Africa Insurance M&A: Global Insurers' Next Frontier

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The insurance industry in general, and M&A opportunities in Africa, are still in their infancy, and this brings a range of opportunities for international insurers and investors. In contrast to more developed markets, most international insurers have little or no presence in Africa. This helps to explain the fact that Africa's global market share in the insurance sector is roughly around 1.5%, and the continent's average insurance penetration rate is 2.9%, falling to 0.9% excluding South Africa.[1]

These figures stand in even greater contrast compared to the rest of the developed and developing world because according to some metrics, the economic and corporate governance climate appears to be generally favourable for the development of insurance products in Africa and for companies looking to invest there. GDP in sub-Saharan Africa is forecast to grow between 2.6% and 3.2% by 2018,[2] foreign direct investment has increased by 5% to $50 billion over the past 15 years, and research suggests that a growing middle class is emerging who expect, and can afford, different categories of products from insurers as a consequence of a rising GDP per capita across Africa.[3] Cutting against these favourable trends, it is estimated that falling commodity prices will cut growth across sub-Saharan Africa by 1% to around 4%, the slowest rate since the late 1990s. For example, in Nigeria, oil still accounts for roughly 70% of the country's annual budget, leaving government spending highly dependent on global energy prices.

Meanwhile, the corporate governance, risk management and capital standards in many African countries are being strengthened, mirroring similar efforts being rolled out globally. For instance, European Solvency II – like regimes are being implemented in South Africa and Kenya, bringing new capital and risk management requirements to insurers located there. Like elsewhere around the world, these new standards present opportunities to acquirers (for instance, if particular business lines are now suddenly more expensive for their current owners to hold), but difficulties for deal-making as well, as acquirers need to understand the new requirements and their impact on valuation and operations.

This article provides an overview of recent M&A activity in the insurance sector in Africa, including commentary on some of the key themes that we have identified. We also summarise some of the main regulatory and compliance issues that an international investor may face when investing in Africa, as well as provide a more in-depth view on the insurance markets in Kenya, Nigeria and South Africa.

1. KPMG, Insurance in Africa 2015, 6/3/2015.
2. World Bank, Global Economic Forecast, June 2017.
3. PWC, Insuring African Growth – Insurance Industry Analysis, March 2015.

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Recent M&A Activity and Opportunities in the Insurance Sector

Between 1 August 2016 and 1 August 2017, we have identified approximately 20 insurance M&A transactions involving targets based in Africa. Based on the publically available information on these deals, we have outlined the following themes:

First, there is a lack of qualitative data on Africa Insurance M&A transactions, which makes it difficult to evaluate any trends when it comes to individual and aggregate deal values. We assume that the consideration for most of these deals is significantly smaller compared to insurance deals internationally, given the low overall insurance penetration rates across the continent (excluding South Africa). The largest transaction that was publically disclosed in this period was the acquisition by Leapfrog of a minority stake in Enterprise Group Ltd (Ghana) (US$ 180m) in June 2017.

This leads on to the second trend that we identified: the majority of recent African insurance M&A has been limited to a handful of African jurisdictions. For example, the target company was based in South Africa in 13 of the 20 transactions we identified. We also did not identify any transactions where the target was not based in South Africa, Nigeria, Ghana, Zimbabwe or Malawi.[4] We make multiple references in this article to the potential opportunities for insurers in "Africa", but, for a multitude of reasons, Africa is not a homogenous continent that is suited to a "one size fits all" analysis. There are reasons to be optimistic that insurance M&A in the aforementioned jurisdictions has the potential for significant growth in the short-to-medium term, but this should be evaluated alongside the fact that only a few countries in the continent (due to political, regulatory, economic or religious reasons) show positive signals that their insurance markets will develop significantly for the foreseeable future, especially considering the recent economic challenges facing most of the continent, such as falling commodity prices, weakening local currencies and higher borrowing costs due to central banks increasing their interest rates.

The final trend is that the majority of purchasers are South African, European or U.S. based insurance companies who are seeking either to consolidate their portfolios in existing markets, or to use the target vehicle as an entry-point into a new market in Africa. For example, the following major insurers have recently made investments in Africa: Prudential Financial Inc. (through its separate account managed by Leapfrog in Enterprise Group Limited (Ghana)), Prudential plc (in Zenith Bank (Nigeria)), AXA (in Mansard (Nigeria)), Old Mutual (in Oceanic Life (Nigeria), Provident Life (Ghana) and UAP Holdings (Kenya)), and Swiss Re (in Ledway Assurance (Nigeria)). We understand that none of the major insurance companies based in Asia have made or are imminently planning on making any acquisitions of insurers in Africa.

With a few exceptions, there is a notable absence of bank and private equity purchasers in the deals we reviewed. In the case of the former, we are seeing the growing use of bancassurance in more developed markets due to banks' established infrastructure and existing client base. By way of example, in July 2017 Prudential plc announced the acquisition of a majority stake in Zenith Life (Nigeria) and an exclusive bancassurance partnership with Zenith Bank in Nigeria. This, combined with the advancement of consumer facing technology and the growing use of "microinsurance", could provide banks in Africa with unique opportunities to engage new and existing customers that are not available to non-bank competitors. Regulations in certain African jurisdictions, however, may prohibit a bank from directly or indirectly owning an insurance company or participating in insurance-related activities. We have seen increasing use of a "financial services" model whereby both a bank and an insurer are held as subsidiaries, allowing the group to provide services to each other and share infrastructure.

Investor Differentiation—Strategics v. Non-Strategics

One area of interest for market participants is how insurance firms compete with non-strategic investors for acquisitions and partnerships with local insurance companies.

Some advantages that insurance companies have over non-strategic investors include technology and systems expertise, as well as the ability to transfer products that they have developed in their home markets. Insurers are also more likely to be subject to more stringent regulatory requirements, so this can help to facilitate the development of sound corporate governance in any local African target consolidated into their portfolio, as well as local regulatory

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4. Sources: S&P, Capital IQ search.

approvals. Finally, local insurance operators may prefer to collaborate with global insurance firms as they are perceived to be longer-term investors, and operating synergies that arise as a result of an acquisition or partnership may give the purchaser flexibility to pay a higher price than a non-strategic investor for the local insurer.

We expect there will be increased interest amongst non-strategic investors for African insurance companies. Some of the advantages accessible to non-strategic investors include a greater access to capital (there were 145 PE deals reported in Africa in 2016, amounting to US$3.8bn, versus US$2.5bn in 2015), and the ability to retain and incentivise management through attractive equity arrangements. Overall, we expect that the private equity investments will initially take the form of minority and majority investments (i.e., not 100% transactions) in insurance companies. Because of the challenges involved in the integration of new acquisitions into a multinational group structure from a legal, compliance, governance, reporting and parent policy compliance, a private equity firm can add value to an African target by conforming a target's compliance policies and procedures to regulatory requirements that are applicable to the private equity investor. This will also help smooth an exit sale to a strategic company.

Life Insurance v. Non-Life Insurance

According to the Africa Insurance Organization, the total value of Africa's insurance premiums was $64 billion in 2015, meaning Africa's share of the global market was approximately 1.1% (US$20.4bn) for non-life insurance premiums and 1.8% (US$43.7bn) for life insurance premiums. Non-life insurance penetration levels in all African countries except for South Africa is lower than the global average of 2.7% with five countries (South Africa, Morocco, Egypt, Kenya and Nigeria) accounting for 85% of total insurance premiums in Africa. Currency depreciation remains the main cause for the declining premium volumes in US$ terms, although only Nigeria and Libya experienced negative real premium growth (adjusted for inflation) in original currency terms in 2015.[5]

Life insurance remains underdeveloped for various reasons, including limited awareness of life insurance products and low average earnings across the continent making life insurance an unaffordable option for large parts of the population. The absence of reliable independent data on mortality and longevity statistics in Africa, due to the underdeveloped life insurance sector, may make it a less appealing area for investment.

As noted above, however, Africa has a growing middle class that can afford a broad range of insurance products, including life insurance services, so we would expect to see growth in this area as more international insurers enter high-growth opportunities in Africa. There are several markets where it may be impractical or unduly time-consuming for a strategic to obtain an insurance licence to operate from the local regulator. For some insurers, therefore, acquiring an existing life insurance company may be the most effective entry route into accessing an existing customer base in Africa, to which the insurer can then cross sell other insurance products in its existing portfolio.

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Anti-Bribery Compliance

Corruption in some jurisdictions in Africa raises the costs and risks of doing business, deters international investment, distorts prices and hinders economic growth. There is a constantly evolving legal landscape attempting to fight corruption, with increasingly aggressive international and local legislation, regulation and enforcement. For example, anti-bribery laws applicable to companies that do business in the United Kingdom and the United States have an extraterritorial reach, extending to portfolio companies and their representatives internationally. An insurer may also be penalised in its home jurisdiction for any breaches by a portfolio company. For example, there is a risk that criminal activities at or involving the target or entities that it controls could expose a U.S. insurer's affiliates to being disqualified as a qualified professional asset manager ("QPAM") under ERISA, and such status as a QPAM is generally required to provide investment management services to ERISA-covered plans. Disciplinary infractions involving the target could disqualify the target and a U.S. insurer's affiliates from engaging in certain other activities under the U.S. securities laws.

5. African Insurance Organisation, Africa Insurance Barometer 2017

A foreign buyer should strive to undertake rigorous pre-transaction diligence in order to minimise its risks and ensure that it receives an appropriate valuation of the target company. It is not always possible, however, to perform complete anti-corruption diligence and there may be limitations as to the quality of information that an African seller is able to provide. To the extent that pre-transaction diligence is unable to be carried out, potential investors should ensure that they undertake post-transaction diligence to identify any anti-bribery risks as soon as possible.

The inclusion of contractual protections in a purchase agreement and shareholders' and investment agreements may mitigate the risk of anti-bribery liability. These could include appropriate representations and warranties from the seller that it has complied with all relevant antibribery legislation and full audit rights for the investor of the target between signing and closing of the transaction to undertake continued diligence. Strong termination rights and post-closing indemnities should be built into the acquisition agreement if the local partner is found to have breached any anti-bribery undertakings. Further, the investor could seek an adjustment of the purchase price upon the occurrence of such an event. A foreign investor buyer should also have comprehensive governance rights in the shareholders' agreement to ensure that its joint venture company complies with its regulatory obligations.

Enforcement Issues

Local courts in Africa have a reputation for being weak, slow and inefficient, and local arbitration may be inadvisable. Therefore, we expect global investors, where possible, to submit to the jurisdiction of a non-African court or decide to arbitrate in the event of a dispute with its local partner. There are, however, some matters that cannot be contracted out under the laws of certain African jurisdictions. Although most African jurisdictions are signatories to the New York Convention, which should, in theory, make the process of enforcing a foreign arbitral awards in a local court straightforward, there are some signatories to the Convention that have a poor record of enforcement.[6] This should be borne in mind when selecting the seat of arbitration.

Counterparty credit risk is another issue to consider, as local partners are unlikely to have the same access to capital as some of the larger multinational insurers. Foreign investors should therefore consider obtaining offshore collateral, third-party guarantees and, where applicable, representation and warranty insurance prior to entering into an investment or joint venture arrangement with a local partner.

Bilateral investment treaties (BIT) may be available to protect investments against expropriation without adequate compensation. There are over 2,200 investment treaties in force and they can provide for international arbitration of treaty claims as an alternative to local courts. Depending on how a deal is structured it may be possible to benefit from more than one BIT.

Local Markets

As mentioned above, Kenya, Nigeria and, in particular, South Africa currently dominate the insurance market in Africa and account for the vast majority of recent M&A transactions. Below is a brief summary of the key features of each of these jurisdictions for those looking to move into the insurance space. Annex I (pages 17-19) contains a further summary of the insurance markets for these jurisdictions.

Kenya and East Africa

Although there is no regulatory framework supporting a cross-border insurance regime in East Africa, there are ongoing discussions within the East Africa Community trading block and cooperation among the member states geared towards having similar legal frameworks and combined regulatory supervision for cross-border transactions. Some steps have already been taken towards achieving this. For example, in relation to local ownership, the law in Kenya prescribing a minimum local ownership requirement was expanded to include East African citizens rather than just Kenyans. It is noteworthy that some of the other East Africa Community members, in particular Rwanda and Uganda, do not have any local ownership requirements, and it is hoped that this will influence the other East African jurisdictions. It is worth noting that the East African Insurance Supervisors Association (EAISA), whose role is to provide uniformity in the East African region, in 2016, developed a practical guide to oversee activities of insurance firms operating in more than once one country. It is envisaged that these guidelines will help in setting standards in insurance service delivery as well as increasing efficiency in the market. Further, the guidelines will make it possible for a regulator in one country to acquire necessary information from sister regulatory organizations concerning cross border insurance companies.

In Kenya, there is currently a significant focus on anti-money laundering and anti-bribery enforcement, which should make it easier for global insurers entering the market to institute and enforce their home nation AML requirements. The spotlight is also on merger control requirements, which are strict, and even seek to police mergers consummated offshore but with an effect in Kenya.

In many East African jurisdictions, bancassurance is key for distribution as banks already have the necessary infrastructure in place, as well as local relationships and trust. The financial services model has also recently grown in popularity as a way of structuring bancassurance offerings, with both the bank and the insurers as subsidiaries of the same non-operating holding parent.

6. E.g., IPCO (Nigeria Limited) v. Nigerian National Petroleum Corporation.

Nigeria

Private equity firms are very active in the Nigerian market, joining European, North and West African entities, which are already active buyers. M&A is seen as the only realistic route to real growth for an insurer so there are many opportunities available. Local regulators have welcomed the presence of private equity investors into Nigeria, and we could begin to see insurers as secondary investors acquiring from PE firms once the PE investors have done the legwork, such as restructuring and implementing corporate governance arrangements.

Despite foreign direct investment in Nigeria reaching a record low of $624.87 million in the second quarter of 2015, the insurance industry in Nigeria is generally perceived as being one of the most welcoming jurisdictions for foreign investment in Africa. Nigerian law does not prohibit a foreign investor owning 100% of a local insurance company (although in practice, the Nigerian regulators would prefer a local company not to be wholly owned by foreign investors).

A key consideration when doing business in Nigeria is that regulation is often unclear, for instance regarding bancassurance, and enforcement of existing laws is relatively weak.

South Africa

The new "Solvency II"style solvency and capital regulation which is being introduced in South Africa will change the market considerably. We are already seeing some players looking to diversify out of the market or redistribute their assets as it is unclear whether assets in other jurisdictions will be recognised for solvency purposes. Once the new regulation is brought into force and the market adjusts, South African insurers may attempt to enter the European market, and more European entities may begin looking to the South African market, although this could be some way off. South Africa could be an attractive entry point from which to develop a broader African presence. However, it is important to bear in mind the Black Economic Empowerment codes, which apply to all entities operating in South Africa. An entity not complying with the codes may face difficulties in doing business in South Africa.

Conclusions—What Next for Industry Participants?

South African insurers and other Pan-African consolidators are already actively making acquisitions in African developing markets. These deals combined with the lack of greenfield opportunities imply that global insurers looking to enter the market will need to develop their African insurance strategy and weigh-up the risks involved.

We expect that investors will initially focus on nonlife insurance in a handful of the most promising jurisdictions, including Kenya, Nigeria, South Africa and Ghana due to their fast growing economies and relatively stable legal and regulatory environments. In contrast, there are some jurisdictions in Africa where we do not envisage significant developments in the insurance M&A sector due to unacceptable regulatory constraints, political and economic uncertainty, and a lack of potential customers.

There are certain parallels between Africa today and Asia and Latin America in the 1980s, including a growing middle class, a developing financial sector and increasing political stability. Asia's world premium of insurance volumes doubled between 1977 and 1992,[7] and it would not be wholly surprising if a similar story emerges in respect of Africa today.

There are legitimate concerns over doing business in Africa due to political, economic and anti-bribery and corruption issues, although these risks should not be overplayed. Conducting satisfactory jurisdictional, operational and historical due diligence, adopting stringent governance policies and obtaining appropriate contractual protections from a local partner should, as a whole, mitigate such risks to an acceptable level for a global insurer seeking to enter or develop its presence in Africa. It's about time that global insurers realise that the Africa insurance market is a "giant waking up"[8] and become a part of its success story.

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Please do not hesitate to contact us with any questions.

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ANNEX I

Ghana, Kenya, Nigeria, and South Africa—an Overview[9]

The below table provides an overview of the insurance industry in each of Kenya, Nigeria and South Africa.

CATEGORY	KENYA	NIGERIA	SOUTH AFRICA
Transparency International ranking (2016)	145/176	136/176	64/176
Population (millions)	48.46m	185.9m	55.9m
Life expectancy	62.13 years	53.05 years	57.44 years
GDP ($bn)	70.53bn	405.1bn	294.8bn
Insurance Penetration Rate (Premiums as % of GDP)	<3%	<0.5%	<14%
Total premiums—non-life insurance	$1.17bn	$1.3bn	$3.4bn
Total premiums—life insurance	$0.704bn	$457bn	Information not publicly available.
Market share—non-life insurance	Jubilee (11.58%) UAP (9.03%) APA (7.39%) CIC (6.91%) Britam (5.75%) Others (59.34%)	Leadway (12%) Custodian & Allied (6%) AIICO (5%) Others (77%)	Mutual and Federal Limited (R12.2bn) Outsurance Holdings Limited (R11.6bn) Santam Limited (R22.7bn) Zurich Insurance Company South Africa (R3bn)
Market Share—life insurance	Britam (23.51%) Jubilee (14.1) ICEA LION Life (13.04%) Pioneer Assurance (7.22) Sanlam Life (6.39%) Others (35.74%)	AIICO (18%) Niger Insurance (9%) Mutual Benefit Life (8%) Leadway (8%) Industrial & General (7%) Capital Express (6%) Others (44%)	Discovery Liberty Holdings Limited MMI Holdings Limited Old Mutual Life Assurance Company South Africa Sanlam Limited1

9. Sources include: World Bank, Transparency International, IRA - Insurance Industry Report for the Period January – December 2016.

ANNEX I (continued)

CATEGORY	KENYA	NIGERIA	SOUTH AFRICA
Regulator	Insurance Regulatory Authority (IRA)	National Insurance Commission (NAICOM)	Financial Services Board (FSB)
Key Legislation and Recent Developments	Insurance Act and subsidiary legislation The Insurance (Amendment) Regulations 2017 The Insurance (Amendment) Act 2016 IRA Guidelines Move from a rule-based to a risk-based regulatory regime under draft Insurance Bill, 2014, which would repeal and replace the Insurance Act.	Insurance Act 2003	Short-Term Insurance Act Long-Term Insurance Act Developments: Move to adopt a "twin peak" regulatory environment with prudential regulation under Solvency Assessment and Management framework (similar to Europe's Solvency II) and conduct of business regulations under the Retail Distribution Review framework.
Limits on Investments	Government securities – up to 100% Cash deposits – up to 30% Equity securities – up to 30% Land and buildings – up to 50% Investment property – up to 70% Secured loans – up to 10% Mortgages – up to 20% Foreign investments – up to 5% Debt investments – up to 10% Fixed deposits – up to 95% Investment in related companies – up to 10% Policy Loans – up to 100% Real Estate Investment Trusts – up to 10%	Securities offered by any one company – up to 20% Quoted equity securities – up to 50% Unquoted equity securities with a minimum credit rating – up to 10% Federal Government securities – up to 100% State government securities with Federal Government guarantee – up to 20% Debt instruments – up to 10% Real estate - 35% (for life insurance funds) or 25% (for non-life insurance funds)	The Acts do not prescribe any proportional limit in relation to the ceiling of investments that an insurer can make into each asset class. No more than 35% of total retail assets under management in respect of non-life insurers and the investment-linked business of life insurers may be invested outside South Africa.
Equality of treatment between domestic and foreign owned insurers	Yes	Yes	Yes
Restrictions on foreign ownership of an insurance company	Yes—at least 1/3 must be owned by East African Citizens.	No, but in practice, the Nigerian regulator is unlikely to allow a foreign company to own 100% of a Nigerian insurance company.	No, but no foreign company may own more than 25% of the shares in an insurer without the prior approval of the insurance regulator.

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ANNEX I (continued)

CATEGORY	KENYA	NIGERIA	SOUTH AFRICA
Black economic empowerment requirements	No	No	Yes
Regulatory approvals required for an acquisition of shares	A transfer of more than 10% of the shareholding of an insurer requires the prior written consent of the insurance regulator. Written approval of the Commissioner in order to register the transfer of any shares where the transfer has the effect of reducing the proportion of shareholding of citizens of Kenya in the insurer.	Approval required from the insurance regulator. Must satisfy a "fit and proper person test".	Approval required from the insurance regulator pursuant to the Short-Term Insurance Act and Long-Term Insurance Act.
Signatory to New York Convention	Yes	Yes	Yes
Offshore re-insurance requirements	Offshore reinsurance is permitted subject to obtaining regulatory approval and satisfying the mandatory cessions requirement with the local insurers.	Insurers are required to utilise all available reinsurance capacity in Nigeria in whatever percentile of choice before they seek coverage with other reinsurers offshore. 100% of the life insurance business must be retained in the country.	Insurance laws prohibit any person from carrying on insurance or reinsurance business in South Africa unless that person is licensed to do so. The only exception to the aforementioned requirements is Lloyd's underwriters who do not have to obtain a license. Consequently, foreign insurers participate in the local market by either establishing a subsidiary in South Africa, or by way of the provision of cross-border reinsurance, provided that in the latter case the activities of the foreign reinsurer do not amount to "carrying on short-term insurance business in South Africa" requiring registration and licensing per the above.