods. Further investigation into the track record of earnings and prospective market conditions is also important, as well as analysis of the sources of income, and performance relative to peers.

AM Best considers prospective earnings generation, absolute earnings, gross versus net profitability, performance relative to peers, and potential market and economic conditions (such as inflation, changes in interest rates or geopolitical developments) as part of its operating performance analysis.

Business Profile

Most assessments of business profile for African (re)insurance companies fall within the Neutral and Limited categories (see **Exhibit 12**).

Exhibit 12
AM Best Business Profile Assessments - Africa
(%)



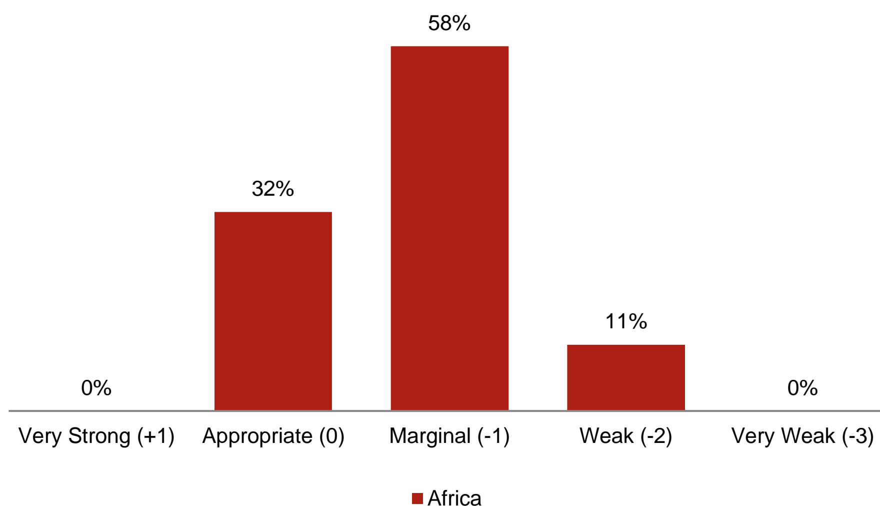
Source: AM Best data and research

AM Best-rated (re)insurers in Africa may hold excellent positions in their respective domestic markets, with good control and leadership positions, but their overall size and level of diversification may be limited. They are more likely to have a greater dependence on third parties to manage complex risks and to be subject to high levels of regulatory risk.

Enterprise Risk Management

AM Best's ERM assessment includes three components—the risk framework evaluation, the risk profile evaluation and the overall assessment. As **Exhibit 13** shows, most rated African companies have a Marginal or Appropriate assessment,

Exhibit 13
AM Best Enterprise Risk Management Assessments - Africa
(%)



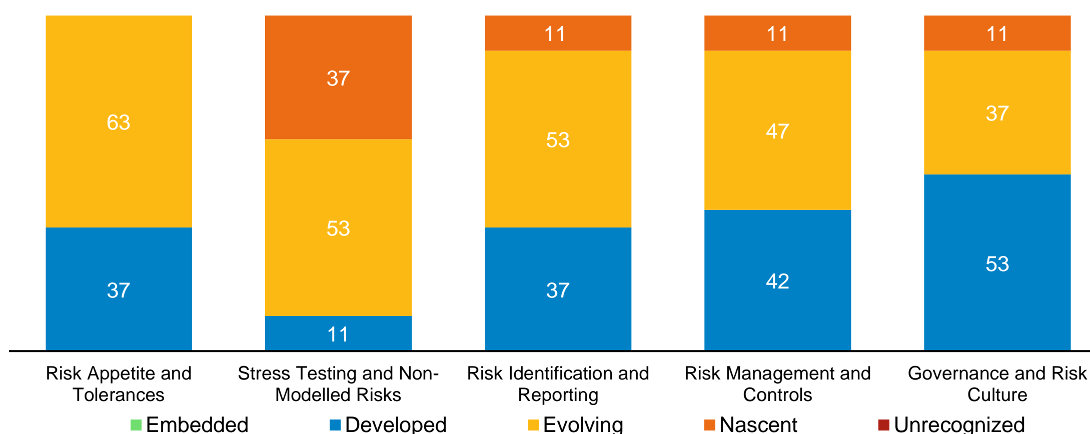
A full listing of AM Best Enterprise Risk Management Assessment categories can be found on our website.
Source: AM Best data and research

In order to achieve the Very Strong ERM assessment, companies need to demonstrate that their risk management approach has been effectively utilised over the medium-to-long term, and is adding value to the organisation. A company needs to demonstrate that ERM is effective and embedded across its organisation.

African companies tend to have *Appropriate*, *Marginal* or *Weak* risk management assessments, in part a consequence of the early stages of insurance and regulatory development of these markets, as well as generally elevated risks prevalent in those operating environments.

AM Best's ERM risk framework evaluation component focuses on five core areas: risk appetite and tolerance, stress testing and non-modelled risks, risk identification and reporting, risk management and controls, and governance and risk culture (see **Exhibit 14**).

Exhibit 14
Africa – AM Best Risk Framework Assessments
(%)



A full listing of AM Best Risk Framework Evaluation assessment categories can be found on our website.

AM Best notes that especially larger and complex insurers may be impacted by occasional shortcomings in governance or weakness of control processes in individual silos when market conditions are challenging, despite having a conservative and prudent approach to risk management, strong risk capabilities relative to its profile and an embedded risk framework. A complex entity that is growing through external acquisitions might especially be prone to risk control shortcomings as it generally takes some time to fully establish a certain level of risk culture that interlinks to good governance and risk management controls.

For African markets, no companies are viewed to have an Embedded risk management framework, which is largely reflective of the immaturity of the markets, the small size of companies and desire to maintain silo risk practices. Most framework assessments are in the Evolving category, with a few companies in the Developed category.

Despite most African companies falling short across many categories, the main areas of concern relate to stress testing (including investment portfolio stress tests and catastrophe modelling), and governance and risk culture. At times, companies have demonstrated good risk management structures on paper, but the utilisation of such models generally remains weak and untested or is highly reliant on third parties.

In the future, AM Best expects companies operating in emerging markets including in Africa to demonstrate improvements in ERM, though it should be noted that the benchmarks of each assessment level are also likely to constantly rise. In order for companies to maintain their current assessments, they will need to be proactive in the development of their risk management practices.

AM Best's ERM risk evaluation consists of eight components and assesses a company's risk management capability relative to its risk profile. AM Best examines

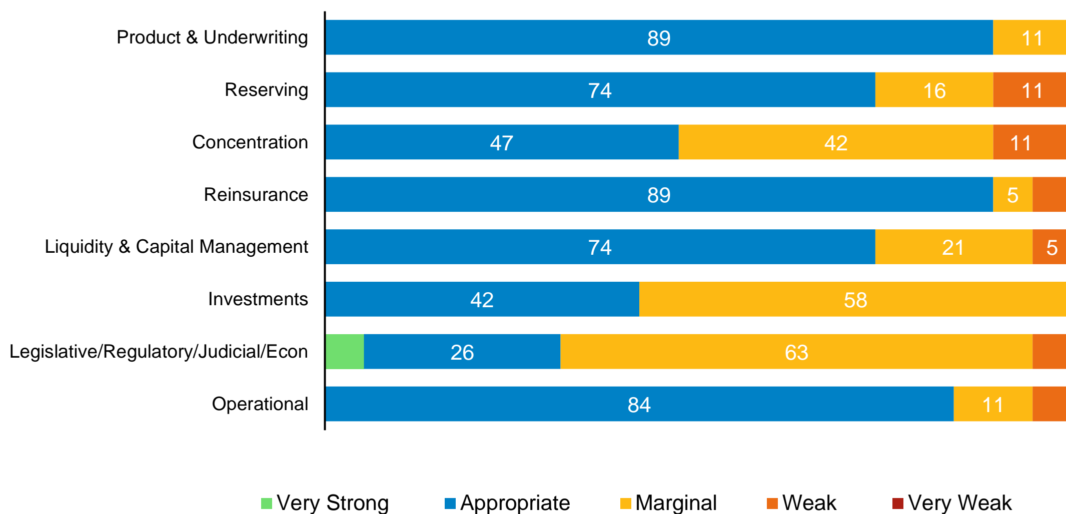
risks related to product and underwriting, reserving, concentration, reinsurance, liquidity and capital management, investments, legislative/regulatory/judicial/economic, and operational.

More diverse and complex companies are viewed to have higher risk profiles. Such companies might include global insurance and reinsurance groups, and enterprises that have substantial catastrophe exposures, long-tailed business, or high embedded life guarantees. These companies will need more robust tools and mechanisms in place to manage their exposures and need a sufficient framework in place to support these risks.

Exhibit 15

Africa – AM Best Risk Capabilities

(%)



A full listing of AM Best Risk capability categories can be found on our website.

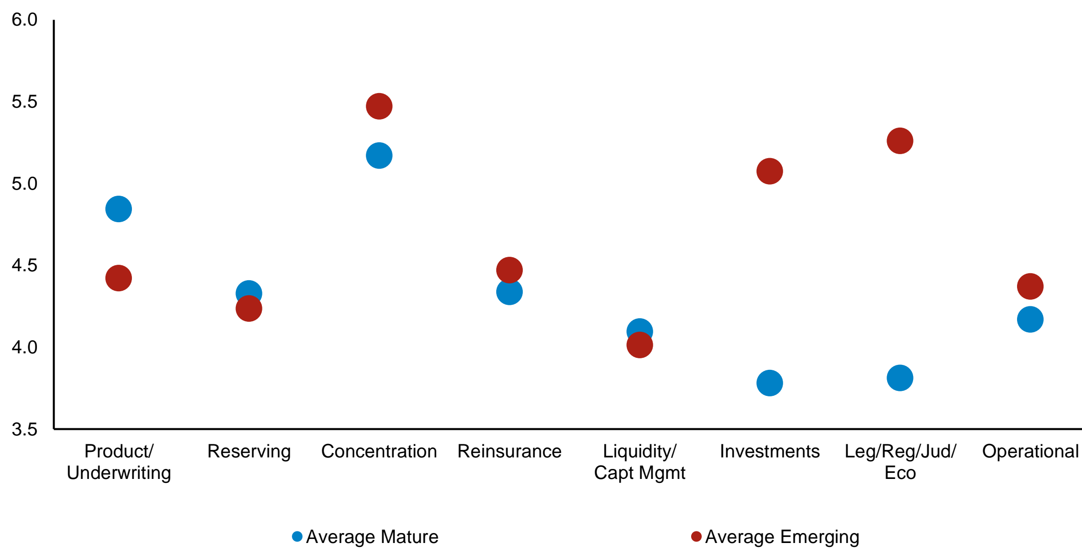
Exhibit 15 highlights the most important features for the ERM assessment. AM Best views global insurance and reinsurance groups as the most risky, in part due to their sheer size and scale. Nevertheless, these companies tend to have the strongest risk management capabilities and tools at their disposal, and to have demonstrated their effectiveness over time.

Most complex global insurance and reinsurance groups have in many cases a risk capability of Very Strong. However, the broadest category is Appropriate.

In any case, AM Best expects companies to improve their ERM approach constantly, as markets and regulations develop. A company's failure to keep pace with the changing landscape and evolving risks and challenges may, over time, exert pressure on its assessment. The litmus test for most companies are volatile market environments and emerging risks that test the adequacy of a company's risk capabilities relative to their defined risk appetite.

Exhibit 16 illustrates the risk profile for the wider EMEA region. For mature market carriers the greatest risk is mainly concentration followed by product and underwriting risks, with the latter reflecting the assumption of complex and long tail risks.

Exhibit 16
EMEA – AM Best Average Risk Profiles
(1: Low Risk to 9: High Risk)



Full details of AM Best's Average Risk Profile categories can be found on our website.
Source: AM Best data and research

For emerging market companies in the EMEA region in general, the greatest risks tend to be concentration, investment, and legal, regulatory, judicial and economic risks. This reflects the risk profile of many (re)insurers being concentrated to a single market, product or counterparty, and the higher asset risk associated with those markets. Also, a number of insurers have shown deficiencies in managing capital and holding sufficient liquidity for their operation.

Prudent Risk Management Remains Crucial

Rating disclosures under the updated BCRM methodology allow for more straightforward and detailed benchmarking.

One should bear in mind that any generalisation always carries the risk of oversimplification, masking wide divergences at the individual level. Additional challenges may also arise when trying to attribute separate rating impacts to specific factors that seem to be acting simultaneously, such as positive operating performance that an analyst may view as a direct result of both a strong business profile and ERM.

This analysis highlights some common themes as weaknesses, the most important of which is risk governance, with some (re)insurers, more so in emerging markets, adopting basic or minimum requirements to run their businesses.

Some companies have only recently taken the initiative to adopt more prudent and sophisticated approaches to managing their operations. This has been highlighted by their significant adjustments with regard to re-stated financial statements, asset write-downs, reserve strengthening, and incidents of fraud.

In part, regulatory developments, which serve to strengthen the market, highlighted certain deficiencies. While the market is likely to endure some short-term pain for prolonged long-term stability, the impact of regulatory changes remains a challenge for a number of insurers with less developed risk governance frameworks.

The buffers that many companies had in their risk-adjusted capitalisation have eroded steadily in recent years, but BCAR assessments still largely remain within the Strongest category. The abrupt interest rate changes during 2022 and the negative impact on fixed interest valuations has tested the resilience of many companies' balance sheets. Asset concentrations in high-risk investments, for example from (re)insurers seeking higher yields in a context of the prior low interest rates, or with exposure to riskier less liquid investments, have remained a concern and add significant volatility to operating performance and capital adequacy. The adoption of prudent risk management practices is critical, to ensure that companies manage risks effectively and in a controlled manner, especially in times of heightened economic uncertainty and market volatility.

Insurance & Reinsurance Market Trends

<<START BOX COPY>> **Opportunities in Africa's Primary Insurance Segment**

The average retention ratio of insurers in Africa is typically lower than in more mature markets, with insurers relying on the international reinsurance market to support underwriting on more complex lines of business (including energy, fire, marine, and specialty).

On a net premium basis, insurers' underwriting portfolios are often primarily concentrated in the life, health, and motor lines.

Life insurance is a major line of business, and is often largely retained by domestic insurers. Life insurance has demonstrated a strong rate of growth in recent years, albeit from a small base. Furthermore, the segment is in its infancy, with underwriting and reserving practices often being unsophisticated.

Many insurers rely on adjusted versions of mature market mortality tables as local data is of limited quality. As such, pricing and reserving methodologies and assumptions can often vary greatly between insurers, increasing the risk of mis-pricing and under-reserving.

Annuity products have grown in popularity in some markets in recent years, and often make up a significant proportion of life business. Given the added complexity of lines such as critical illness cover, claims handling expertise is sometimes needed as there can be heightened potential for moral hazard and fraudulent claims.

AM Best notes that a shortage of technical expertise across some lines of business presents a challenge for insurers that seek to innovate and tailor products for local markets, as well as respond to emerging risks. Furthermore, the costs associated with the hiring of experienced and qualified individuals can be significant. This means that insurers have to be certain that the added value provided by these individuals is justified.

Many markets in the region have regulations that favour domestic companies ahead of foreign competition. A number mandate that all local reinsurance capacity must be exhausted before cedants can access cover from international reinsurers, while others require certain reinsurers to be given priority over a certain proportion of all outwards reinsurance treaties.

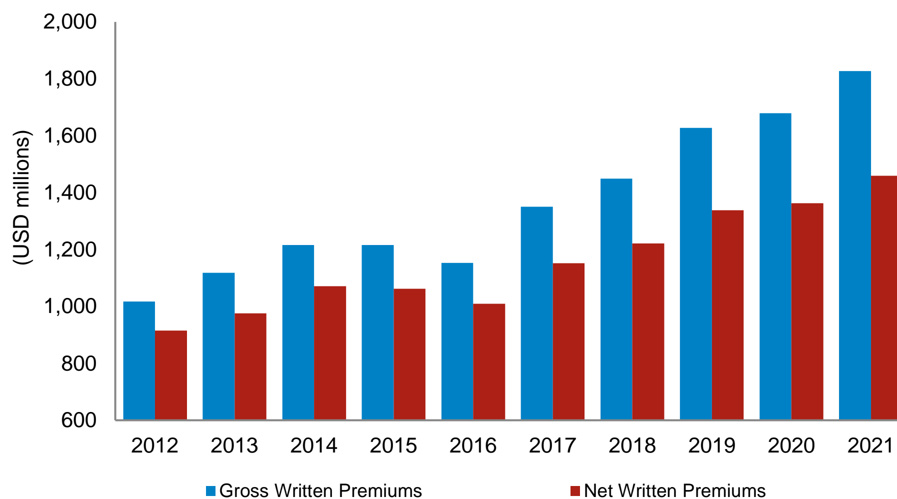
<<END BOX COPY>>

<<START NEW BOX COPY>>

Growth Prospects of the Regional Reinsurance Market

Steady real GDP growth – together with international investment – have contributed to the expansion of the region's reinsurance market over the past decade. SSA reinsurers rated by AM Best have experienced healthy growth over the underwriting cycle.

Exhibit 17
Sub-Saharan Africa – AM Best-Rated Reinsurers, Premiums, 2012-2021



Sources: BESTLINK
Best's Financial Suite – Global, AM Best data and research

Gross written premium (GWP) has grown at a 10-year compound annual growth rate of 6% (calculated in US dollars) (see **Exhibit 17**). GWP growth has been driven predominantly by the non-life insurance segment, with the life segment at a nascent stage of development in many of the region's countries.

But the trend seen in **Exhibit 17** does not tell the whole story: the currencies in two of the region's largest economies have fared badly against the US dollar during the period. The Nigerian naira and South African rand depreciated against the US dollar by 62% and 47%, respectively, between 2012 and 2021. In local currency terms, the growth in GWP has been even more marked.

While AM Best expects steady real GDP growth, together with international investment in local infrastructure projects, to continue, uncertainties exist regarding the near-term prospects for the SSA reinsurance market. Wavering global economic activity and weakening local currencies in particular have the potential to put the brakes on near-term real growth rates.

<<END BOX COPY>>

<<START NEW BOX COPY>>

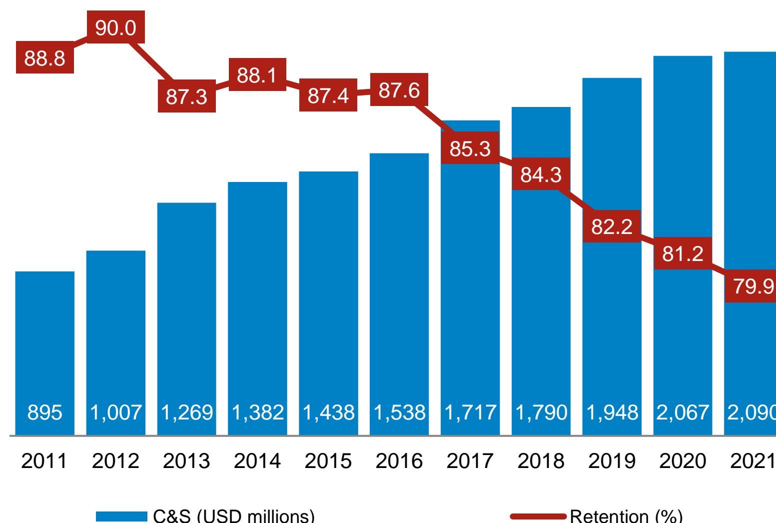
Limited Regional Reinsurance Capacity

The larger reinsurers in SSA (excluding South Africa) tend to be either national or supranational entities, and often benefit from compulsory cessions and/or have a mandate to develop the local (re)insurance industry. With a few exceptions, African reinsurers tend to focus on local and regional markets. Further competition comes from a relatively small group of sophisticated global reinsurers, and a handful of smaller privately-owned African companies.

Exhibit 18

Sub-Saharan Africa – AM Best-Rated Reinsurers, Capital & Surplus vs. Retention, 2011-2021

(C&S: USD millions Retention: %)



Sources: BESTLINK

Best's Financial Suite – Global, AM Best data and research

Despite solid growth in capital in recent years, the capacity offered by Africa-domiciled reinsurers remains low, and insufficient to meet the needs of local primary

markets fully, particularly where major property and energy risks are concerned. As the region's economies have industrialised, their insurance needs have grown. This in turn has contributed towards declining levels of retention for SSA reinsurers (see **Exhibit 18**). As well as capacity, local players often lean on more sophisticated global reinsurers for the expertise needed to underwrite complex risks.

<<END BOX COPY>>

<<START NEW BOX COPY>>

High Barriers to Entry for Reinsurers

Barriers to entry remain high in many African reinsurance markets and include protectionist local regulations and the presence of state-owned reinsurance companies or specialised state-sponsored pools. The limited competition from global reinsurers is due to a multitude of factors, including the expansive geography of the continent, the small size of national reinsurance markets, and the significant cultural and fiscal policy differences between countries.

Over the past decade, local regulators have become more active in championing their national markets, often forcing primary insurers to exhaust the capacity of local reinsurers, which are generally of a weaker credit quality, before they can explore international markets. Supranational reinsurers such as Africa Re, CICA Re and ZEP Re, play an important role in supporting the underlying insurance markets, maintaining a mandate that goes beyond a predominantly commercial existence.

However, high barriers to entry have not completely deterred new market entrants. In early 2021, specialty reinsurance start-up Africa Specialty Risks commenced underwriting from Mauritius.

<<END BOX COPY>>

AM Best Contact:

Dr Edem Kuenyehia
Director, Market Development & Communications - EMEA & AP
Tel: +44 20 7397 0280 Edem.Kuenyehia@ambest.com