

Market Review
October 1, 2012

**Premium
Growth has
Slowed in 2011
and 2012**

Executive Summary

Political Unrest Overshadows MENA's Strong Insurance Demand

The insurance, reinsurance, Takaful and cooperative markets within the Middle East and North Africa (MENA) continue to offer opportunity for growth, although the global slowdown of financial markets and political instability in the region threaten to dampen prospects for some companies.

Whilst the MENA insurance markets have experienced double-digit premium growth in recent years, the pace of growth has slowed in 2011 and 2012, with most markets expected to achieve increases in total gross premiums written (GPW) of less than 5% this year. Declines in GPW have been more pronounced in countries affected by the Arab Spring where growth has either declined or stagnated in 2011, with difficult trading conditions in 2012.

The drivers for heightened insurance demand and the factors contributing to a challenging environment have been identified in a variety of reports published by A.M. Best Co. in the past year. This compendium of reports looks specifically at the impact of the Arab Spring on economic growth, as well as A.M. Best's ratings actions in the MENA region. Reports have also examined insurance, reinsurance, Takaful and cooperative markets in specific countries and, in particular, Jordan and Saudi Arabia.

Exhibit 1 shows the development of total GPW from 2005 through 2011. The region has experienced strong growth over this period, with premium volumes more than doubling from 2006. This is indicative of the growing economies of these markets, where insurance penetration has been extremely low. Take-up of insurance becomes more pronounced as opportunities develop and recognition of the importance of insurance improves.

Furthermore, developments in regulation and compulsory insurance have assisted growth in some markets. Premium volumes continued to rise in 2011 in the United Arab Emirates (the UAE), Saudi Arabia, Morocco, Egypt, Lebanon, Algeria, Qatar, Tunisia, Kuwait, Oman, Jordan and Bahrain, and are expected to further increase in 2012, albeit at a slower pace.

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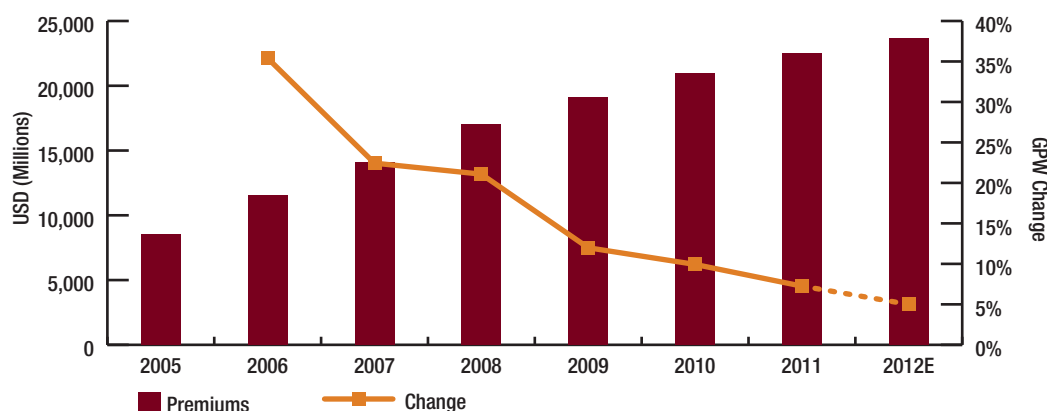
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Exhibit 1

Middle East & North Africa – Gross Premiums Written (2005-2012E)

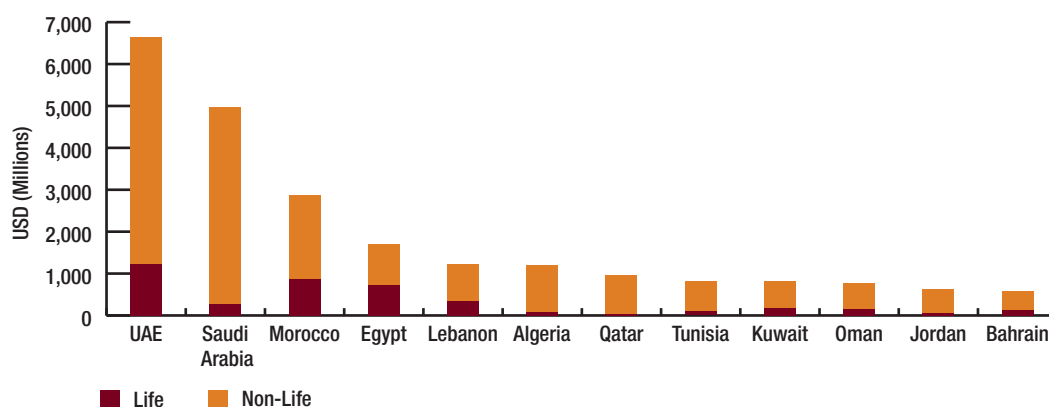


Source: A.M. Best research

As illustrated in **Exhibit 2**, the two main regional markets remain the UAE and Saudi Arabia, which is indicative of their economies and the potential of their markets. Both countries benefit materially from oil revenues, which have stimulated growth, in addition to the introduction of compulsory medical schemes. Both countries are expected to maintain their status as the main markets of the Middle East in the short-to-medium term.

Exhibit 2

Middle East & North Africa – Life & Non-Life Gross Premiums Written (2011)



Source: A.M. Best research

Non-life insurance products, which include medical insurance, dominate the market and account for approximately 80% of premiums generated. The life sector is more underdeveloped than the non-life sector, with both segments considered to have opportunities for growth.

The MENA insurance markets tend to be immature, with very low penetration rates compared to their international peers. There is greater demand for insurance as the awareness of the benefits of insurance grows and regulators encourage the take-up of insurance with the introduction of compulsory lines of business, including motor third-party liability and medical health care. Obligatory medical schemes are considered to present the greatest opportunities in the region, although they remain fiercely competitive and need to be controlled to produce profitable growth.

Global demand for the region's oil and gas resources is fuelling strong economic development and gross domestic product (GDP) growth, particularly for the oil rich Gulf Cooperation Council (GCC) economies. Oil prices are above economic budgets for these countries at present, enabling governments to continue to finance infrastructure and development projects and subsequently increase insurance activity.

While economic growth in the MENA territory is strong compared to other more developed regions, GDP prospects have been impacted by the financial crisis of 2008 and the Arab Spring of 2011. This has been outlined in A.M. Best's special report published in November 2011, which examined the economic growth opportunities in the region. Political instability in the region has caused a drop in investors' confidence and remains very much apparent.

A.M. Best places companies into five categories based on the risk presented by their country of domicile, ranging from the lowest risk, "CRT-1" (Country Risk Tier 1), to "CRT-5" (Country Risk Tier 5) for countries considered to face the highest economic and political risks. Since the Arab Spring, A.M. Best has lowered the CRT for one country, Egypt, from CRT-4 to CRT-5, in light of the social unrest and worsening economic fundamentals of the country.

A number of MENA countries have held elections and the reforms proposed by governments will be fundamental in determining if further unrest is likely to occur. Therefore, the level of regional instability in MENA insurance markets is a direct threat to growth, with the situation and degree of impact being very uncertain and volatile.

Focus Towards Prudent Underwriting

In general, MENA insurers have tended to adopt aggressive investment strategies, with a high concentration of assets invested in equities and real estate markets. It has generally been the strategy of companies and shareholders to achieve high returns through investment activity, rather than through prudent underwriting. Furthermore, investment portfolios are concentrated in a limited number of classes, with holdings in a few major companies, indicating the generally low level of diversification within some insurers' asset profile.

Issues regarding the liquidity of assets have been more pronounced during depressed market conditions and are a concern for the short to medium term. Over the past six years, there have been considerable fluctuations in equity and commodity markets, with the stock market crash within the GCC in 2006, followed more recently by depressed international equity markets and political uncertainty in the region. As a result, companies have suffered from fluctuating returns on equity (ROE), with volatile capital positions and overall earnings. Companies are no longer able to rely exclusively on strong investment returns to support underwriting performance.

Competition in the MENA markets remains fierce, as a number of companies seek top-line growth, and increasing market share is a priority. This has been exacerbated in recent years by the increasing number of new entrants into the market. However, given the low interest rate environment and volatile performance of equities and real estate markets, which have underperformed in recent years, there is a renewed focus on improving underwriting activity.

The market is generally split into two categories. The leading companies that are established and have a good reputation, benefit from economies of scale and the capacity to

underwrite large projects. They have generally shown sound technical results and either have maintained or improved market share. Conversely, the small-to-medium sized companies (including start-up operations) have found it difficult to grow whilst maintaining technical profitability.

Many smaller players are straining to write sufficient business to service capital levels in tough market conditions with low investment yields. The attractiveness of writing compulsory risks (in particular, medical health care), which is sought-after, highly competitive business, is adding further pressure. These insurers face poor profitability, particularly in medical and property lines, which are sometimes grouped into “bouquet” treaties. This can create a very delicate balance between maintaining client relationships and servicing reinsurance needs because certain lines require independent reinsurance coverage.

Overall, while combined ratios have been steadily increasing, profitability for the sector remains sound. Consequently, A.M. Best expects prospective consolidation in some countries, with the smaller players either merging, or exiting the market as the low level of profitability or losses are unsustainable over the medium term.

The fragmented marketplace may be ripe for consolidation, but there are limiting factors. Larger insurers that have a strong presence in their markets may see little advantage in purchasing often underperforming smaller players. Furthermore, many companies are family owned and may be reluctant to explore a merger or acquisition and possibly relinquish ownership. The challenging operating environment has also resulted in an absence of new start-ups in the past year. Acquisitions are likely to depend on companies’ strategic objectives, as companies seek regional expansion.

The market’s dynamics remain unchanged, with commercial risks continuing to be ceded into the international market and cash flows largely created through motor and medical business lines. Motor and medical business remain sensitive to pricing and service levels, with commercial risks heavily reliant on reinsurance and Re-Takaful capacity. A.M. Best expects retention levels to gradually improve, albeit to remain low in the near-to-medium term for the majority of insurers and Takaful operators. Pressure on ceding commissions may also encourage retention. Some companies have made an effort, or indicated plans, to change strategy and increase retention levels, which makes prudent underwriting even more crucial.

Over the past few years, the leading companies have attempted to restructure their operations and achieve a profile more commensurate to their international peers. A number of companies have adopted a more prudent investment policy – de-risking from volatile asset charges such as equities and real estate, with a shift toward a more liquid investment portfolio – which should generate a steady income stream to supplement underwriting activities. In addition, regulators’ actions to introduce stricter guidelines should expedite requirements for a more prudent allocation of investments.

MENA Reinsurance Market has Mixed Results

The reinsurance market in the MENA region has grown substantially over the past few years, benefiting from the expansion of local markets. This has not just resulted in a greater number of regional reinsurers domiciled within MENA territories, but increased the interest from international players seeking greater diversification in lower catastrophe exposure areas.

The added capacity in the MENA reinsurance markets in recent years continues to drive rates down further, resulting in lower levels of profitability. The majority of business emanating from MENA countries is proportional, with most risks (and to some extent including medical) placed on a bouquet basis. However, there is a gradual shift towards non-proportional placements where reinsurers can have more control over pricing and risk selection.

There have been some concerns regarding commissions, which now have a greater tendency to be linked to the underwriting performance of the respective portfolio. Such changes and the bottoming of reinsurance rates should improve the attractiveness of reinsurance in the region.

The wide variations in results between local reinsurers have been indicative of companies' market strategies. Reinsurers that have been very selective in terms of territories and risks, i.e. restricting themselves to familiar markets of the Middle East and North Africa, have tended to perform remarkably well with combined ratios below 100% in recent years. Conversely, those that have sought international expansion have been hit aggressively by catastrophe losses and have subsequently suffered given their moderate sizes and capital bases. This has highlighted some concerns regarding risk management, and in particular, concentration, accumulation of risks and adequacy of reinsurance protection relative to capital and surplus levels.

Rated MENA Companies Generally have Sound Capital Adequacy

The majority of A.M. Best-rated companies in the region have sound capital adequacy despite the aggressive investment policies of direct writers and some reinsurers' exposure to catastrophe events. **Exhibit 3** shows the Financial Strength Ratings (FSRs) and Issuer Credit Ratings (ICRs) of rated entities. The ratings should be viewed in accordance with A.M. Best's ratings methodologies (available at www.ambest.com), which incorporate a number of factors, including business profile, operating performance, risk management and country risk.

Capitalisation plays an important part, with secure ratings only achieved provided that risk-adjusted capitalisation levels are sufficiently strong. Prospective capital adequacy is largely dependent on companies' ability to generate capital internally through strong operating performance, supplemented by a sound franchise in their respective markets and the ability to control, manage and mitigate risks effectively.

Most companies' capital adequacy appears to be sound, however, there are concerns regarding the high dividend pay-out ratios in the region. Dividends are generally paid as a proportion of paid-up capital and in many cases, not in conjunction with overall earnings. Whilst at present many companies can absorb these pay-outs, capital adequacy can be eroded during unprofitable years.

Combined with aggressive investment strategies, companies' risk-adjusted capitalisations and profitability levels can fluctuate significantly year on year. Moreover, a major concern is that the management of companies have limited control over investment activity, which is largely dictated by their board and may not be suitable to the relative risks pertaining to the (re)insurance company.

This further highlights the need for companies to adopt prudent risk management techniques to ensure risks are controlled and mitigated effectively. There has been significant investment in risk management practices over the past few years, both in terms of

investment in personnel and respective models purchased from third parties.

While these are positive steps, further enhancements need to be taken. Moreover, there are concerns regarding management of the accumulation and concentration of risks, particularly pertaining to catastrophe events or political unrest.

Given the low retention levels on commercial risks, primary insurers are exposed to a high amount of counterparty credit risk, which can have negative repercussions in the event of a catastrophe owing to large facultative placements. As markets mature and companies become more complex, it is paramount that (re)insurers adopt suitable capital and catastrophe management practices to ensure risks are controlled and mitigated effectively. Regional reinsurers tend to have much stronger control and understanding of their key metrics over primary insurers.

Regulators Key to Promoting Insurance Further

Regulation continues to develop at a slow pace in the region although in general, there are deemed to be some active regulators in MENA countries, such as the Saudi Arabian Monetary Agency and the Insurance Commission in Jordan. Regulators have introduced many rules to regulate the market, however, there is evidence that these rules, such as minimum capital or solvency margins, have been breached on a number of occasions. The need to provide effective supervision and further promote the insurance industry is of paramount importance.

In the past few years, progress has been made with regard to Takaful regulation. Specific legislation on Takaful is required to instil greater confidence in the sector, particularly by providing further clarification on the segregation of policyholders' funds and shareholders' funds.

Takaful Trends

It remains to be seen whether Takaful operators can provide the value-added proposition they seek to deliver to their clients. Takaful operators are generally in competition with conventional players, which means they are attempting to sell policies on price and service.

The Takaful market has expanded significantly in recent years, and most new companies operating in the MENA markets are Takaful operators, which are yet to establish themselves. The lack of a brand or reputation in the market is one hurdle they need to overcome, in addition to the requirements to meet shareholders' expectations and ROE requirements. This creates a significant strain and makes it extremely difficult for Takaful operators to balance growth and profitability. Subsequently, most Takaful operators' policyholders' funds are dependent on a Qard' Hasan (interest free loan), which invariably means surplus generation and distribution is limited.

Exhibit 3

Middle East & North Africa – A.M. Best Rated Companies as at 10th September 2012

Domicile	A.M. Best Company Number	A.M. Best Company Name	FSR and Outlook/Implications		FSR Action	Date	ICR and Outlook/Implications		ICR Action	Effective Date
Algeria	90777	Compagnie Centrale de Reassurance	B+	Stable	Affirmed	18/07/2012	bbb-	Stable	Affirmed	18/07/2012
Bahrain	90059	ACR ReTakaful MEA	A-	Stable	Affirmed	04/01/2012	a-	Stable	Affirmed	04/01/2012
Bahrain	85013	Arab Insurance Group	B++	Stable	Affirmed	21/12/2011	bbb+	Stable	Affirmed	21/12/2011
Bahrain	85489	Bahrain Kuwait Insurance Co.	A-	Stable	First	23/11/2011	a-	Stable	Assigned	23/11/2011
Bahrain	77623	Life Insurance Corp. (International)	B++	Stable	Affirmed	22/09/2011	bbb+	Stable	Affirmed	22/09/2011
Bahrain	86326	Trust International Insurance & Reinsurance Co.	A-	Stable	Affirmed	30/08/2012	a-	Stable	Affirmed	30/08/2012
Egypt	90946	Arab Misr Insurance Group	B++	Negative	Affirmed	15/06/2012	bbb	Negative	Downgraded	15/06/2012
Jordan	78183	Arab Orient Insurance Co.	B++	Stable	Affirmed	20/06/2012	bbb+	Stable	Affirmed	20/06/2012
Jordan	91584	First Insurance Co.	B++	Stable	First	24/01/2012	bbb	Stable	Assigned	24/01/2012
Jordan	91740	General Arabia Insurance Co.	B+	Stable	First	10/04/2012	bbb-	Stable	Assigned	10/04/2012
Jordan	88866	Jordan Insurance Co.	B++	Stable	Affirmed	14/12/2011	bbb+	Stable	Affirmed	14/12/2011
Jordan	89837	Middle East Insurance Co.	B++	Stable	Affirmed	23/08/2012	bbb	Stable	Affirmed	23/08/2012
Kuwait	88954	Al Fajer Retakaful Ins Co. (Closed)	B++	Negative	Affirmed	06/07/2012	bbb+	Negative	Affirmed	06/07/2012
Kuwait	90842	Gulf Insurance Co.	A-	Stable	Affirmed	18/06/2012	a-	Stable	Affirmed	18/06/2012
Kuwait	90950	Gulf Life Insurance Co. (Closed)	A-	Stable	Affirmed	18/06/2012	a-	Stable	Affirmed	18/06/2012
Kuwait	85585	Kuwait Reinsurance Co. (Closed)	A-	Negative	Affirmed	05/07/2012	a-	Negative	Affirmed	05/07/2012
Lebanon	90592	Al Ittihad Al Watani (L'Union Nationale) Societe Generale d'Assurances	B+	Negative	Under Review	21/08/2012	bbb-	Negative	Under Review	21/08/2012
Lebanon	89190	Arab Reinsurance Co.	B+	Stable	Affirmed	14/11/2011	bbb-	Stable	Affirmed	14/11/2011
Lebanon	91312	Arabia Insurance Co.	B++	Stable	First	26/04/2012	bbb+	Stable	Assigned	26/04/2012
Morocco	84052	Societe Centrale de Reassurance	B++	Stable	Affirmed	08/08/2012	bbb	Stable	Affirmed	08/08/2012
Oman	78110	National Life & General Insurance Co.	B++	Negative	Affirmed	23/08/2012	bbb	Negative	Affirmed	23/08/2012
Qatar	85452	Qatar General Insurance & Reinsurance Co.	B++	Positive	Affirmed	13/10/2011	bbb+	Positive	Affirmed	13/10/2011
Saudi Arabia	91741	Arabia Insurance Cooperative Co.	B++	Stable	First	10/04/2012	bbb	Stable	Assigned	10/04/2012
Saudi Arabia	91583	Trade Union Cooperative Insurance Co.	B++	Stable	First	13/12/2011	bbb+	Stable	Assigned	13/12/2011
Tunisia	83349	Societe Tunisienne de Reassurance	B+	Stable	Affirmed	25/06/2012	bbb-	Stable	Affirmed	25/06/2012
Turkey	85454	Milli Reasurans Turk Anonim Sirketi	B++	Negative	Under Review	14/05/2012	bbb	Negative	Under Review	14/05/2012
United Arab Emirates	85825	Abu Dhabi National Insurance Co.	A	Stable	Affirmed	23/08/2012	a	Stable	Affirmed	23/08/2012
United Arab Emirates	78732	Alliance Insurance	A-	Stable	Affirmed	20/08/2012	a-	Stable	Affirmed	20/08/2012
United Arab Emirates	90714	Al-Sagr National Insurance Co.	B+	Stable	First	23/08/2012	bbb-	Stable	Assigned	23/08/2012
United Arab Emirates	78593	Arab Orient Insurance Co.	A	Stable	Affirmed	25/04/2012	a	Stable	Affirmed	25/04/2012
United Arab Emirates	90584	Dubai Insurance Co.	B++	Stable	Affirmed	24/05/2012	bbb	Stable	Affirmed	24/05/2012
United Arab Emirates	85401	Emirates Insurance Co.	A-	Stable	First	12/09/2011	a-	Stable	Assigned	12/09/2011
United Arab Emirates	88930	Gulf Reinsurance Limited	A-	Stable	Affirmed	25/07/2012	a-	Stable	Affirmed	25/07/2012
United Arab Emirates	78342	Islamic Arab Insurance Co. (Salama)	A-	Stable	Affirmed	14/09/2011	a-	Stable	Affirmed	14/09/2011
United Arab Emirates	90718	National General Insurance Co.	B++	Stable	Affirmed	03/05/2012	bbb+	Stable	Affirmed	03/05/2012
United Arab Emirates	78177	Oman Insurance Co.	A	Stable	Affirmed	23/08/2012	a	Stable	Affirmed	23/08/2012

Source:  BestLink® – Global Insurance Database

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Regulatory Review
September 24, 2012

Changing MENA Insurance Market Poses Regulatory Challenges

Overview

**Benign
Conditions of
Previous Years
Are Quickly
Disappearing**

Over the past decade, the insurance industry in the Middle East and North Africa (MENA) region has experienced strong growth in terms of premiums. The main drivers of this growth have been the significant economic developments in most countries in the region, combined with the introduction of compulsory insurance covers in many markets. At the same time, the number of insurance companies operating in these markets has dramatically increased as investors have come to view insurance as a growth market that delivers good returns to their investments. Many of the new investors were attracted by the introduction of Takaful, which provided the opportunity to bring insurance to parts of the population that either had not perceived the need for insurance or were unable to purchase it. Overly optimistic projections for increases in insurance penetration resulted in high expectations on profitability and company valuations. Consequently, new shareholders entered the market with high expectations of returns on their capital and little appreciation for the riskiness of the insurance business. This coupled with the significant emphasis that many companies traditionally have placed on investment returns, has resulted in many insurers becoming akin to high-risk investment funds.

The global economic slowdown has been felt in the MENA markets, where growth, although still good, lags behind that of previous years. At the same time, insurers have been experiencing lower investment returns and, in some cases, investment losses that have depleted their capitalisation. In this environment, regulators are required to adapt quickly as the benign conditions of previous years are quickly disappearing.

Regulatory Challenges and Priorities

Insurance regulation in the MENA region has moved at varying speeds to meet the challenges posed by the changing face of the market. Many local regulators have failed to adapt to the changes, while offshore regulators have established systems more in line with the challenges faced by today's insurance industry. The disparities between common practices in the MENA insurance market and its regulatory frameworks were highlighted in a paper commissioned by the World Bank and issued in March 2011. The paper recommended that local regulators, among other things, should:

1. Require minimum aggregate retentions above a certain threshold, e.g., 30% - 40%.
2. Consider measures to foster market consolidation.
3. Develop a risk-based supervisory model.
4. Ensure that supervisors are provided consistent, timely and high-quality data.
5. Establish more rigorous requirements for "fit and proper" regimes.
6. Ensure separation between life and non-life business.
7. Avoid moral hazards by discouraging guarantee funds (except for life business).

This special report examines the evidence in support of the first four of these recommendations and attempts to identify some solutions.

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1. Establishing Minimum Aggregate Retention Ratios

The recommendation to require minimum net aggregate retention levels is based on the theory that insurers with no interest in the performance of the risks assumed will underprice and ultimately destabilise the market. Several companies are retaining very small percentages of their gross written premiums (GWP) and are acting almost as brokers for this business.

In many cases, there is a counterargument that certain companies in their early years of formation need to retain small amounts of their business to protect their capital bases. Proponents of this theory argue that a company's capitalisation can be easily depleted in the first five years of operations if it were to experience significant claims resulting in operating losses.

A.M. Best has conducted its own proprietary analysis of the results of 115 insurance companies in MENA for the years 2006-2010. This analysis shows that:

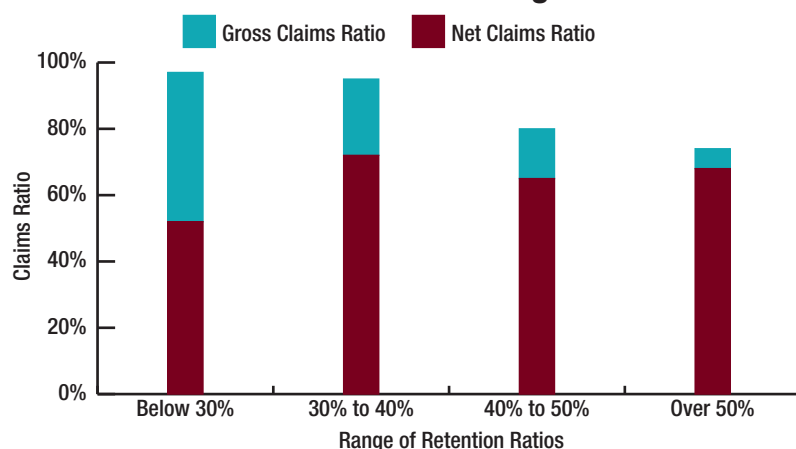
1. Approximately 4% of the companies analysed have very low retention levels (aggregate retention below 30%), the majority of which are small insurers.
2. There is no apparent link between an insurer's size and its net retention. Indeed, the larger and better-established companies tend to retain between 30% and 50% of risks, whereas some smaller-than-average companies (by GWP) have higher retentions (over 50%).

These two observations tend to dispel the link between size and the need for high reinsurance cessions. Instead, the main driver tends to be the mix of the business underwritten. Larger-than-average insurers tend to attract the majority of the more volatile large risks (mainly engineering, construction and energy) and tend to reinsure with international reinsurers. While some of the smaller companies may accept part of these risks (often in the form of co-insurance), the majority of their books are made up of motor and health business which are either net retained or have retentions close to 40%-50%, respectively.

However, when analysing technical profitability by market segment, it is evident that there are significant differences, depending on retention level.

Exhibit 1

Middle East & North Africa – Insurers' Average Claims Ratios vs. Retention Ratio Range



Source: A.M. Best research, BestLink – Global Statement File

Exhibit 1 shows the 2009 average gross and net (of reinsurance) claims ratios by market segment. The difference between gross and net claims ratios also can be an indicator of the profitability of the business ceded to reinsurers. As the exhibit shows, the companies with lower retention levels have significantly higher claims ratios than all the other segments. In this segment there also is a higher preponderance of insurers with claims ratios close to or above 100%. Looking at the

operating performance of these companies, it becomes evident that they depend disproportionately on reinsurance commissions which more than offset their operating costs and, therefore, reduce the burden of bad claims experience. This creates a long-term problem because the financial prosperity of the insurers of this segment is heavily linked to reinsurers which, based on this analysis, do not seem to make strong profits out of these transactions.

The two highest retention ratio segments (40% and above) have similar performance with their net claims ratios being between 60%-70%. It is worth noting that the segments with retentions over 41% include several regional reinsurers, which means they are exposed to greater catastrophic losses (several of these companies write business outside MENA). In that respect, if the reinsurers were to be removed from these segments, the analysis would show that the higher the retention levels, the more profitable the insurers in the region tend to be.

Impact of Low Retention

Low retention levels impact the industry as a whole. Insurers with a low retention present artificially good results that depend heavily on reinsurance commissions. The higher claims ratios of the companies with high reinsurance sessions indicate that they typically underprice the risks assumed. This, in turn, places pressure on the insurance market to compete on price. The practice of utilising reinsurance commissions to support financial performance is partly to blame for the personal lines price war, for which most of the companies in the market complain.

The lack of required minimum aggregate retention levels has encouraged new insurers to enter the market at a time when the market is already overcrowded. This was not viewed as a problem when premium volumes were growing in double-digit numbers. However, as the pace of growth has slowed, new entrants are increasing competition.

Additionally, insurers have a reduced incentive to develop local underwriting skills in order to profitably grow their business. Pricing tends to be led by underwriters of the leading reinsurer, while the local companies act primarily as fronting companies, particularly for large risks. In many cases, the insured is more interested in the credit worthiness of the reinsurer than that of the insurer writing the risk. For many insurers, even if they had the underwriting capability to retain the risks, retention of large risks would be problematic because it would impact their risk-adjusted capitalisation.

In the longer term, low retentions of large risks could expose the insurance industry to potential capacity shortages. Currently, the capacity made available to the local markets seems adequate to fully reinsure these risks outside of the MENA region. Significant cessions of personal lines of business can only continue for as long as they are profitable for the reinsurers or when there is enough “naïve capacity.”

Potential Regulatory Action

There is a legitimate case to be made for the regulators to encourage local insurers to increase their aggregate retentions.

Establishing a minimum aggregate retention of, say, 20%-30% would encourage companies to focus on their technical profitability and further develop their technical skills. Such minimums also would discourage the entry into the market of new insurers looking to target income generation through commissions. Retention requirements should differ for captives which, in some cases, need to reinsure a greater proportion

of the business because of their nature. However, at present, this is not an urgent consideration given the low numbers of captives in the MENA region.

Finally, regulators should establish stricter training requirements, particularly for technical skills, so as to build the market's overall expertise.

2. Consider Measures to Assist Market Consolidation

It has already been implied that many MENA markets are overcrowded and that this results in intense competition which, in turn, drives down rates to inadequate levels.

Exhibit 2 shows the average premiums (total market premiums divided by insurance companies in the market) written by MENA insurers and compares them to some developed insurance markets and emerging markets.

With a few exceptions, the majority of the MENA markets have companies that underwrite much smaller portfolios even compared to other emerging markets such as Malaysia and Turkey. If premiums net of reinsurance had been shown in **Exhibit 2**, the differences between the MENA countries and the others would have been even greater due to MENA's exceptionally high cession ratios. Furthermore, in many of these markets there is one company, at least, that is significantly larger than its competitors, resulting in the majority of companies in these markets underwriting much smaller portfolios than the average GWP numbers indicate.

Several factors have helped create these overcrowded markets with low GWP and low retention rates, including:

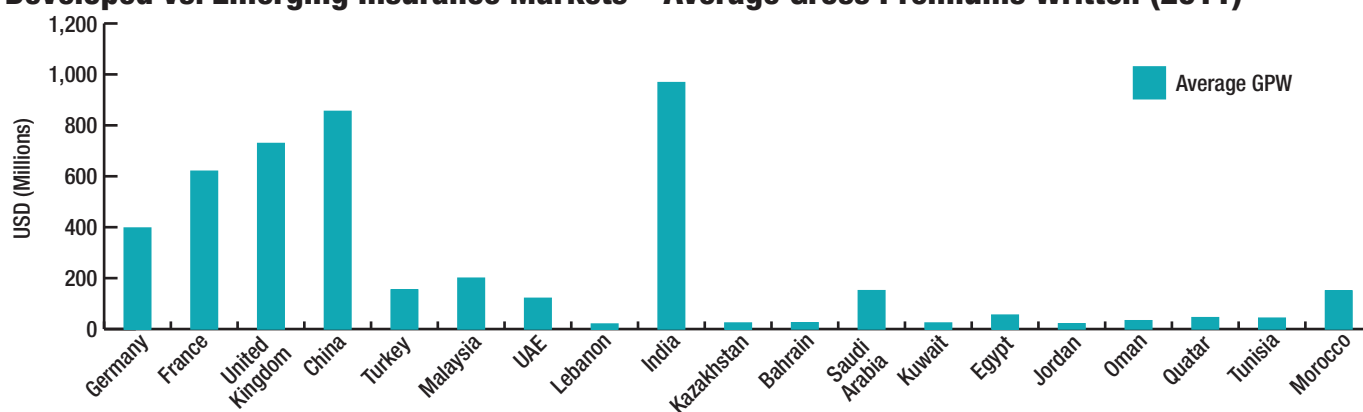
- Extreme optimism of the market's growth potential by many recent new entrants.
- Introduction of several Takaful operators that have failed to significantly increase insurance penetration, as originally anticipated.
- Individual/family owners of several companies who are reluctant to cede control to third parties, especially to acquirers from the same market.
- Lack of supervisory pressure.

Impact of High Number of Insurers

Intense competition among insurers is regarded by some as a positive development because it helps drive down premiums especially for personal lines. The corollary to

Exhibit 2

Developed vs. Emerging Insurance Markets – Average Gross Premiums Written (2011)



Source: A.M. Best research, BestLink – Global Statement File

this is that competition has focused most companies on growth and away from technical profitability of the business. For many years this appeared to be an appropriate strategy as many of MENA's insurance markets were growing at double-digit rates. However, with the growth rate slowing, the viability of some of these companies becomes questionable and the need to focus on the basics, particularly technical profitability, is imperative.

Furthermore, the extreme fragmentation of the market combined with the relative lack of insurance professionals in many of the MENA markets has resulted in few companies having the resources to develop their technical skills and risk systems.

Potential Regulatory Action

In some cases, the regulators have started taking action, mainly by restricting the number of new licenses to the market. This is a positive development, but it does not solve the problem of an already over-fragmented market.

There has been some takeover activity, although the majority of the acquisitions have been between companies from different markets; for example, a European insurer purchasing a local insurer or an acquirer from one MENA market obtaining control of a company in another MENA market. In most cases, the impact of consolidation on the market has been minimal.

If regulators decided to take a more active role in market consolidation, they could start by allowing non-viable entities to enter into run-off and, in some cases, by actively encouraging mergers and acquisitions between competitors. While there might be the will to move in this direction, the current supervisory systems do not assist regulators in identifying which companies have non-viable operations.

3. Develop Risk-Based Supervisory Model

In most cases, regulatory capital requirements are similar to Europe's Solvency I regime, whereby capital requirements are a percentage of premiums and reserves. A few of MENA's national regulators have implemented a version of risk-sensitive models but in many countries, capital requirements are based on a minimum amount.

The majority of insurance regulators depend on simple models that are not risk sensitive and therefore provide inadequate protection to policyholders. In many cases, high initial capital requirements and the expectation that shareholders will ultimately support their companies have acted as greater safety nets for policyholders.

Some regulators have specific provisions for Takaful companies, but these vary significantly from market to market, creating an opportunity for regulatory arbitrage.

Impact of Lack of Risk-Based Capital Requirements

The lack of a risk-based capital (RBC) requirement has meant that companies, by and large, have been relatively free to define their risk appetite. The problem is that in most cases, risk appetite is defined by common practices and, in many cases, by shareholder preferences, rather than as part of a reasoned decision-making process.

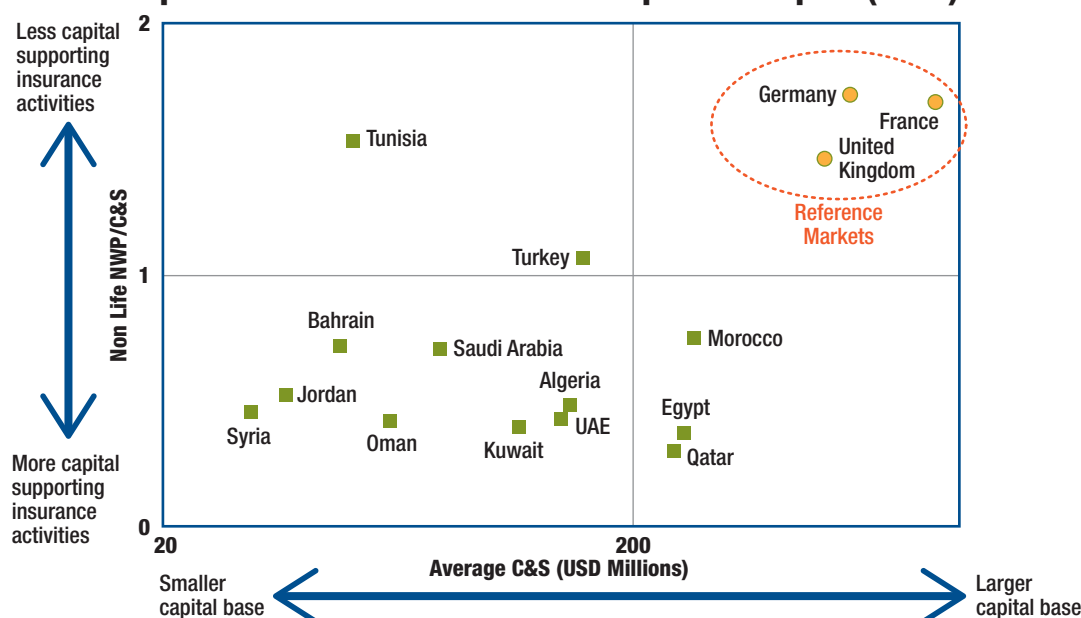
Exhibit 3 shows the absolute amounts of capital for the MENA markets in relation to the insurance risk assumed. For comparison, the relevant comparable amounts are shown for the developed markets of the United Kingdom, France and Germany. As shown in **Exhibit 3**, most of the local markets have companies with relatively small

capital bases (hence they are situated to the left of the horizontal axis). At the same time, they assume relatively low insurance risk as they are on the lower end of the vertical axis.

This, however, does not mean that there is free capital available to support policyholder obligations. **Exhibit 4** shows the relationship between capital and the investment risk assumed by the companies in the MENA markets (compared to the United Kingdom, France and Germany). It is evident that insurance companies in the MENA region have assumed disproportionately high insurance risk. This often is the result of shareholder decisions or pressures, and in several cases, investment decisions have been taken without the involvement of senior management of the insurance company.

Exhibit 3

Developed vs. Emerging Insurance Markets – Relationship Between Insurance Risk and Capital & Surplus (2011)



Source: A.M. Best research, BestLink – Global Statement File

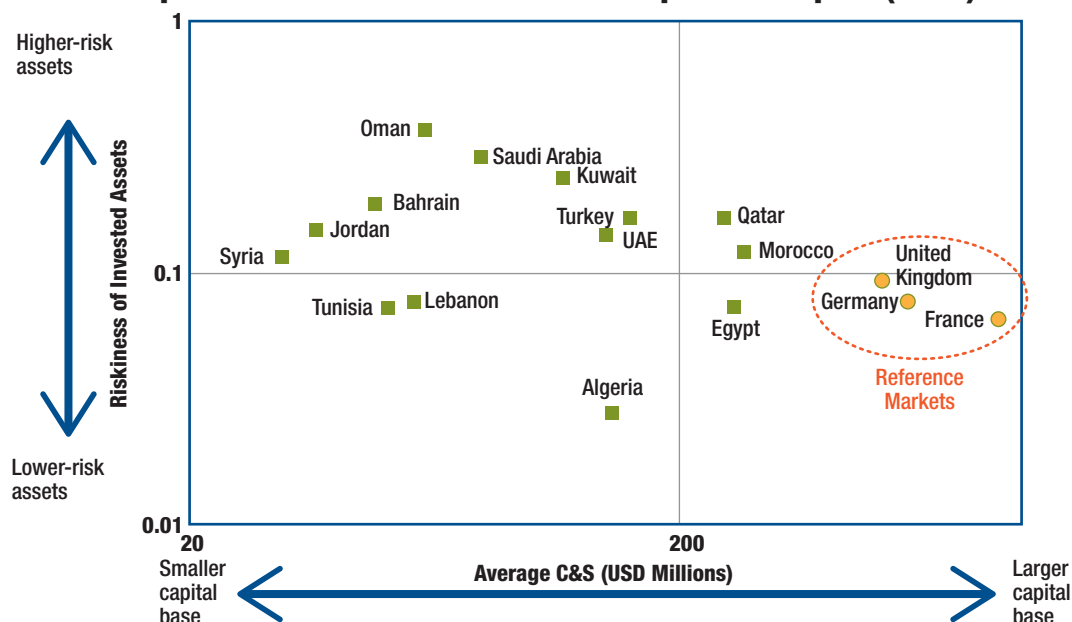
Insurance companies in the region commit a higher proportion of their capital to supporting their investments than to their insurance risks. The lack of RBC models on the part of regulators prevents them from setting realistic capital guidelines for insurers. In some cases, insurers themselves have their own internal capital models but their use is sporadic and such models are never utilised for defining the company's risk appetite and/or company strategy.

For many years, insurers (as well as the overall economy) benefited from very high yields and little volatility, even in the more risky asset classes. However, reduced property values and equity market volatility of recent years have meant that insurers are starting to face the consequences of their investment decisions as their investment losses erode profits and, in many cases, reduce capitalisation. Still, most insurers are showing little inclination to de-risk their investment portfolios at this stage.

Of more concern is that, in some cases, shareholders treat insurers as leveraged investment funds whereby shareholders are the sole decision makers for investment decisions. In such cases, there is little or no reference to the liability profile, and investments are

Exhibit 4

Developed vs. Emerging Insurance Markets – Relationship Between Investment Risk and Capital & Surplus (2011)



Source: A.M. Best research, BestLink® – Global Statement File

chosen based on interests external to the insurance company. While this may benefit some shareholders, it leaves policyholders unduly exposed to investment market volatility.

Potential Regulatory Action

There is an acceptance for the need for regulators to move to a capital requirement regime that will better reflect the risks assumed by the companies. In many cases, the possibility of adopting a Solvency II-style regulation is being discussed. It is unclear if this is being examined as a real option or if it is discussed because it delays adoption of any RBC regime far into the future.

In any case, any regulatory regime to be introduced will have to be easily understandable and adaptable to the characteristics of the local market. With most European regulators and insurers having significant problems with the implementation of Solvency II, it is almost certain that the local markets will struggle to implement it. Even if they were able to implement Solvency II, it would have little impact on the way local insurers are run on a daily basis.

The MENA insurance markets would be better served by a parametric model which, while reflecting the risks assumed by an insurer, is relatively simple to understand and therefore can be utilised for considering significant business decisions and in defining an insurer's risk appetite.

An example of a parametric model is shown in **Exhibit 5** below, where components of Best's Risk Based Capital Model (BCAR) are shown. Based on

Exhibit 5

A.M. Best's Capital Adequacy Ratio (BCAR)

Net Required Capital	Total Adjusted Capital
+ (B1) Fixed-Income Securities	+ Shareholders funds
+ (B2) Equity Securities	+ Positive adjustments. Typically:
+ (B3) Interest Rate	• Discounting of reserves
+ (B4) Credit	• Difference between market and book values
+ (B5) Loss Reserves	• Value of In-Force Business (VIF)
+ (B6) Net Written Premium	• Economic Reserves e.g. Free RfBs
+ (B7) Off Balance Sheet Risks	• Hybrid Equity
- COVARIANCE	- Negative adjustments:
	• Deduction of one cat PML
	• DAC

$$\text{BCAR Score} = \frac{\text{Total Adjusted Capital}}{\text{Net Required Capital}}$$

Source: A.M. Best Company

this (as with all parametric models), the available capital of an insurer can be compared to the risk-adjusted capital requirements. To derive the risk-adjusted capital requirements, the model uses parameters, derived from market experience, which are consistent for all companies in the market.

Regulators, therefore, can decide on the minimum ratio with which they will require companies to comply and can define different levels for:

1. Early intervention and corrective action, and
2. Ultimate action to withdraw the license of a company.

More importantly, most of the information utilised is already available from companies' public documents (mainly reports and accounts). Therefore, it can be easily updated and act as a tool for discussion between regulators and insurers to ensure that insurers do not reach the intervention levels described above.

Finally, there is a need for all regulators to adopt specific Takaful capital requirements. The separation of the Takaful fund from the operator's fund, combined with the lack of permanence of the Qard' Hasan means that regulators need to identify what surplus they expect to be built up within a Takaful fund and under which time frame (in the case of new Takaful companies). This is imperative when considering the lack of clarity as to the prevailing law in case of a wind-up of a Takaful company (temporal law versus Shari'a law) and the fact that there seems to be no seniority of policyholder liabilities under Shari'a law.

4. Consistent and Timely Information to be Provided to Regulators

In most cases, regulators require insurers to provide annual information. As expected, the amount and quality of detailed information varies significantly from market to market and between companies operating within the same market.

Annual-only reporting, however, does not provide adequate warning to regulators or to the management of the companies in the case of adverse financial developments. It also provides an uneven playing field, whereby some companies report only annually, whereas their publicly-listed competitors are required by the authorities regulating the local stock exchanges to report on a quarterly basis.

Frequently, the reporting levels lack granularity, making it difficult for regulators to identify potential problem areas at an early stage. There is empirical evidence to support this in the form of Takaful operators who have committed almost 50% of their capital as a Qard' Hasan and insurers that operate with capital below what the regulators deem necessary.

Potential Regulatory Action

There is a need for a robust system under which insurers provide information to regulators at least on a quarterly basis. This information should be detailed enough to provide regulators with early warnings so that they can request corrective actions. The data also should be sufficient for regulators to evaluate the capital adequacy of the companies.

More detailed information – including business plans, risk appetite and the strategy of the company – should be provided to, and reviewed by, regulators on an annual basis. Indeed, these are some of the basic requirements under Solvency II which, as noted, has been discussed as the alternative to the current regimes.

Imperatives Going Forward

While there have been changes in the regulatory systems in the MENA region, many regulators have found it difficult to keep pace with the developments in their insurance market.

For years, the high growth rates of the MENA economies and insurance markets, combined with very strong investment results, resulted in insurers posting very good results, and the need for regulatory intervention was reduced.

This is no longer the case as the economies and most of the insurance markets are slowing down, while investment yields have decreased.

Regulators, acting as the protectors of policyholder interests, need to adapt to the new market conditions. The introduction of RBC regimes and the establishment of stringent data requirements will be imperative for their ability to evaluate the viability of insurance operations and take corrective actions.

These can also provide valuable input on regulators' potential considerations to increase aggregate retention levels and/or reduce the number of insurers operating in their market.

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SR-2012-413

Trend Review
August 20, 2012

**Risk-Adjusted
Capitalisation
Of Rated
Entities Is
Sound, on
Current and
Prospective
Bases.**

Jordan's A.M. Best-Rated Insurers Remain Well-Capitalised

In response to the licence suspensions of three local companies, A.M. Best Co. has confirmed its opinion of the capital positions of the five A.M. Best-rated entities in Jordan. Over the past 18 months, the Insurance Commission of Jordan (ICJ) suspended, and has since reinstated, the licences of three local insurers – Arab German Insurance Co., Barakah Takaful Co. and Arab Jordanian Insurance Group Co. – none of which are rated by A.M. Best. The decision to revoke the licences was prompted by the respective breaches in the ICJ's minimum solvency ratios. A.M. Best understands that the ICJ is now working with these companies and monitoring compliance with companies' respective plans to rectify the regulatory capital deficiencies.

Of the companies affected, Arab German Insurance Co. had enjoyed a particularly sound franchise in Jordan, ranking as the third largest insurer in terms of gross premiums written (GPW) in 2010. The fact that a company of Arab German's stature fell below minimum solvency requirements and could not rectify the situation to prevent action by the regulator has raised concerns among the local market.

Capital strength, as measured by local regulators such as the ICJ, is not deemed a key driver by A.M. Best in its assessment of capitalisation. However, some consideration must be made in order to assess the likelihood of business interruption through licence revocation, as occurred recently with the aforementioned companies.

In A.M. Best's opinion, Jordanian insurers remain unsophisticated in their management of capital and rely largely on compliance with local requirements. Of the five A.M. Best-rated companies in Jordan, only Arab Orient has an internal capital model reflecting the company's membership within the Gulf Insurance Co. group.

A.M. Best considers Jordanian regulatory capital requirements to be fairly basic though broadly in line with regional standards. Companies licensed before 2005 are required to hold minimum capital of JOD 4 million (or JOD 8 million for a composite). However, as stipulated in Regulation No. 73 (2005), the minimum capital requirements for new companies as of 2005, are as follows:

- General insurers – JOD 25 million;
- Life insurers – JOD 25 million;
- Reinsurers – JOD 100 million.

In addition, companies are subject to the ICJ's solvency margin instructions. Instruction No.3 (2002) requires all Jordanian insurers to maintain a ratio of net assets to required capital of no less than 150%. Required capital is apportioned to four risk categories, namely; asset risks, policy liabilities, reinsurance-ceded risks and life assurance risks. Despite the simplicity of risk charges and the absence of any charge on Jordanian government debt, A.M. Best believes that the fairly high minimum solvency ratio of 150% is likely to provide a fair level of policyholder protection. However, A.M. Best is aware of local market concerns that insurance companies have been permitted to

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operate below the minimum solvency margins for prolonged periods, with little apparent effort made to rectify the situation by the parties involved. Such claims remain difficult to substantiate given the relative opaqueness of the ICJ, which makes only limited information public. Therefore, whilst A.M. Best recognises the solid fundamentals of Jordan's insurance regulatory framework, there is less clarity with regards to other equally important components of regulation such as monitoring, enforcement and actions.

As outlined below, all A.M. Best-rated insurers in Jordan remain comfortably above the minimum regulatory solvency margin of 150%, whilst most insurers are considerably above the requirement (see **Exhibit 1**).

Exhibit 1

AMB-Rated Jordanian Companies – Regulatory Solvency Margins

(Year-End 2011 – First Quarter 2012)

	Arab Orient Insurance Co.	Jordan Insurance Co.	Middle East Insurance Co.	First Insurance Co.	General Arabia Insurance Co.
31/12/2011	183%	251%	396%	749%	218%
31/3/2012	184%	261%	394%	487%	251%

Source: A. M. Best research

A. M. Best's Risk-Adjusted Capitalisation Assessment

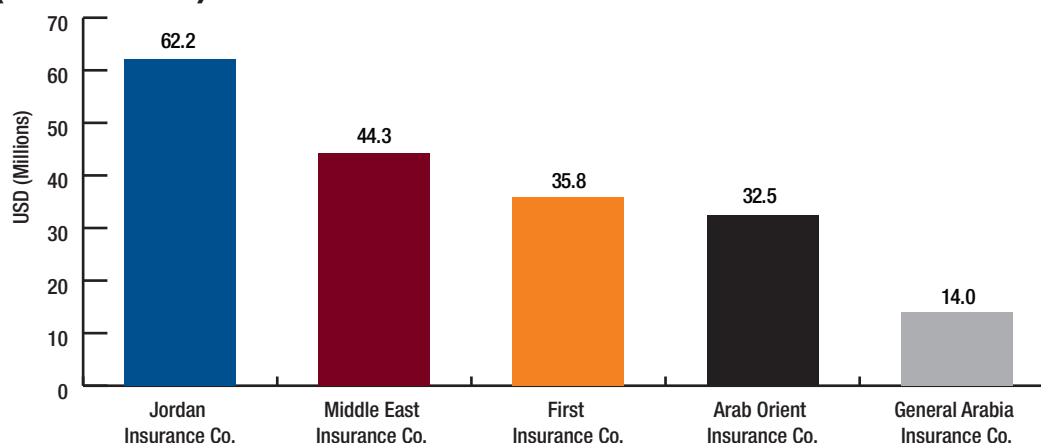
A.M. Best assesses insurers' and reinsurers' risk-adjusted capitalisation through its proprietary Best Capital Adequacy Ratio (BCAR) model. (For further information see *Understanding Universal BCAR* at www.ambest.com / Ratings & Criteria / Methodology/ Universal Criteria Reports.) The perceived strength of a company's risk-adjusted capitalisation is a key rating driver, and a sound BCAR score underpins the vast majority of secure stand-alone credit ratings.

In A.M. Best's opinion, the BCAR model is likely to provide a more prudential assessment of current risk-adjusted capitalisation than local regulatory requirements. A.M. Best's BCAR model also generates prospective capital-adequacy scores based on in-house projections and the market conditions under which a company operates. The model considers a number of critical factors, including: underwriting risk, asset (investment and interest rate) risk, credit and any off-balance sheet exposures. The model is further calibrated to apply higher-risk charges for excessive growth, in addition to assessing the robustness of the company's capital base relative to catastrophe and investment shocks. Therefore, A.M. Best believes that its internal assessment is more likely to provide an early signal of capital deterioration.

Jordanian insurers are very small by international standards. The largest by book equity is Jordan Insurance Co. (JIC) whose total capital and surplus stood at JOD 44.3 million, equivalent to USD 62 million at year-end 2011 (see **Exhibit 2**). Nevertheless, those Jordanian insurers rated by A.M. Best have a good-to-excellent level of capitalisation on a risk-adjusted basis, benefitting from the low underwriting risks, resulting from low premium retention and high reinsurance dependence on commercial lines. Furthermore, whilst the reliance on reinsurance creates higher credit risk charges for Jordanian insurers, this is largely mitigated by the generally sound credit standing of respective reinsurance panels.

Regarding invested assets, A.M. Best observes a range of different investment strategies, from the highly conservative, focused on cash and term deposits, to those with high

Exhibit 2

**AMB-Rated Jordanian Companies – Total Capital and Surplus
(Year-End 2011)**

Source: A. M. Best research

exposure to real estate and equity. Given that local regulation limits foreign currency investments largely to what is needed to match foreign currency insurance liabilities, some companies have used real estate and equity as an indirect hedge against depreciation of the Jordanian dinar. A.M. Best has previously highlighted such investment strategies as risky; something borne out by the volatility in capitalisation and operating performance of those companies engaging in these strategies. However, while A.M. Best maintains its view, all Best-rated companies are considered to have sufficient capital to absorb most conceivable stock and real estate market scenarios.

The risk-adjusted capital of all insurers is subjected to catastrophe stress tests as standard within A.M. Best's BCAR model. Again, the low retention on commercial lines reduces the net retained underwriting risk, although such a scenario implies a significant increase in credit risk through higher receivables from reinsurers.

Insurers' own catastrophe assessments and probable maximum loss (PML) calculations remain unsophisticated throughout the country and indeed the region. Earthquake is the main catastrophe exposure in Jordan. All companies calculate their PML using a percentage of the aggregate sum insured of policies subject to natural perils, which is based on advice by leading international reinsurers. In A.M. Best's opinion, some conservatism is factored into the companies' assumptions used to purchase reinsurance protection. Going forward as the market develops, A.M. Best expects some companies to increase their retention of commercial risks, therefore increasing the need to effectively manage accumulation and concentration risks in order to ensure that companies' capital bases remain robust under stressed conditions.

Prospectively, A.M. Best expects risk-adjusted capitalisation of its rated Jordanian insurers to remain sound. Whilst the Jordanian insurance market has suffered mixed fortunes, A.M. Best-rated companies have generally performed above par. In A.M. Best's opinion, most rated companies have sufficient capital to support even the most ambitious growth strategies given their relatively underutilised capital bases, and for most companies, a good ability to generate profits. However, whilst companies continue to generate sound technical profits, A.M. Best notes that these profits rely heavily on inward commissions from reinsurers. Going forward, profits on certain business lines could potentially come under pressure should insurers fail to improve the performance of ceded business.

Exhibit 3

AMB-Rated Jordanian Companies – Overview

	Arab Orient Insurance Co.	Jordan Insurance Co.	Middle East Insurance Co.	First Insurance Co.	General Arabia Insurance Co.
Issuer Credit Rating*	bbb+	bbb+	bbb	bbb	bbb-
Financial Strength Rating*	B++	B++	B++	B++	B+
Outlook	Stable	Stable	Stable	Stable	Stable
External Support Uplift	Includes uplift due to implicit parental support.	N/A	N/A	N/A	Includes uplift due to implicit parental support.
Total Book Capital and Surplus YE 2011 (JOD Millions)	23.1	44.3	31.5	25.4	10.0
A.M. Best Opinion of Risk-Adjusted Capitalisation	Good	Strong	Strong	Excellent	Strong
Trend	Declining in recent years due to rapid growth, though signs of stabilisation in 2011.	Volatile due to the company's exposure to equity and real estate investments, though fair value movements easily absorbed.	Volatile due to the company's exposure to equity and real estate investments, though fair value movements easily absorbed.	Declining from a high base given its incorporation in 2007, post minimum capital requirements implemented in 2005.	Declining as a result of premium growth and greater retention of non-life business. Some volatility due to the company's exposure to equity and real estate investments, though fair value movements easily absorbed.
Internal Capital Generation Ability	Very good track record of profitability. Return on equity has been good and stable in recent years whilst profit retention has been excellent (mostly fully retained).	Good track record of profitability though levels remain modest due to high capital base. Low level of profit retention in recent years with dividends often in excess of net income.	Good track record of profitability though levels remain modest due to high capital base. Sound track record of full profit retention prior to 2011.	Generating profits though track record is limited due to start-up status. Mixed profit retention experience reflects over-capitalisation.	Return on equity is weak, whilst dividends have exceeded net income in recent years.
Underwriting Risks	Increasing underwriting leverage has driven higher underwriting risks, though somewhat mitigated by the low risk retention.	Low due to modest risk retention.	Low due to modest risk retention.	Low due to modest risk retention.	Low due to modest risk retention.
Credit Risk	Low credit risk associated with reinsurance panel.	Low credit risk associated with reinsurance panel.	Low credit risk associated with reinsurance panel.	Low credit risk associated with reinsurance panel.	Higher credit risk assumed due to the material portion (c.25%) of non-rated entities on the company's reinsurance panel.
Investment Risk	Low investment risk due to conservative investment strategy.	Fairly high investment risk due to focus on equity and real estate investments.	Fairly high investment risk due to focus on equity and real estate investments.	Low investment risk due to conservative investment strategy.	Fairly high investment risk due to focus on equity and real estate investments.
Internal Capital Modelling Capability	Provided by group	No	No	No	No

* Ratings as of 6/20/12.

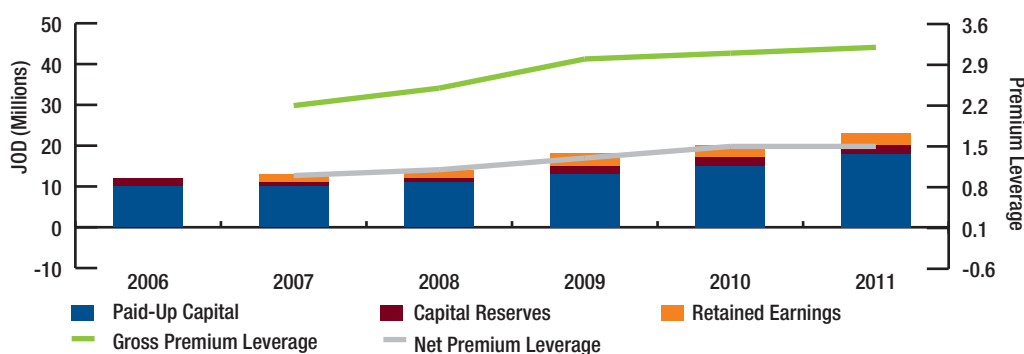
Source:  BestLink® – Global Statement File and A. M. Best research.

Arab Orient Insurance Co.

Despite being incorporated just 15 years ago, Arab Orient's aggressive growth strategy has propelled it to its leading position by GWP. The company has achieved this by focusing on the rapidly expanding health insurance market where it now ranks as the dominant firm. Arab Orient's growth has far outpaced that of the market, therefore attracting a higher "growth factor" charge in A.M. Best's BCAR model, which has driven a continued deterioration in risk-adjusted capitalisation prior to 2011. However, in A.M. Best's opinion, Arab Orient maintains a good level of risk-adjusted capitalisation, noting that the company showed some improvement in its BCAR score in 2011.

Exhibit 4

Arab Orient Insurance Co. – Key Financial Data (2006-2011)

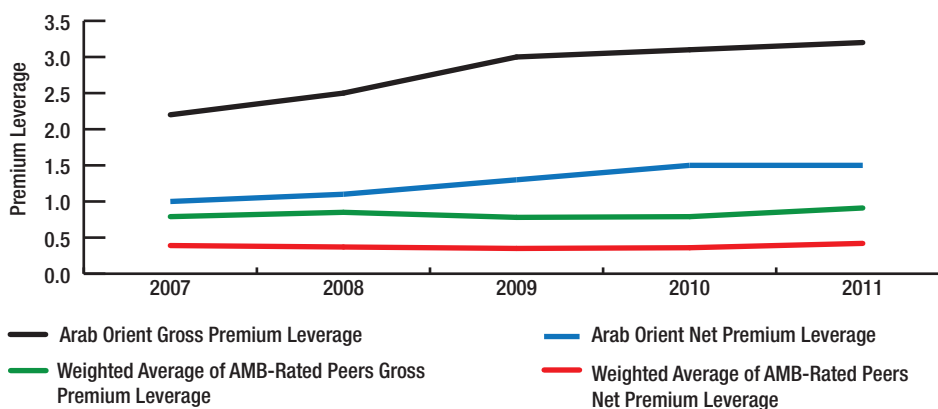


Source: A. M. Best research

Although the company has a very good track record of profit generation and an excellent profit-retention policy – which has generated stable year-on-year growth in capital and surplus – the rate of premium growth has heightened premium leverage. Net premium leverage – which is a good approximation of underwriting risks, assuming a flat capital charge across products – was approximately 1.5x in 2011, whilst gross premium leverage reached 3.2x (see **Exhibit 4**). Such levels are well above the average amongst A.M. Best-rated entities, however, A.M. Best believes this reflects a more efficient use of capital by Arab Orient compared to that of its peers, which tend to underutilise their capital bases. Furthermore, whilst A.M. Best considers Arab Orient's premium leverage as high (see **Exhibit 5**),

Exhibit 5

Arab Orient vs. AMB-Rated Jordanian Peers – Premium Leverage (2007- 2011)



Source: A. M. Best research

it remains manageable and must be viewed in conjunction with the company's other risks such as investment and credit risks – which are fairly modest due to the company's conservative investment strategy and the support it receives from a highly rated panel of reinsurers.

Going forward, management expects a slowing of growth which will continue to ease pressure on the company's BCAR score. Furthermore, A.M. Best takes comfort in Gulf Insurance Co. K.S.C.'s (GIC) involvement in Arab Orient's capital management and overall risk management. GIC has centralised the group's capital management and continually monitors the risk-adjusted capital position of Arab Orient through its internal economic capital model.

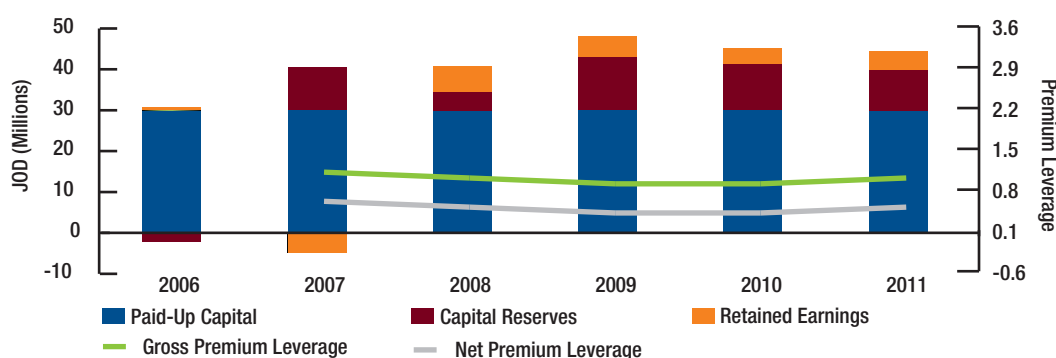
Jordan Insurance Co. Plc

In A.M. Best's opinion, JIC's risk-adjusted capitalisation remains strong, on both a current and prospective basis, with sufficient room to absorb any conceivable growth in premiums over the next two years. Total capital and surplus fell 2.2% to JOD 44.3 million at year-end 2011 following a decrease in the company's investment reserves. A.M. Best believes JIC's investment strategy exposes the company's equity to a greater fluctuation than that of some of its peers, as is apparent in the volatility in its retained earnings and capital reserves – predominantly in investment reserves – (see **Exhibit 6**). However, A.M. Best considers the company's capital position to be amply strong to absorb any potential shocks, and notes that the company benefits from material hidden reserves in its real estate portfolio, which is held at cost. Furthermore, the company remains fairly unleveraged in respect of underwriting risks, and benefits from a strong panel of reinsurers.

Going forward, A.M. Best expects the company to continue to generate profits underpinned by sound technical earnings. JIC has typically paid dividends equal to 12% - 15% of its paid-up capital – which in the past three years has led to dividends being paid in excess of net income. However, in light of JIC's capital strength, A.M. Best does not believe such a dividend policy poses any risk in the medium term.

Exhibit 6

Jordan Insurance Co. – Key Financial Data (2006-2011)

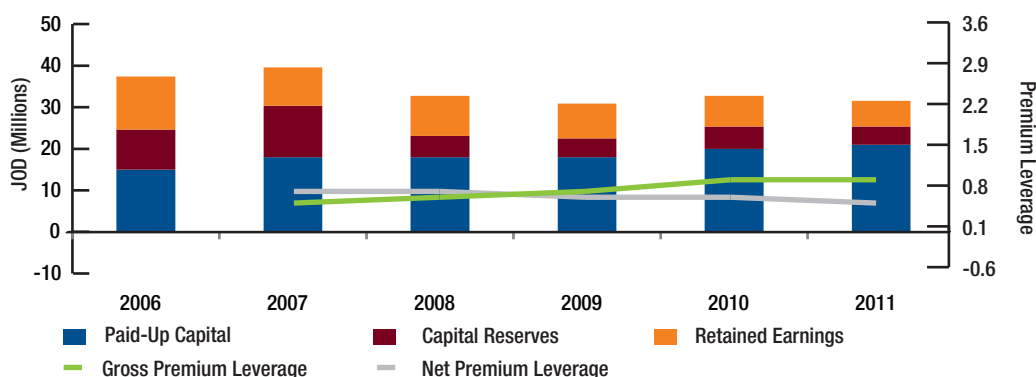


Middle East Insurance Co. Plc

Similar to JIC, Middle East Insurance Co. Plc (MEICO) has a high exposure to risky asset classes though MEICO's investment portfolio is more skewed toward real estate investments rather than equities. Such investments have been the source of volatility in the company's capital base in recent years (see **Exhibit 7**).

Exhibit 7

Middle East Insurance Co. – Key Financial Data (2006-2011)



Source: A. M. Best research

The company's somewhat risky investment strategy is the key driver of MEICO's capital consumption and is likely to remain so moving forward, particularly given the relatively low level of business retention and modest credit risk associated with the company's reinsurance programmes.

However, in A.M. Best's opinion, the company's current and prospective risk-adjusted capitalisation remains strong with sufficient room for growth or to withstand most perceivable shocks to the Jordanian real estate and equity markets. Furthermore, the company has substantial hidden reserves in its property portfolio which further bolsters MEICO's capital base.

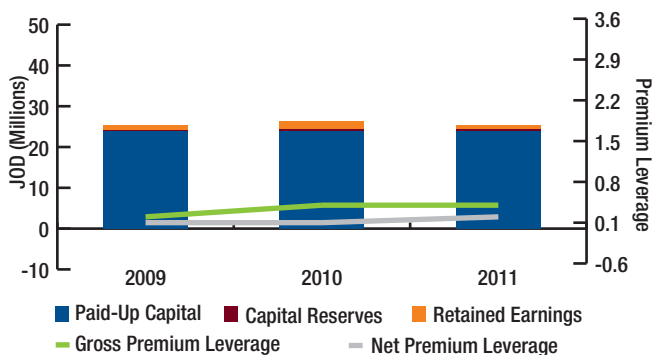
First Insurance Co.

As a result of improved takaful regulation in Jordan, A.M. Best is confident that there is sufficient regulatory oversight to ensure policyholder protection and that the obligatory Qard Hasan is provided where needed. Furthermore, policyholders are likely to have a legal basis for any claims on shareholders' capital located in the shareholders' fund. As such, A.M. Best views the company's capital on a consolidated basis (shareholders' and policyholders' accounts). For further information, see *Rating Takaful (Shari'a Compliant) Insurance Companies* at www.ambest.com / Ratings & Criteria / Methodology/ Specialty Insurers Criteria Reports.

In A.M. Best's opinion, FIC's level of risk-adjusted capitalisation is excellent. The company's capital position is a product of its post-Regulation No.73 (2005) incorporation and the modest level of risks assumed in the three years it has been operating. The company has a low level of business leverage (see **Exhibit 8**), a reinsurance programme of good credit quality and a conservative investment portfolio. In 2011, FIC wrote gross premiums of JOD 15 million,

Exhibit 8

First Insurance Co. – Key Financial Data (2009-2011)



Source: A.M. Best research

with net premiums of JOD 6 million against a capital base of JOD 25 million. As the company grows its premium base and accepts new risks, FIC's level of risk-adjusted capitalisation will be reduced, but it is likely to remain strong in the short-to-medium term.

FIC's capital base is not expected to grow in the medium term given the company's already strong level of capitalisation. Dividend payments equal to annual profits, therefore, can be expected in the coming years. Although A.M. Best expects surpluses to be distributed from the Takaful fund over the medium term, the mechanism for this has not been finalised and a small accumulated surplus is expected to develop in the policyholders' fund.

General Arabia Insurance Co.

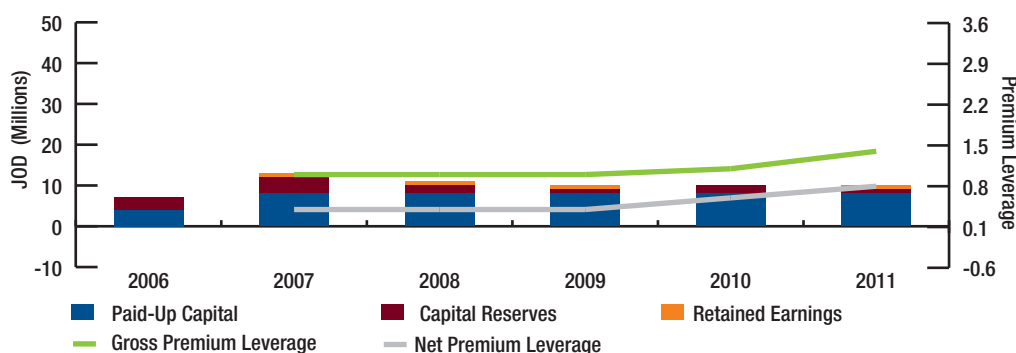
In A.M. Best's opinion, risk-adjusted capitalization for General Arabia Insurance Co. (GAIC) remains strong despite deteriorating in recent years as a result of increasing business volumes and greater risk retention in the company's non-life business. Furthermore, in 2010, 2008 and 2006, the company paid dividends in excess of net income. However, A.M. Best notes that no dividends were paid in 2011.

GAIC's underwriting leverage is modest, however in A.M. Best's opinion, the company's reinsurance programme is a source of higher-than-average credit risk given that 25% of reinsurance recoverables relate to non-rated companies which receive a 100% charge in the BCAR model.

In A.M. Best's opinion, GAIC runs fairly high investment risks given the company's exposure to equities and, to a lesser extent, real estate investments – almost 50% of investments combined. A.M. Best believes that the company's investment strategy is a potential source of volatility going forward. However, given GAIC's currently strong risk-adjusted capital position, the company is expected to be able to absorb any unforeseen shocks. In A.M. Best's opinion, GAIC's risk-adjusted capital position is likely to weaken further in the next two years as a result of further growth. However, management is expected to maintain at least a good level of capitalisation.

Exhibit 9

General Arabia Insurance Co. – Key Financial Data (2006-2011)



Source: A. M. Best research

Appendix

AMB-Rated Jordanian Companies – Financial Indicators (2006-2011)

Arab Orient Insurance Co.

(JOD Millions)	2011	Yr/Yr Chg	2010	Yr/Yr Chg	2009	Yr/Yr Chg	2008	Yr/Yr Chg	2007	Yr/Yr Chg	2006
Total Capital and Surplus	JOD 23.1	15.8%	JOD 20.0	17.5%	JOD 17.0	17.6%	JOD 14.4	14.7%	JOD 12.6	4.4%	JOD 12.1
Paid-Up Capital	17.5	16.7	15.0	16.7	12.9	16.8	11.0	10.0	10.0	0.0	10.0
Reserves	2.3	25.8	1.9	21.4	1.5	38.7	1.1	14.0	1.0	-45.7	1.8
Retained Earnings	3.3	5.7	3.1	19.0	2.6	11.2	2.3	43.7	1.6	469.2	0.3
Gross Written Premiums	69.6	23.1	56.6	21.0	46.7	39.8	33.4	24.7	26.8	21.1	22.1
Net Written Premiums	32.2	13.6	28.4	39.9	20.3	33.6	15.2	19.1	12.7	25.4	10.2
Net Technical Reserves	23.0	15.8	19.9	46.9	13.5	25.3	10.8	24.6	8.7	13.3	7.7
Gross Premium Leverage	3.2	-	3.1	-	3.0	-	2.5	-	2.2	-	-
Net Premium Leverage	1.5	-	1.5	-	1.3	-	1.1	-	1.0	-	-
Net Reserve Leverage	0.5	-	0.4	-	0.3	-	0.3	-	0.3	-	-

Jordan Insurance Co.

(JOD Millions)	2011	Yr/Yr Chg	2010	Yr/Yr Chg	2009	Yr/Yr Chg	2008	Yr/Yr Chg	2007	Yr/Yr Chg	2006
Total Capital and Surplus	JOD 44.3	-2.2%	JOD 45.3	-5.9%	JOD 48.1	18.5%	JOD 40.6	13.9%	JOD 35.7	25.2%	JOD 28.5
Paid-Up Capital	30.0	0.0	30.0	0.0	30.0	0.0	30.0	0.0	30.0	0.0	30.0
Reserves	9.8	-14.3	11.4	-13.0	13.2	192.5	4.5	-56.9	10.4	-582.8	-2.2
Retained Earnings	4.5	16.1	3.9	-22.5	5.0	-18.7	6.1	-229.6	-4.7	-816.8	0.7
Gross Written Premiums	46.8	8.1	43.3	7.1	40.5	4.3	38.8	13.3	34.2	23.8	27.7
Net Written Premiums	23.1	11.1	20.8	7.0	19.4	5.8	18.3	-2.2	18.8	24.1	15.1
Net Technical Reserves	17.8	10.8	16.1	11.6	14.4	3.4	13.9	-4.7	14.6	19.1	12.3
Gross Premium Leverage	1.0	-	0.9	-	0.9	-	1.0	-	1.1	-	-
Net Premium Leverage	0.5	-	0.4	-	0.4	-	0.5	-	0.6	-	-
Net Reserve Leverage	0.4	-	0.3	-	0.3	-	0.4	-	0.5	-	-

First Insurance Co.

(JOD Millions)	2011	Yr/Yr Chg	2010	Yr/Yr Chg	2009
Total Capital and Surplus	JOD 25.4	-3.4%	JOD 26.4	4.1%	JOD 25.3
Paid-Up Capital	24.0	0.0	24.0	0.0	24.0
Reserves	0.4	49.0	0.3	248.6	0.1
Retained Earnings	1.1	-49.1	2.1	70.1	1.2
Gross Written Premiums	11.7	27.6	9.1	194.6	3.1
Net Written premiums	4.3	46.4	3.0	117.3	1.4
Net Technical Reserves	1.9	32.3	1.5	64.3	0.9
Gross Premium Leverage	0.4	-	0.4	-	0.2
Net Premium Leverage	0.2	-	0.1	-	0.1
Net Reserve Leverage	0.1	-	0.1	-	0.1

Middle East Insurance Co.

(JOD Millions)	2011	Yr/Yr Chg	2010	Yr/Yr Chg	2009	Yr/Yr Chg	2008	Yr/Yr %Chg	2007	Yr/Yr %Chg	2006
Total Capital and Surplus	JOD 31.5	-3.7%	JOD 32.8	6.2%	JOD 30.9	-5.8%	JOD 32.8	-17.3%	JOD 39.6	5.9%	JOD 37.4
Paid-Up Capital	21.0	5.0	20.0	11.1	18.0	0.0	18.0	0.0	18.0	20.0	15.0
Reserves	4.3	-19.5	5.4	18.8	4.5	-11.4	5.1	-58.5	12.3	28.3	9.6
Retained Earnings	6.2	-15.8	7.4	-11.4	8.3	-13.7	9.6	4.0	9.3	-27.4	12.8
Gross Written Premiums	29.7	9.8	27.0	14.3	23.7	6.4	22.2	16.0	19.2	9.7	17.5
Net Written Premiums	11.7	1.5	11.5	14.8	10.1	8.6	9.3	9.3	8.5	14.9	7.4
Net Technical Reserves	12.0	6.0	11.3	14.4	9.9	5.8	9.3	4.3	8.9	4.9	8.5
Gross Premium Leverage	0.9	-	0.9	-	0.7	-	0.6	-	0.5	-	-
Net Premium Leverage	0.5	-	0.6	-	0.6	-	0.7	-	0.7	-	-
Net Reserve Leverage	0.6	-	0.6	-	0.6	-	0.7	-	0.7	-	-

Appendix

AMB-Rated Jordanian Companies – Financial Indicators (continued)

(2006-2011)

General Arabia Insurance Co.

(JOD Millions)	2011	Yr/Yr Chg	2010	Yr/Yr Chg	2009	Yr/Yr Chg	2008	Yr/Yr Chg	2007	Yr/Yr %Chg	2006
Total Capital and Surplus	JOD 10.0	-1.9%	JOD 10.1	0.0%	JOD 10.1	-3.9%	JOD 10.6	-15.2%	JOD 12.5	71.1%	JOD 7.3
Paid Up capital	8.0	0.0	8.0	0.0	8.0	0.0	8.0	3.6	7.7	93.1	4.0
Reserves	1.3	-24.3	1.7	18.2	1.4	-22.9	1.8	-49.8	3.7	22.9	3.0
Retained Earnings	0.7	46.4	0.5	-35.5	0.7	1.0	0.7	-32.2	1.1	256.7	0.3
Gross Written premiums	14.0	23.7	11.3	10.4	10.3	10.4	11.8	19.8	9.9	26.1	7.8
Net Written premiums	7.7	34.9	5.7	32.3	4.3	32.3	4.3	6.5	4.0	22.3	3.3
Net Technical Reserves	6.9	29.3	5.3	20.2	4.4	20.2	4.1	-0.3	4.1	8.0	3.8
Gross Premium Leverage	1.4	-	1.1	-	1.0	-	1.0	-	1.0	-	-
Net Premium Leverage	0.8	-	0.6	-	0.4	-	0.4	-	0.4	-	-
Net Reserve Leverage	0.7	-	0.5	-	0.4	-	0.4	-	0.4	-	-

Source:  **BestLink** – Global Statement File

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SR-2012-382

Market Review
March 12, 2012

Sound Economy To Boost Insurance Demand.

Saudi Arabia's Insurance Market Adapts to Dramatic Change

The insurance market in Saudi Arabia has changed dramatically in the past decade, with further development anticipated in the next few years.

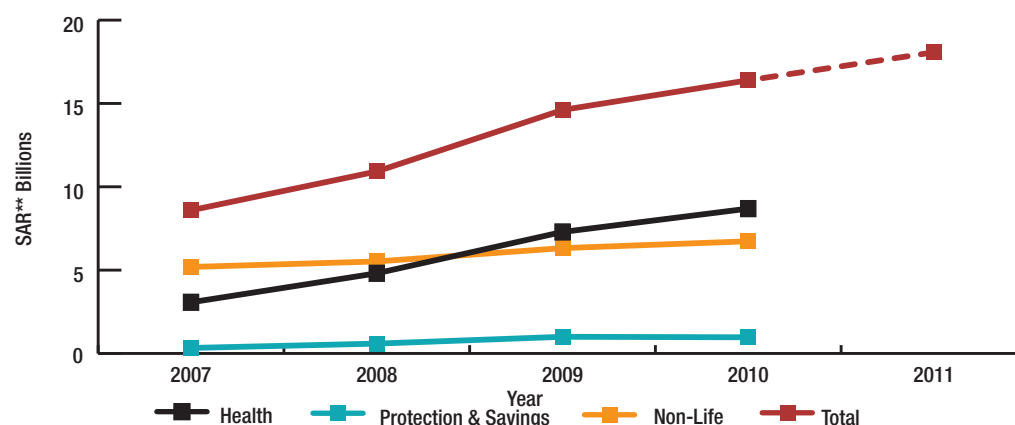
Since the Saudi Arabian Monetary Agency (SAMA) began regulating the sector in 2003, there have been significant advancements to the regulatory environment, in particular structural changes to insurers. Companies were required to become majority Saudi-owned and have needed to move onshore to the Kingdom. Strong premium growth has been another key characteristic of the insurance sector in recent years, as the market has benefited from economic development and the introduction of compulsory lines of business (see **Exhibit 1**).

A.M. Best notes:

- Insurance penetration in Saudi Arabia is low but has grown rapidly in the past few years. A.M. Best believes the country's economic outlook is sound, supporting an increased demand for insurance. The country was mildly affected by the Arab Spring, but whilst political concerns were somewhat heightened, stability was maintained.
- The introduction of compulsory health schemes, which began with expatriates from 2006, has been a major driver of growth in recent years. Health represented 53% of gross written premiums in 2010. The majority of business retained by Saudi insurers is retail, in particular, motor and medical.
- The majority of insurers were loss-making in 2011, although larger players tended to generate profits. In the short to medium term, persistent low rates as a result of intense competition and the zakat burden faced by companies are likely to continue to create a difficult operating environment and pose a risk to shareholders' equity, particularly for the industry's

Exhibit 1

Saudi Arabia – Gross Premiums Written (2007-2011E*)



*E = Estimate based on data filed by insurers on the Tadawul stock exchange, February 2012.

**SAR = Saudi Arabian riyals

Source: Saudi Arabian Monetary Agency, The Saudi Insurance Market Report 2010

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smaller insurers. A.M. Best considers the environment conducive for consolidation. In the long term, Saudi Arabia's market appears to have considerable potential.

- Risk profiles for insurers are generally modest. Despite widespread loss-making and deteriorating capitalisation, capital levels are broadly considered to be good as a result of the low premium leverage, limited retention of insurance risks, highly conservative investment strategies and low credit risk associated with companies' panels of international reinsurers.

- A.M. Best considers SAMA to be one of the more rigorous insurance regulators in the Middle East. Whilst there have been some concerns regarding the regulator's efficiency, SAMA remains well respected locally and appears to supervise insurers effectively.

Economic Outlook Supportive of Further Insurance Growth

Saudi Arabia's economy stagnated in 2009, but a rebound in oil prices has helped spur a recovery, funding large amounts of public spending on development programmes. These include projects to modernise infrastructure and improve water and electricity facilities. Saudi Arabia is the world's largest exporter of petroleum, with oil-export revenues accounting for almost half of gross domestic product (GDP).

In 2011, GDP was estimated to have grown by 6.5%, and whilst growth is expected to slow, the International Monetary Fund (IMF) has forecasted expansion of 3.6% in 2012. Combined with improving insurance penetration rates, this will support further demand for insurance.

The Arab Spring of 2011 amplified political uncertainty in much of the Middle East and North Africa region, including in Saudi Arabia, and caused a drop in investors' confidence. A.M. Best places companies into five categories based on the risk presented by their country of domicile, ranging from the lowest risk, "CRT-1" (Country Risk Tier 1), to "CRT-5" (Country Risk Tier 5) for countries considered to face the highest economic

Exhibit 2

Saudi Arabia – Key Facts

	2007	2008	2009	2010	2011
Population ¹ (Millions)	24.9	25.8	26.7	27.6	28.2
Gross Domestic Product ¹ (SAR ² Billions)	802.2	836.1	836.9	871.6	928.0
Change in GDP ¹ (%)	2.0	4.2	0.1	4.1	6.5
Insurance Penetration (Health)	0.4%	0.6%	0.9%	1.0%	n/a
Insurance Penetration (Protection & Savings)	0.0%	0.1%	0.1%	0.1%	n/a
Insurance Penetration (Non-Life)	0.6%	0.7%	0.8%	0.8%	n/a
Insurance Penetration (Total)	1.1%	1.3%	1.7%	1.9%	2.0% ³
Insurance Density (Total) (SAR)	344.5	423.5	547.8	594.5	641.5
Insurance Premium (Health) (SAR Billions)	3.1	4.8	7.3	8.7	n/a
Insurance Premium (Protection & Savings) (SAR Billions)	0.3	0.6	1.0	1.0	n/a
Insurance Premium (Non-Life) (SAR Billions)	5.2	5.5	6.3	6.7	n/a
Insurance Premium (Total) (SAR Billions)	8.6	10.9	14.6	16.4	18.1 ³
Change in Premium Volume (Total)	23.8%	27.1%	33.7%	12.2%	10.0% ³

Notes:

1 Estimates start after 2009.

2 SAR = Saudi Arabian riyals

3 Based on data filed by insurers on the Tadawul stock exchange, February 2012.

Sources: International Monetary Fund, World Economic Outlook Database, September 2011; Saudi Arabian Monetary Agency, The Saudi Insurance Market Report 2010

and political risks. Saudi Arabia is a CRT-3 country, in line with all other countries in the Gulf Cooperation Council (GCC). A.M. Best currently rates no emerging market country higher than CRT-3.

Premium as a percentage of GDP is low in Saudi Arabia compared with other markets in the region. **Exhibit 2** shows, based on annual data from SAMA and GDP estimates from the IMF in 2010, that total insurance penetration was 1.9%. This comprised 0.8% for non-life, 0.1% for life (protection and savings) and 1% for health risks, with total premiums in 2010 reaching 16.4 billion Saudi Arabian riyals (SAR) (USD 4.4 billion). According to company accounts in 2011, total premiums reached SAR 18.1 billion, with insurance penetration increasing to 2.0%.

A.M. Best believes the Saudi Arabian insurance market has opportunities for growth, given its population of 28 million. Insurance density has increased strongly in recent years, but gross premiums written (GPW) per capita remain low compared with other countries in the region.

Although Saudi Arabia dwarfs the other GCC states in area and population, its insurance industry ranks second behind the United Arab Emirates, but it has the greatest potential within the GCC (see **Exhibit 3**). Saudi Arabia's consumer market is considered to be underdeveloped, whilst larger commercial business is often ceded outside the country.

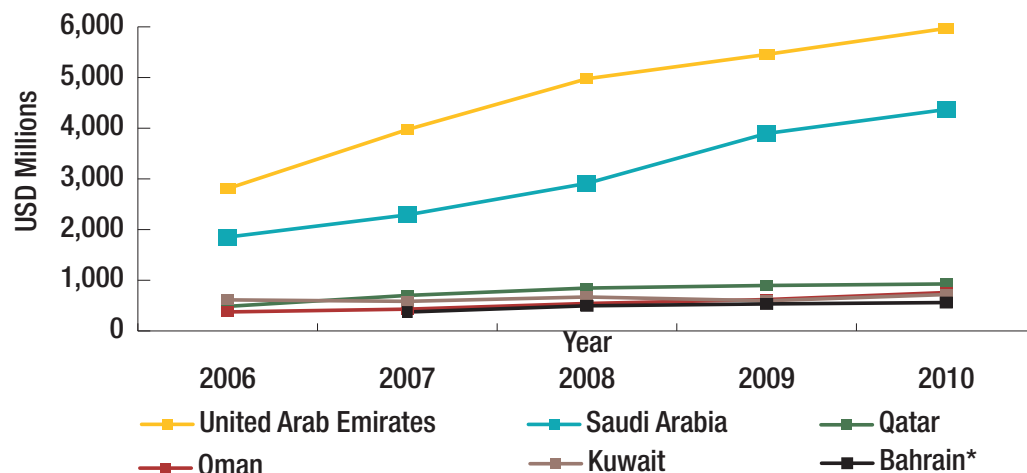
Compulsory Lines Dominate Business Profiles

The introduction of compulsory health insurance for non-Saudi nationals, combined with the large expatriate community in Saudi Arabia, has been the key catalyst for growth in recent years. As shown in **Exhibit 4**, from representing a third of the market in 2006, the health sector grew to 53% of gross premiums in 2010.

In addition to health, other compulsory lines include motor third-party liability, professional indemnity for certain professions and workers' compensation. Health and motor are the market's core products, accounting for 73% of total GPW and 86% of net premiums written (NPW) in 2010.

Exhibit 3

Gulf Cooperation Council Countries – Total Premium Volume (2006-2010)



* 2006 figure not listed.

Source: Swiss Re, *sigma* No 3/2008, No 3/2009, No 2/2010 and No 2/2011

With the majority of commercial lines business underwritten in Saudi Arabia ceded to the international reinsurance market, NPW remains highly skewed toward personal lines business. Motor and medical business accounted for 26% and 60% of NPW in 2010, respectively.

Demand for health coverage is expected to continue. A.M. Best understands that the Saudi authorities intend to roll out compulsory health insurance to all Saudi nationals, although there has been no indication of whether this is imminent.

There is little demand for traditional life products. Protection and savings insurance stood at just SAR 1.0 billion in 2010, decreasing by 3.1% from 2009, according to annual figures from SAMA. Protection and saving products grew from 3% of total GPW in 2006 but represented just 6% of total GPW in 2010. This may indicate a gradual increase in demand for life products, but in the current economic climate, it is susceptible to change given individuals' financial constraints.

Market Faces Significant Regulatory Demands

Saudi Arabia's insurance sector has been evolving rapidly in the past decade.

The Saudi Arabian Monetary Agency (SAMA), which was established in 1952 and also regulates the banking sector, took over regulation of the insurance sector with the introduction of the Cooperative Insurance Companies Control Law of 2003.

SAMA requires all companies to operate the domestic cooperative model whereby the policyholder is entitled to 10% of the net surplus (no losses are transferred to the policyholder). Companies must provide the financial position, profit and loss, and cash flow statements for their insurance operations, as well as for the shareholders' account. In 2011, some companies were operating a Takaful model, although these companies were an exception. SAMA has required them to convert their products to the cooperative model, which they have done effective 1 January 2012.

Insurers and reinsurers are not permitted to open branches or offices inside or outside the Kingdom or to agree to a merger with, own, control or purchase shares in other insurers or reinsurers without SAMA's approval. The regulator is also understood to be looking at ways to improve technical standards in the market, moving more into line with international levels. New legislation could require the use of actuaries for claims reserving.

The Move From Offshore to Onshore

Before the introduction of Saudi insurance legislation in 2003, Saudi Arabia was effectively an unregulated insurance market, with most companies operating as offshore entities, typically based in Bahrain.

The Cooperative Insurance Companies Control Law meant that all insurance companies were required to bring their operations onshore, list on Saudi Arabia's stock exchange and ensure a majority Saudi ownership.

As a result, the Saudi insurance market has changed significantly. Whilst a number of companies have exited the market, selling their Saudi branch operations to Saudi locals, others have had to restructure their operations to form affiliated Saudi companies with local partners and must have partial listings on the local stock exchange.

An example is Trade Union Cooperative Insurance Co. (TUCI) (A.M. Best Financial Strength Rating of B++ and Issuer Credit Rating of bbb+). TUCI has operations dating from 1983 and operated as an offshore company based in Bahrain, before incorporating itself in Saudi Arabia in 2008.

In February 2010, SAMA unveiled plans to prohibit all foreign insurance companies operating in the Kingdom through local agents from issuing and renewing insurance policies unless they obtained authorisation from SAMA.

While Saudi insurers and reinsurers can have foreign investors, overseas insurers are unlikely to invest in unprofitable insurers, particularly considering insurance share prices have climbed significantly since companies have listed on the stock exchange. Individual investors trading in short-term positions, as opposed to institutional shareholders buying based on a company's long-term prospects, are said to be driving these stock valuations. With a

While Saudi Arabia is associated with energy and infrastructure projects, many of these larger commercial lines bypass the Saudi insurance sector. The largest domestic companies tend to have their own captives incorporated outside of Saudi Arabia, which reinsure directly with the international market. State-owned energy giant Saudi Aramco established its Stellar Insurance captive in Bermuda in 2001. Meanwhile, Saudi Ready-mix has domiciled its Masheed Captive Insurance Co. in Bahrain, while petrochemical company Sabic has a captive in Guernsey.

Saudi Arabian insurers that do underwrite these risks tend to rely heavily on reinsurers, with retention levels in 2010 at just 2.3% for energy and 13.2% for property and fire. Energy represented 2% of total GPW in 2010, and property stood at 6%.

Insurers expect the long-awaited overhaul of mortgage legislation, combined with increased government spending on house-building initiatives, to encourage more

few exceptions, investors tend to hold stakes of less than 5% of a company's shareholding unless they are founders.

Saudization Regulatory Requirements

A number of companies are seeking higher quality personnel and talent from outside the country, drawing in expertise with generous remuneration packages, but attracting such staff is generally difficult.

Like many developing insurance markets, Saudi Arabia to an extent faces a shortage of underwriting skills and expertise, as its insurance market is young but growing rapidly. This problem is compounded by the need to use local workers in light of the "Saudization" policies. Newly licensed insurance companies are required to adhere to a Saudization ratio of 30% during the first year of operations.

Some insurers exceed the required Saudization levels. Companies run training programmes to improve the technical skills of insurance staff for those who do not possess them. Nevertheless, retaining talent remains difficult.

Regulatory Focus on Distribution

The insurance regulator has taken an increasing interest in distribution channels in the past few months. In December 2011, SAMA published specific regulations for online insurance activities. It must approve companies' online business plans and product offerings. The regulator also has rules related to factors that include website management, transparency and disclosures, data security and outsourcing.

The insurance market is awaiting the impact of new regulations that limit commissions payable to brokers and agents. The Insurance Intermediaries Regulation, which was published in October 2011, affects insurance agents and (re)insurance brokers.

Maximum commission rates permitted are prescribed, with the lowest rate of 8% for some aspects of compulsory motor and health insurance. The highest rate of 15% covers most other classes of business, such as accident and liability, property, marine, aviation, and protection and savings.

While the impact of the new commission limits is not yet clear, these are considered unlikely to impact reinsurance brokers placing large energy and infrastructure risks in the international market. However, the new regulation is expected to affect brokers and agents placing medium-sized risks. Commission rates as high as 25% are said to have been commanded. Some insurers hope that limits on broker commissions could curtail acquisition costs and possibly improve profitability. However, in light of competition, premium rates could fall to counter any benefit of reduced commission rates.

The Insurance Intermediaries Regulation also stipulates brokers may have no more than five branches in the Kingdom when their capital is at SAR 500,000. Agents must increase their capital by SAR 100,000 for every additional branch. SAMA must approve branches.

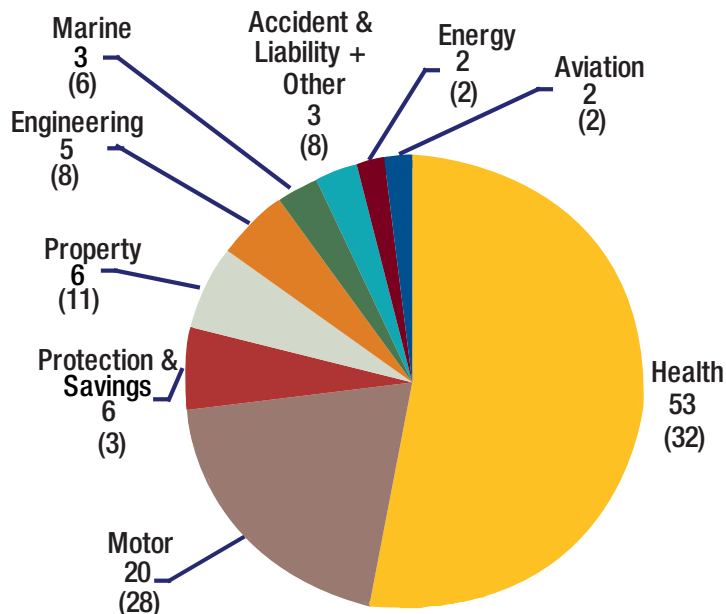
SAMA also maintains specific requirements for bancassurance. For example, the regulator must approve distribution agreements, including the insurance products to be marketed, and bank staff training.

Exhibit 4

Saudi Arabia – Insurance Market Share by Line (2006* and 2010)

Based on gross premiums written.

(%)



*2006 Figures in parentheses.

Source: Saudi Arabian Monetary Agency, The Saudi Insurance Market Report 2010

Saudi Arabians to purchase their own properties. Companies hope this would result in greater demand for credit life and household products.

Competition Remains a Challenge

Whilst demand for insurance is increasing, A.M. Best believes there is capacity for the business currently retained, and competition therefore remains intense. In July 2011, there were 31 licenced insurers and reinsurers with four companies approved to be established. In comparison, in May 2009, there were 21 licenced insurers and reinsurers, with nine companies approved. SAMA requires insurers to be capitalised with SAR 100 million, whilst companies underwriting reinsurance business must have SAR 200 million. These capital requirements can be perceived as high barriers to entry.

The former state-owned Company for Cooperative Insurance (Tawuniya), which was established in 1986 and privatised in 2004, dominates the insurance sector. In 2011, it reported GPW of SAR 4.4 billion, equivalent to a 25% market share.

The top three insurers – Tawuniya, Medgulf and Bupa Arabia Cooperative – account for more than 50% of the market's GPW and an even greater share of the industry's profits, as the majority of insurers currently are loss-making. Bupa underwrites solely medical risks.

Competition remains intense for health business as newer entrants fight for market share. Insurers complain that there has been a significant reduction in rates over the past 12 months. **Exhibit 5** shows the six largest companies by market share and their respective loss ratios for motor and medical.

As demonstrated, the results for medical vary by company, ranging between 58% and 91% over the two-year period, with overall profitability expected to be negative or marginal in most cases. This highlights the competitive nature of medical and the differing

underwriting competencies of companies, whether administered in-house or through third-party administrators. Given that a number of companies have been making significant losses in recent years, it is likely that companies will be more selective and increase rates where possible to improve profitability prospectively.

The performance for motor has been similarly volatile, with loss ratios increasing for the largest companies during 2011, exemplifying the competitive nature of the market. While the new rules on commission payments may assist some companies, competition is expected to remain intense. In addition, motor claims are also expected to rise, as blood money limits (for accidental deaths) were increased in September 2011 to SAR 300,000 from SAR 100,000 for men and to SAR 150,000 from SAR 50,000 for women.

Potential Risks Facing Insurers

The majority of Saudi insurers were loss-making in 2011, reflecting the lack of scale in many of the newly formed companies and the intense competition for business as insurers strive for market share.

Based on 2011 company accounts, 18 of the 31 Saudi insurers hold less than a 2% market share, and losses remain concentrated in the infant industry's smaller players. By contrast, the country's two largest insurers, Tawuniya and Medgulf, accounted for more than 75% of the industry's combined profits in 2011.

However, larger companies have also struggled. Allianz Saudi Fransi, the fifth-largest insurer in the country, recorded a pretax loss of more than SAR 8 million in 2010. Having grown more than 30% in 2011, the company generated pretax profits of SAR 1.6 million in 2011. However, zakat of SAR 1.9 million left shareholders with a small loss for the year, illustrating the zakat burden that exists in the country.

In Saudi Arabia, zakat – a form of compulsory charitable contribution under Islamic law – is levied at a rate of 2.5% on a company's "zakat base." This is calculated by adding adjusted (for zakat purposes) net income to paid-up capital and other capital items and subtracting permissible items such as the net value of fixed assets and investments in the Kingdom's government bills. Zakat is payable irrespective of a company's profitability.

Smaller insurers with low market shares are struggling with the burdens of meeting SAMA's minimum paid-up capital requirements, combined with zakat. In particular, those newly incorporated insurers that are unable to meet these capital levels remain at risk of losing their licences or having restrictions put on them by SAMA, even for companies that are able to achieve pretax profitability. According to SAMA's annual report, 12 companies had share-

Exhibit 5

Saudi Arabia – Loss Ratios of Largest Insurers (2010-2011)

Company	Medical		Motor	
	2011	2010	2011	2010
Tawuniya – The Company for Cooperative Insurance	71.7%	58.6%	64.7%	61.0%
Medgulf	76.4%	75.1%	89.6%	73.5%
Bupa Arabia for Cooperative Insurance	80.5%	81.3%	-	-
United Cooperative Assurance	80.5%	90.9%	88.2%	76.5%
Allianz Saudi Fransi Cooperative Insurance Co.	76.2%	78.6%	84.1%	74.7%
Malath Cooperative Insurance and Reinsurance Co.	58.4%	62.5%	69.5%	62.0%

Source: Company reports

holders' equity of less than SAR 100 million at the end of 2010, whilst seven of these were less than SAR 50 million.

Some smaller companies have been able to record profits, although these remain an exception. Al Sagr was one of these, generating a good return on equity (ROE) of 12.6% in 2011. Arabian Shield and Wala'a were among a few other, smaller insurers carving out positive, although more modest net income.

A.M. Best expects competition to remain intense. Whilst demand for insurance is expected to expand somewhat, it is unlikely to cause rates to improve in the short to medium term as companies fight to establish market share and identity. Thus, losses are expected, particularly at the lower end of the market. Likewise, profitable companies will need to manage downward pressure on their prices.

Given the low retention of large commercial lines, with these risks ceded to highly rated international reinsurers (see sidebar, **Reinsurance Trends in Saudi Arabia**), the insurance risk retained by Saudi companies is limited, and profit-and-loss accounts benefit from stable inward commissions.

Saudi Arabia is considered to have only limited risk of major natural catastrophes. Earthquake risk exists in Western Jeddah but is judged to be low, whilst flooding had previously been considered a 1-in-50 year event. However, there have been notable catastrophes in recent years, with flooding in Jeddah in both 2009 and 2011. Reliable industry loss estimates are not available, though Tawuniya alone reported losses of SAR 97 million for the 2011 floods and approximately SAR 40 million for the 2009 event. Some investment in new drainage systems has been made, although local opinion remains mixed as to whether improvements are sufficient to avert a repeat of these events.

Saudi companies' investment strategies are subject to SAMA regulations, which A.M. Best considers conservative, as given their security and liquidity, these assets attract the lowest charges in A.M. Best's capital adequacy model.

Risk-adjusted capitalisation of profitable companies, given their improving capital bases, appears to be strong. Conversely, those that have suffered reductions of their capital base in the past, or have grown significantly faster than the market in recent years, may have weaker or declining capital positions.

Companies can hold no more than 15% of investments in equities, and general insurers are prohibited from investing in real estate, whilst life companies are limited to 5% for real estate. For general insurers, a minimum of 20% of investments must be held in Saudi government bonds and a further 20% held with Saudi banks. Use of derivatives is limited and subject to SAMA's prior approval.

Whilst such restrictions reduce the risk of market-driven shocks to insurers' capital bases, investment returns are constrained, particularly given the current low interest rate environment. Furthermore, the lack of investment opportunities in Saudi Arabia, where 80% of all investments must reside, leads to some concentration of risks.

A.M. Best considers SAMA one of the more rigorous regulators in the Middle East. The regulator's powers are extensive, ranging from appointing a consultant to a company to manage its business, to revoking licences, independent checks,

regular monitoring or demanding that an insurer be wound up. SAMA approves all products sold. Locally, the regulator's inefficiency is a common criticism, and its ability to respond to regulated companies' requests is often slow. However, it remains widely respected.

Transparency is good, with insurers required to post quarterly results on the Tadawul stock exchange. After regulatory changes in 2008, upon licensing, all insurance or reinsurance companies were required to offer 40% of the company's shares in an initial public offering (IPO) (unless the largest shareholder was a licensed Saudi bank, in which case 30% was offered). Companies report under International Financial Reporting Standards and must appoint two auditing firms licensed to operate in the Kingdom.

Reinsurance Trends in Saudi Arabia

As the Saudi Arabian insurance market is characterised by young companies, there is a heavy reliance on reinsurance and expertise provided by reinsurance partners. Regulatory requirements stipulate that insurers in Saudi Arabia retain at least 30% of their total insurance premiums. This figure is being met as insurers retain motor and health risks, which represent the two largest sectors of the market.

As **Exhibit 6** shows, retention ratios for personal lines tend to be significantly higher than for large, specialised commercial risks, which is to be expected given the market's stage of development.

Total retention levels are increasing, reaching 70.9% in 2010 compared with 63.9% in 2007. Insurers are required to reinsure at least 30% of their total premiums within the Kingdom, although insurers can apply for a waiver, given the limited reinsurance capacity in the country, and A.M. Best understands that this requirement is not strictly enforced.

Specific reinsurance regulations were published in October 2010. The broad reinsurance rules also examine the use of facultative reinsurance and stipulate that companies must produce an annual scenario testing report. This includes exposure to an earthquake or flood affecting the Red Sea/Arabian Gulf and a large-scale terrorist attack.

There is no state reinsurer in the country. Saudi Reinsurance Co. is the sole local reinsurer and was established in 2008, although to diversify risk, it is also active in other

Middle Eastern markets, including Jordan and Lebanon, as well as Africa.

Local and foreign reinsurers used are required to have a minimum rating, which for an A.M. Best-rated entity must be at least a Financial Strength Rating of B+. If the reinsurer's rating falls below this level, the insurer must notify SAMA immediately.

In the wake of natural catastrophe losses in Thailand, Japan and New Zealand, and the need to repair balance sheets, some international reinsurers are said to have achieved marginal rate increases during Saudi Arabia's key 1 January reinsurance renewal season. Insurers are struggling to pass on these increased costs to clients and find it difficult to even achieve low single-digit percentage increases. However, some insurers are also said to be attempting to introduce deductibles to clients. The next major reinsurance renewal period takes place on 1 July.

Exhibit 6

Saudi Arabia – Non-Life & Health Retention Ratio By Line of Business (2007-2010) (%)

Line of Business	2007	2008	2009	2010
Accident & Liability and Other	38.0%	40.9%	44.9%	54.4%
Motor	94.1%	96.7%	96.4%	95.7%
Property/Fire	11.3%	11.9%	11.6%	13.2%
Marine	31.9%	32.5%	34.9%	33.8%
Aviation	3.1%	4.0%	0.6%	1.6%
Energy	0.8%	0.4%	1.7%	2.3%
Engineering	20.3%	17.9%	15.5%	13.1%
Total General Insurance	55.4%	56.2%	57.1%	56.5%
Total Health Insurance	78.4%	78.1%	76.2%	81.9%
Total	63.9%	66.4%	67.4%	70.9%

Source: Saudi Arabian Monetary Agency, The Saudi Insurance Market Report 2010

SAMA's minimum capital requirements are aligned with the European Union's Solvency I directive, though A.M. Best is aware that the more sophisticated companies in the Kingdom operate, or are working on, internal economic capital models. With this in mind, A.M. Best considers capital management in Saudi Arabia to be in line with stronger regional peers.

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**Ratings Have
Held Steady
After the Arab
Spring.**

MENA Insurers and Reinsurers Show Resilience Despite Regional Developments

Insurers and reinsurers in the Middle East and North Africa (MENA) region have shown resilience in the past year, with all A.M. Best-rated entities continuing to maintain secure ratings.

Analysis of the distribution of ratings over the past 12 months shows that despite the continuing uncertainty in MENA territories after the Arab Spring of 2011, there has been no dramatic downward shift in ratings. This is based on A.M. Best's ratings of insurers and reinsurers in Algeria, Bahrain, Egypt, Jordan, Kuwait, Lebanon, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, Turkey and the United Arab Emirates (UAE).

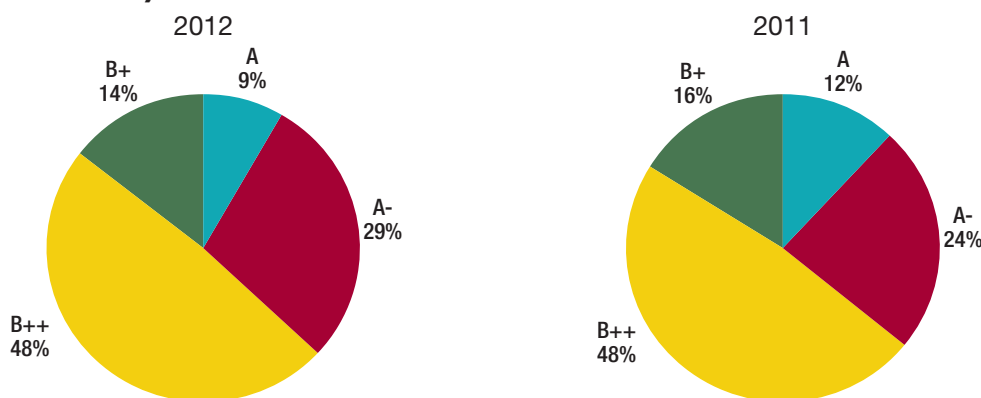
Exhibits 1 and 2 show that on May 31, 2012 and May 31, 2011, all companies had "Secure" Best's Ratings (i.e., Financial Strength Rating [FSR] of B+ or higher, which corresponds to an Issuer Credit Rating [ICR] of bbb- or higher). No company achieved the highest FSRs of A++ or A+, equating to ICRs of aaa, aa+, aa or aa-, which is unsurprising, given that these countries' insurance markets are in relatively early stages of development.

During the past 12 months, the number of A.M. Best-rated entities in MENA territories has grown significantly, from 25 (re)insurers to 35, representing a 40% increase. The percentage of companies with an FSR of A fell from 12% on May 31, 2011, to 9% a year later, although in absolute terms it remained constant. In both years, three companies have maintained this rating – Abu Dhabi National Insurance Co., Arab Orient Insurance Co. and Oman Insurance Co., which are all domiciled in the UAE.

In general, FSRs and ICRs have remained unchanged over the 12-month period, indicative of the challenging operating environment stemming from the global slowdown of financial markets and the Arab Spring. However, outlooks on some companies have been revised downward to stable or negative.

Exhibit 1

Middle East & North Africa – Best's Financial Strength Ratings Distribution (2011-2012)



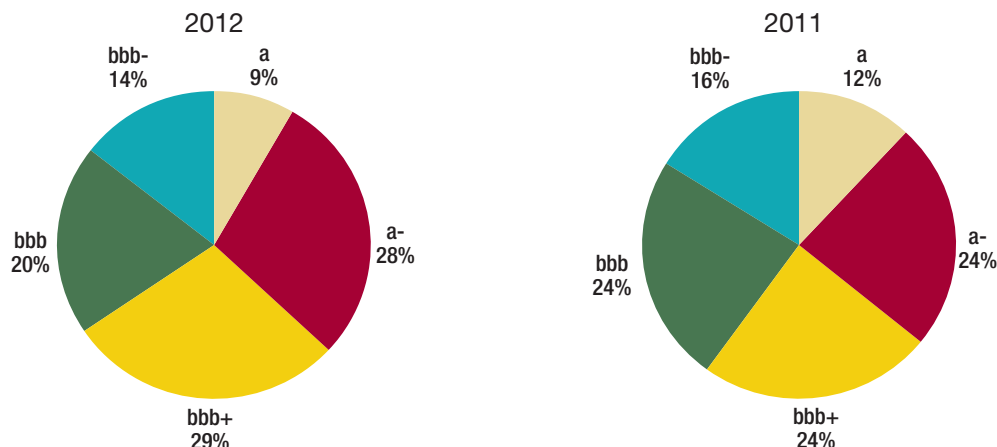
Source: A.M. Best Co.

Researcher & Writer
Yvette Essen



Exhibit 2

Middle East & North Africa – Best's Issuer Credit Ratings Distribution (2011-2012)



Source: A.M. Best Co.

Exhibit 3 shows that the FSR outlook for MENA insurers and reinsurers is broadly stable (for 80% of rated companies), although there is a heavier weighting toward negative outlooks (14%) than positive (6%). In general, rated companies are more than adequately capitalised to face market challenges and absorb market deficiencies to a certain level.

A.M. Best's MENA Country Risks Tiers

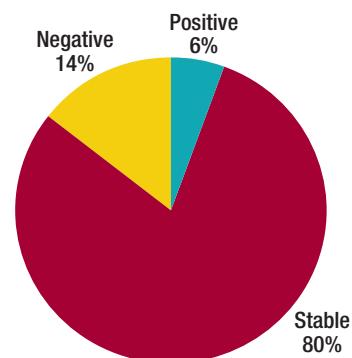
A.M. Best's country risk criteria entail an evaluation of economic, political and financial-system risks. Countries fall into one of five tiers, ranging from Country Risk Tier 1 (CRT-1), denoting a stable environment with the least amount of risk, to Country Risk Tier 5 (CRT-5) for countries that pose the most risk and the greatest challenge to an insurer's financial stability, strength and performance. CRTs do not act as a cap on a rating.

Exhibit 4 shows that countries within the Gulf Cooperation Council (GCC) – the UAE, Bahrain, Saudi Arabia, Oman, Qatar and Kuwait – all continue to have an A.M. Best CRT-3. Compared with other emerging market economies, this is at the higher end of the scale

In the past year, Egypt – which in February 2011 experienced social unrest

Exhibit 3

Middle East & North Africa – A.M. Best Financial Strength Rating Outlooks (2012)



Source: A.M. Best Co.

Exhibit 4

Middle East & North Africa – Country Risk Tiers

Country	Country Risk Tier
Bahrain	CRT-3
Kuwait	CRT-3
Oman	CRT-3
Qatar	CRT-3
Saudi Arabia	CRT-3
United Arab Emirates	CRT-3
Jordan	CRT-4
Morocco	CRT-4
Tunisia	CRT-4
Turkey	CRT-4
Algeria	CRT-5
Egypt	CRT-5
Lebanon	CRT-5
Libya	CRT-5

Source: A.M. Best Co.

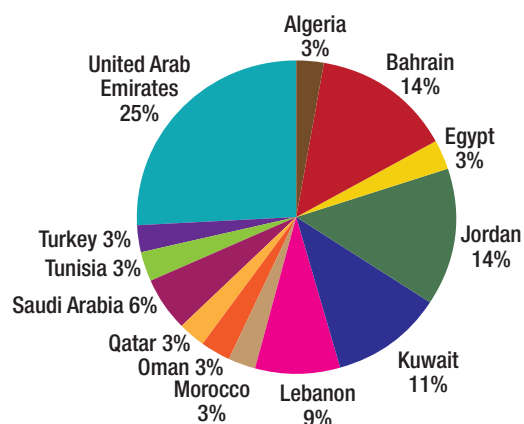
resulting in long-serving president Hosni Mubarak being removed from office – has fallen one tier, from CRT-4 to CRT-5. A.M. Best expects political uncertainty associated with the revolution and the building of a new political system to weigh heavily on the Egyptian economy in 2012.

Last year, A.M. Best analysed the economic impact of the Arab Spring protests and the implications on country risk assessments and medium-term projections of premium growth in the MENA countries. Details can be found in the special report *Middle East & North Africa – Country Risk Issue Review*, published Nov. 28, 2011, and the Best's Briefing *Rating Implications of Recent Unrest in the MENA Region*, published March 3, 2011.

Increased Ratings Demand

Insurance markets in certain countries are evolving quickly, and regulatory pressures are mounting in countries such as Saudi Arabia and Kuwait for companies to consider being rated.

Exhibit 5 Middle East & North Africa – A.M. Best Ratings Distribution by Country (2012)



Source: A.M. Best Co.

For example, there are minimum FSR ratings for local and foreign reinsurers used by Saudi insurance companies (See A.M. Best's special report *Saudi Arabia – Market Review*, published March 12, 2012). In the past 12 months, A.M. Best has published ratings in Saudi Arabia for the first time for Arabia Insurance Cooperative and Trade Union Cooperative Insurance Co. Ratings in Saudi Arabia now represent 6% of A.M. Best's ratings in the MENA region (see **Exhibit 5**). The UAE continues to represent the majority of ratings, with nine rated companies, representing 26% of A.M. Best rated companies in the MENA region.

While some companies have obtained initial ratings, others have sought ratings for their subsidiaries. A number of the newly rated entities are affiliated with insurers that have already been rated. For example, Gulf Insurance Co. in Kuwait majority owns the recently rated Bahrain Kuwait Insurance Co. (domiciled in Bahrain), Arab Misr Insurance Group (Egypt) and Gulf Life Insurance (Kuwait). Arabia Insurance is the main shareholder of General Arabia Insurance Co. (Jordan) and Arabia Insurance Cooperative (Saudi Arabia).

All of the companies that A.M. Best has rated for the first time in the past 12 months have been direct insurers. Direct insurers may be following the lead of regional reinsurers, most of which have sought third-party opinions of their financial strength. Furthermore, primary insurers' pursuit of ratings is driven by factors such as the increasing use of brokers providing access to large commercial projects; regulatory requirements; and the desire to gain a competitive advantage in fragmented markets.

Furthermore, few reinsurance companies have been formed in the past few years. This contrasts with 2008, when there were several new reinsurance start-ups in the MENA region as opportunities in the market attracted new entrants.

A.M. Best's special report *Middle East & North Africa - Reinsurance Market Review* (published Sept. 26, 2011) stated that opportunities that were first apparent for reinsurers have not quite materialised, with start-ups finding it difficult to achieve their initial business plans. This was in part a consequence of the changing economic environment, as well as intense competition among reinsurers, including those based elsewhere.

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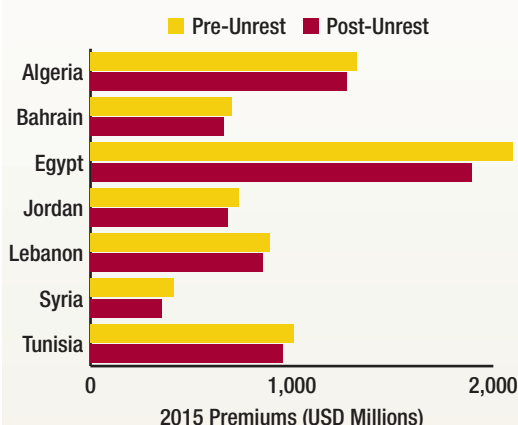
Country Risk Issue Review

November 28, 2011

Sector

Non-Life & Life

MENA – Projected Inflation-Adjusted Premiums in Selected Countries (2015)



Source: A.M. Best Co.

Additional Information

2011 Special Reports

Middle East and North Africa – Market Review

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Methodology

Assessing Country Risk

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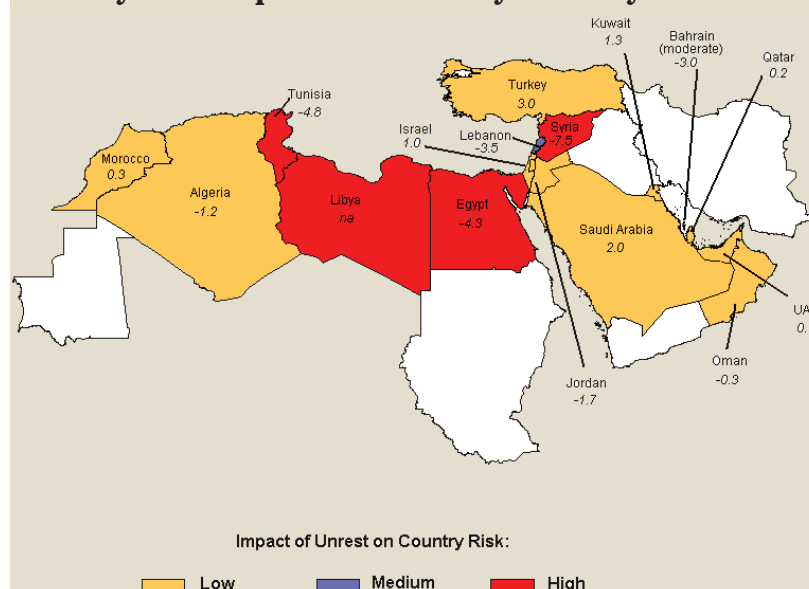
Protests Alter Forecasts for Premium Growth in MENA

The Arab Spring of 2011 has altered insurers' prospects throughout the Middle East and North Africa (MENA). Political unrest can have direct effects on the insurance industry, including premium flows and a higher incidence of claims.

The International Monetary Fund (IMF) has recently published revised economic growth forecasts which, holding all other market factors constant, imply revised growth prospects for insurance premiums. Using these data, A.M. Best has performed an analysis of the economic impact of the protests, as well as the implications on country risk assessments and medium-term projections of premium growth in the MENA countries. Some key findings of this analysis are:

- While the protests will affect the insurance industries of each country to varying degrees, premiums for the region, as a whole, are projected to be only 0.7% lower in 2015 than they would have been otherwise.
- Eleven of the 16 MENA countries are expected to experience lower premium growth than they otherwise would have before the protests, while five other MENA countries are projected to experience modest increases.
- Relative to country risk assessments, with the exception of Tunisia, all the countries where the impact from the unrest is deemed high are classified as CRT-5, the highest risk tier.

MENA – Changes in IMF GDP Growth Forecasts and Country Risk Impact of Unrest by Country



Source: International Monetary Fund and A.M. Best Co.



Premium Growth Linked to Economic Activity

The Arab Spring of 2011, a time of mass social unrest and political turmoil in the Middle East and North Africa (MENA), has altered insurers' prospects throughout the region. The revolutions in certain countries not only have taken a huge human toll in terms of violent protests, deaths, injuries, and arrests, but also have changed the region's landscape

in terms of its business environment, as well as economic, political and financial system risks, which are the metrics A.M. Best uses to assess country risk. This special report examines the impact of the protests on country risk assessments, and prospects for the regional economy and insurance premium growth in the MENA region.

A.M. Best's current Country Risk Tiers (CRT) for the MENA countries and its assessment of the political unrest's level of impact on each country are shown in **Exhibit 1**. With the exception of Tunisia, all countries where the impact from the unrest is deemed high are classified as CRT-5, the highest risk tier. (For more information, visit www.ambest.com for A.M. Best's *Assessing Country Risk* methodology.) In September 2011, Egypt was moved from CRT-4 to CRT-5, due to its elevated risk. Although the country risk impact on Tunisia is deemed high, Tunisia's classification as a CRT-4 has not changed at this time due, in part, to its relatively stronger economic, political and financial system conditions prior to the protests.

For the insurance industry specifically, political unrest can have direct impacts, including the disruption of business activ-

ity and possible liquidity issues. Premiums are likely to be depressed because of the days lost to the unrest and, in some cases, the inability or inefficiency in collecting premiums. Alternatively, there may be incidental benefits, such as increased premiums for cargo business due to increases in oil prices and reinsurance opportunities

arising from reconstruction efforts and government infrastructure spending.

While claims due to civil unrest and civil war are typically excluded, the incidence rates of claims could be higher. Moreover, changes in government regimes resulting from political protests, at a minimum, can trigger a review of a government-owned companies' senior management, preferential treatment or compulsory cessions. New regimes also can implement changes to insurance regulations and the supervisory authority.

Importantly, political unrest can also fundamentally change

real economic activity in the short, medium and possibly long run, which can have far-reaching implications on the size of the insurance industry. Specifically, a country's growth in inflation-adjusted insurance premiums is determined, at least partially, by the overall level of real economic activity in that country. Nominal gross domestic product (GDP) growth historically is highly correlated with insurance premium growth (see **Exhibits 2** and **3** for examples for the cases of Egypt and Tunisia).

Although the political situations in the MENA countries are still developing, several key economic changes are already underway

Exhibit 1
MENA – A.M. Best's Country Risk Tiers* and Impact of Unrest

Country	Country Risk Tier ¹	Impact of Unrest on Country Risk
Algeria	CRT-5	Low
Bahrain	CRT-3	Medium
Egypt	CRT-5	High
Israel	CRT-3	Low
Jordan	CRT-4	Low
Kuwait	CRT-3	Low
Lebanon	CRT-5	Medium
Libya	CRT-5	High
Morocco	CRT-4	Low
Oman	CRT-3	Low
Qatar	CRT-3	Low
Saudi Arabia	CRT-3	Low
Syria	CRT-5	High
Tunisia	CRT-4	High
Turkey	CRT-4	Low
UAE	CRT-3	Low

¹A.M. Best's tiers range from CRT-1, which indicates low risk, to CRT-5, indicating very high risk.

*As of Oct. 31, 2011

Source: A.M. Best Co.

that can provide a better understanding of the potential impact on the insurance industry. The International Monetary Fund (IMF) has recently published revised economic growth prospects which, holding all other factors constant, imply revised growth prospects for insurance premiums as well. Using these data, A.M. Best has performed an analysis of the economic impact of the protests as well as the implications on medium-term projections of premium growth in the MENA countries.

The protests will affect the insurance industries of each country to varying degrees. The impacts range from Syria's projected premiums in 2015 being 14.3% lower than they otherwise would have been before the protests, to Turkey's projected premiums in 2015 being 1.0% higher. Premiums for the region, as a whole, in 2015 are projected to be 0.7% lower than they otherwise would have been. Thus, while the overall effect of the protests in the short-to-medium run is negative, it will be relatively minor on the regional insurance industry.

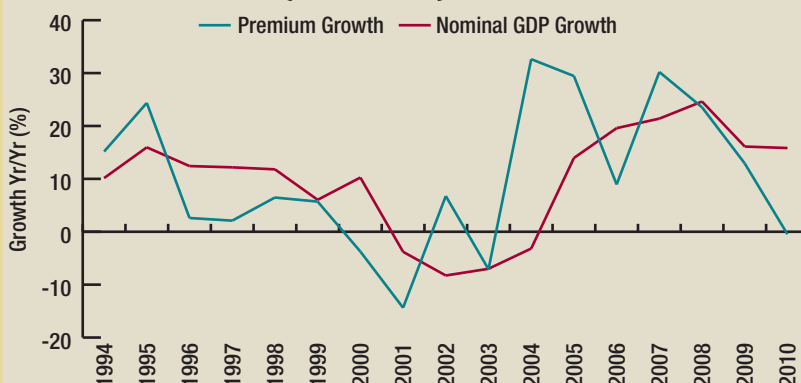
Revised Regional Economic Growth Outlook

In September 2011, the IMF downgraded its growth projections for eight of the 16 MENA region countries since the protests began, including Algeria, Bahrain, Egypt, Jordan, Lebanon, Oman, Syria, and Tunisia, and raised its projections for seven others, as shown in **Exhibit 4**.

Syria, interestingly, is the only country for which GDP is now projected to contract in 2011 (by 2.0%), whereas GDP for the other MENA countries is expected to continue to grow at positive, albeit slower, rates in 2011 and the years ahead. The economic impact on these countries due to the protests is expected to be felt most heavily in 2011, with growth rates generally returning to their pre-crisis growth path by about 2013 or 2014 (see **Exhibit 5**). Again, Syria is the exception, with growth rates expected to be below their pre-crisis growth path into 2016.

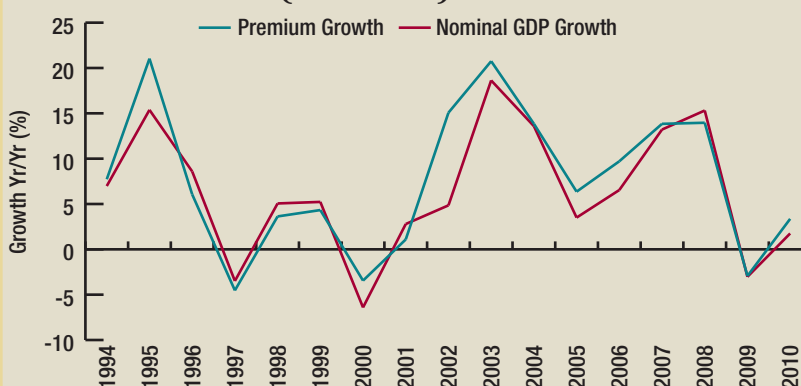
Even if the growth rates eventually return to their pre-crisis growth paths, there will be long-lasting reductions in absolute GDP levels that will be difficult to regain without significant accelerations in growth beyond

Exhibit 2 Egypt – Nominal GDP Growth and Insurance Premium Growth (1994-2010)



Source: IMF World Economic Outlook, September 2011 and Axco.

Exhibit 3 Tunisia – Nominal GDP Growth and Insurance Premium Growth (1994-2010)



Source: IMF World Economic Outlook, September 2011 and Axco.

pre-crisis norms. Specifically, GDP per capita in Syria in 2015 is forecasted to be 8.4% less than the forecast before the protests, while Egypt's GDP per capita forecast for 2015 is 5.5% less; Jordan's is 3.2% less; Algeria's, 1.9% less; and Bahrain's, about 0.3% less.

Drivers of Economic Growth In MENA Region

Changes in key sectors of the MENA economies, namely, tourism, private financing (particularly foreign direct investment) and the oil market, are largely driving the reductions in GDP projections. Tourism and investment are highly dependent on consumer and investor sentiment, and thus are vulnerable to shocks such as domestic unrest.

Several countries have experienced reduced tourism, a removal of foreign direct investment and higher risk premiums on debt and equity as a result of

Exhibit 4

MENA – IMF Economic Growth Forecasts for 2011 (before and after protests)¹

Country	2011 GDP Growth Estimates (%)		Revisions in GDP Growth <i>Before vs. After Protests</i> (in percentage points)
	<i>Before Protests</i> (forecasted in October 2010)	<i>After Protests</i> (forecasted in September 2011)	
Algeria	4.0	2.9	-1.2
Bahrain	4.5	1.5	-3.0
Egypt	5.5	1.2	-4.3
Israel	3.8	4.8	1.0
Jordan	4.2	2.5	-1.7
Kuwait	4.4	5.7	1.3
Lebanon	5.0	1.5	-3.5
Libya	6.2	na	na
Morocco	4.3	4.6	0.3
Oman	4.7	4.4	-0.3
Qatar	18.6	18.7	0.2
Saudi Arabia	4.5	6.5	2.0
Syria	5.5	-2.0	-7.5
Tunisia	4.8	0	-4.8
Turkey	3.6	6.6	3.0
UAE	3.2	3.3	0.1

¹Due to the heightened uncertainty of Libya's political situation, the IMF has not provided a GDP growth estimate for the country; however, economic activity has declined significantly as a result of the revolution.

Source: IMF *World Economic Outlook*, October 2010 and September 2011.

the unrest. However, elevated oil prices resulting from the turmoil have been able, thus far, to support the economies of the region's oil exporters, while creating further challenges for oil importers. The degree to which each country in the MENA region depends on these various sectors therefore determines the level of economic impact these economies will face due to the Arab Spring.

Foreign Direct Investment

Foreign direct investment (FDI) is an important sector in the economies of this region and has been heavily impacted in certain countries. The percent of GDP accounted for by FDI stocks and flows in each MENA country in 2010 is shown in **Exhibit 6**. (The share accounted for by FDI stock indicates the size of total FDI in the country relative to that country's entire economy. FDI flows, on the other hand, represent the change in new FDI entering the country in a given year.)

The magnitudes of both the stock and flows of FDI relative to GDP can help determine

the effects of changes in FDI flows on a nation's economy. For instance, total FDI stock in Lebanon accounted for 95.5% of GDP in 2010, with FDI flows accounting for 12.6%. A change in FDI flows in Lebanon could have a relatively large impact on its GDP growth.

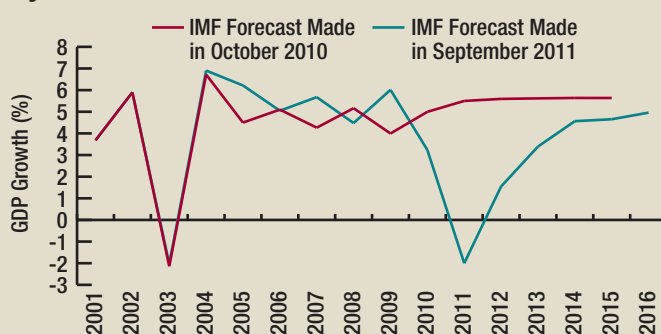
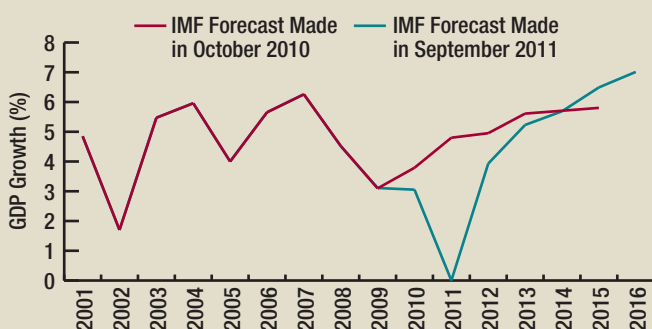
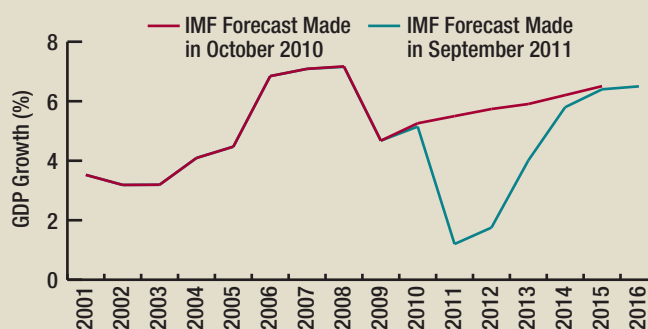
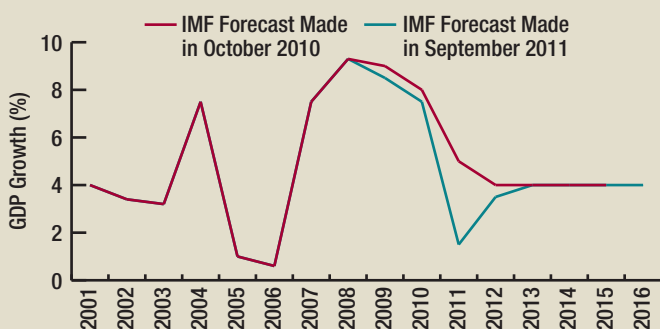
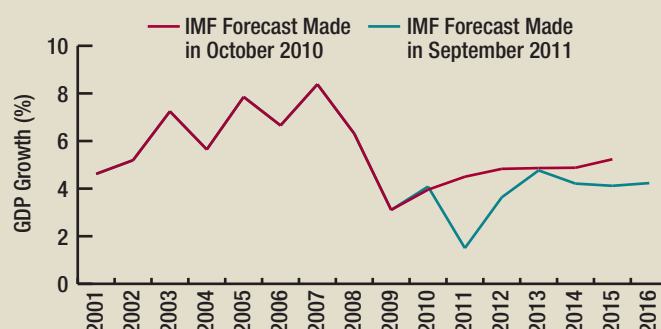
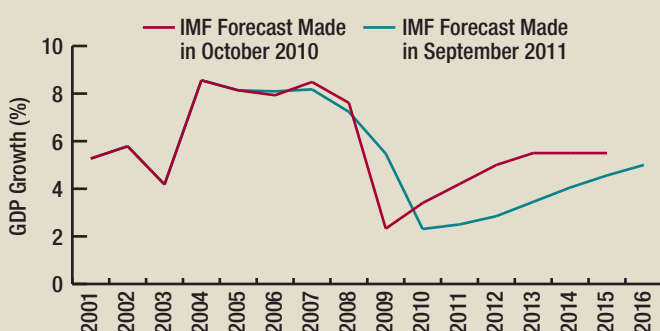
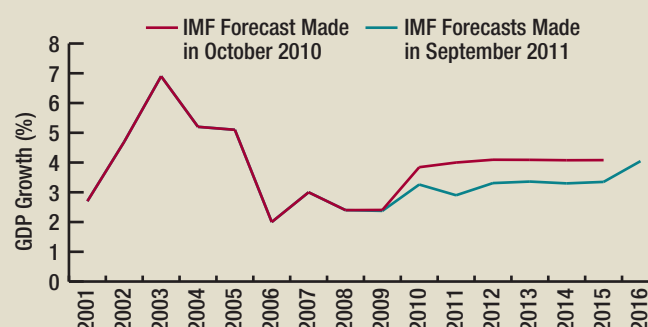
Alternatively, Bahrain's total FDI stock accounted for 66.9% of GDP in 2010, while flows represented only 1% of GDP; therefore, a change or absence of that flow would have a smaller effect on GDP. Likewise, Kuwait's total stock FDI accounted for only 5% of GDP and flows accounted for 1%, implying a change in FDI flows would have an even smaller impact on GDP.

New FDI flows into the MENA region have been reduced by this past year's political turmoil because such flows rely heavily on investor confidence. The IMF projects that FDI in Egypt and Tunisia could be reduced by approximately 67% and 53%, respectively, in 2011, which implies GDP reductions in these coun-

Exhibit 5

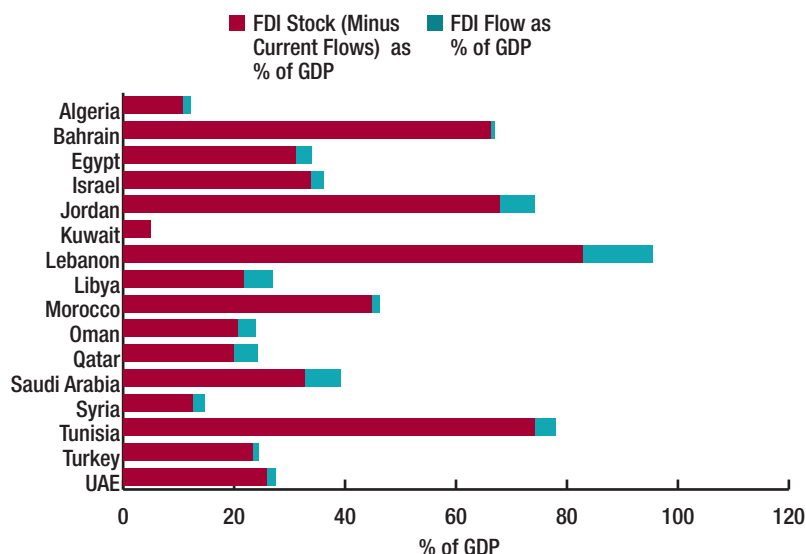
**IMF Economic Growth Projections
(October 2010 & September 2011)**

These graphs show the International Monetary Fund's economic growth forecasts from 2001 to 2016 for Algeria, Bahrain, Egypt, Jordan, Lebanon, Syria and Tunisia made before the protests (forecasted in October 2010) and after the protests (forecasted in September 2011).

Syria**Tunisia****Egypt****Lebanon****Bahrain****Jordan****Algeria**

Source: IMF

Exhibit 6 MENA – Foreign Direct Investment (FDI) Stock and Flows by Country



Source: United Nations Conference on Trade and Development (UNCTAD).

tries of up to 1 to 2 percentage points in 2011.

Tourism

The level that each MENA country relies on tourism is positively correlated with the degree of impact from the regional protests. Specifically, the larger the share of GDP accounted for by travel and tourism in a given country, the larger the downward revision to projected GDP growth

for 2011 following the MENA protests. The countries with the highest tourism contributions to GDP include Lebanon, Jordan, Morocco, Tunisia, Egypt, and Bahrain (see **Exhibit 7**).

The IMF estimates that tourism in Tunisia alone decreased 40% from January to February 2011, and it expects further declines throughout the year. Tourism in the region is expected to recover very slowly, as it relies on consumer sentiment, which is based on long-term conditions of a country. A diminished tourism industry, therefore, could continue to be a drag on economic growth.

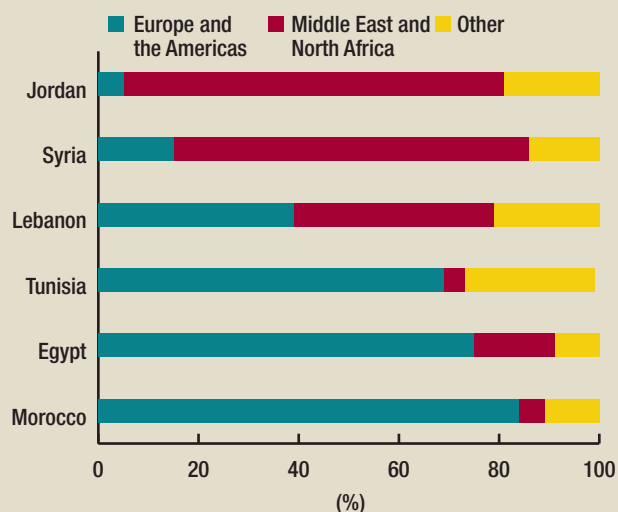
Tourists emanating from outside the MENA region probably will be the most able, and likely, to cancel their travel plans and take longer to return to the region. **Exhibit 8**, which presents the tourists' origination points to select MENA countries for which data were available, indicates that nearly 40% of visitors to tourism-reliant Lebanon are from Europe and the Americas. Moreover, Europe and the Americas account for large majorities of tourists to the other tourism-dependent countries of Morocco, Egypt and Tunisia. Interestingly, the majority of tourists to Jordan and Syria are from the region, and thus, the two countries may experience less of a decline in tourism than others in the region.

Exhibit 7 MENA – Travel & Tourism's Contribution to GDP by Country (2010)



Source: World Travel & Tourism Council

Exhibit 8 MENA – Origin of Tourists to Selected Countries (For Latest Available Year)



Source: IMF

Oil Market

Not surprisingly, the IMF reports that the MENA region's oil exporters have more favorable long-term growth outlooks than the region's oil importers. Indeed, there is a negative correlation between the level of oil exports in a given country and the IMF's level of revision to projected GDP growth in 2011. Specifically, most of the countries experiencing prospective growth downgrades in 2011 are net oil importers, including Egypt, Jordan, Lebanon, Syria, and Tunisia. Moreover, countries with upgraded economic growth since the protests include key oil exporters – namely, Kuwait, Qatar, Saudi Arabia and the UAE.

During the MENA protests, there has been increased volatility in the oil market. Specifically, supply disruptions (especially in Libya) in the first quarter of 2011 led to oil prices spiking to USD 120 a barrel at the end of April. Prices currently are back down towards pre-crisis levels due partially to increased oil production from other members of the Organization of Petroleum Exporting Countries (OPEC), most notably Saudi Arabia, and the release of emergency reserves by International Energy Agency members. (OPEC members in the MENA region include Algeria, Kuwait, Libya, Qatar, Saudi Arabia, and the UAE.) The IMF projects that oil prices will rise 30.6 % in 2011 over 2010; decrease 3.1% in 2012; and further decline 1.1% from 2013 to 2016.

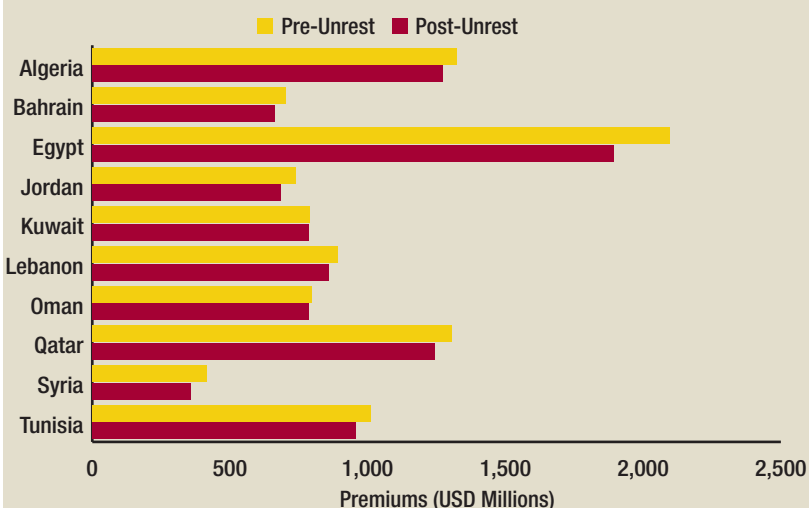
Potential Effect on Insurance Premium Growth

As noted previously, economic growth is highly correlated with growth in insurance premiums. Therefore, it is possible to project inflation-adjusted insurance premium growth based on IMF forecasts of real GDP. Specifically, by keeping the relationship between premiums and GDP constant (i.e., a stable level of insurance penetration), a projected level of premiums can be calculated by applying the projected growth rates of annual real GDP to insurance premiums. Importantly, these projections focus on the effect of real economic activity alone on insurance premiums – all other market conditions (including inflation, structural changes in the insurance market, changes in consumer preferences and changes in regulation or government

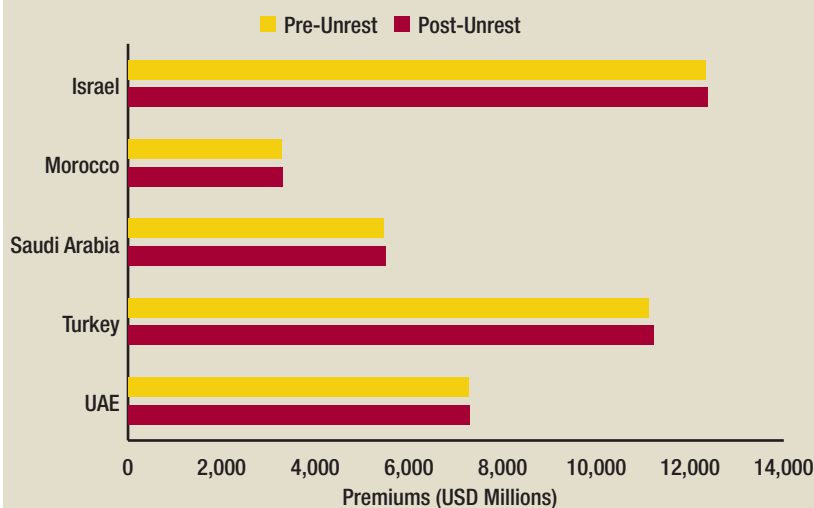
Exhibit 9

MENA – Projected Inflation-Adjusted Premiums

Countries with Approximately \$2 Billion or Less in Projected Premiums in 2015



Countries with More Than \$2 Billion in Projected Premiums in 2015

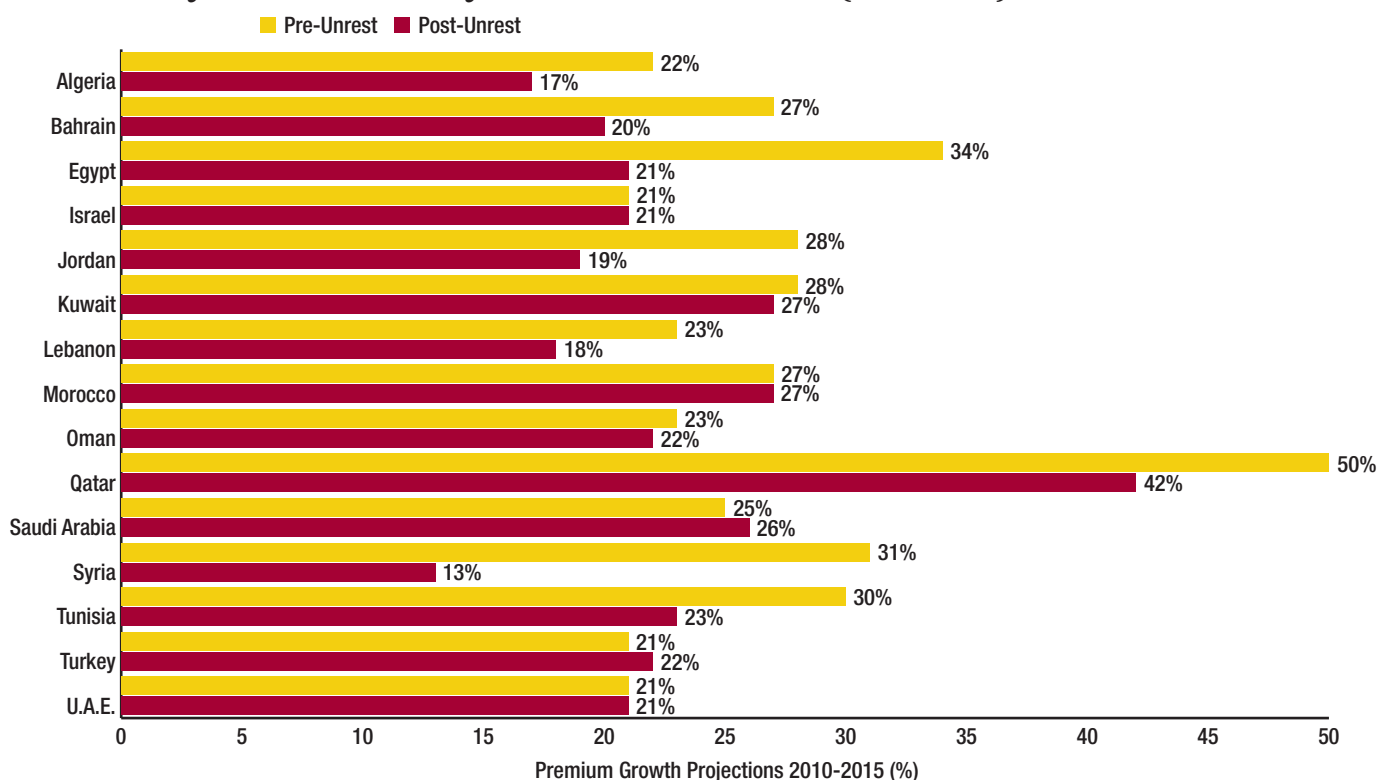


Source: A.M. Best Co.

regimes) are held constant. A.M. Best recognizes that other market conditions, in fact, may change by 2015. For example, A.M. Best expects that compulsory covers and insurance awareness in the MENA region will raise insurance market penetration over time. Therefore, these projections create a baseline forecast. Changes in other market conditions will be reflected in variations around this baseline.

Exhibit 9 shows projections of inflation-adjusted premiums for 2015, based on GDP growth projected before and after the unrest. Likewise, **Exhibit 10** presents the projected growth in premiums from 2010

Exhibit 10

MENA – Projected Inflation-Adjusted Premium Growth (2010-2015)

Source: A.M. Best

to 2015, pre- and post-unrest. As shown in these exhibits, 10 of the MENA countries are expected to experience a decline in premium growth. Syria and Egypt are expected to experience the largest growth declines due to the unrest. Alternatively, Israel, Morocco, Saudi Arabia, Turkey, and the UAE are expected to experience modest increases in insurance premium growth from pre- to post-unrest. The protests will affect the insurance industries of each country to varying degrees. The impacts range from Syria's projected premiums in 2015 being 14.3% lower than they otherwise would have been before the protests, to Turkey's projected premiums in 2015 being 1.0% higher. Premiums for the region, as a whole, in 2015 are projected to be 0.7% lower than they otherwise would have been.

Conclusion

Economic activity certainly will play an important role in the growth of the MENA region's insurance industry. Moreover, the region's long-term economic growth will rely heavily on investor and consumer confidence, which affects the

important sectors of investment, tourism and oil demand. The turbulence of the Arab Spring has shaken consumer and investor confidence in the region, which is evident in the recent volatility of its equity markets. Clearly, other factors also impact equity markets, such as the global economic slowdown and the sovereign debt crisis in the eurozone. Equity markets across MENA are down 15.9%, on average – since the start of 2011 to mid-November – ranging from a full rebound in the Qatar exchange to a drop of 41% in the Egyptian exchange. The stock markets in Bahrain, Egypt, Jordan and Lebanon are among the region's hardest hit and have not yet shown signs of recovery.

However, there is some evidence that investor confidence in certain other countries is gradually returning. Eight of the equity markets in the MENA region, while still down from January, have partially rebounded from their troughs earlier in the year, including those in Kuwait, Morocco, Qatar, Tunisia, Turkey, Saudi Arabia and the UAE-Dubai exchange. Moreover, elections in Egypt,

Morocco, Oman, and Tunisia in October and November could be turning points in the region's political landscape and have captured the interest of the international community and investors. The stock markets in some of these countries have seen modest recoveries leading up to these elections – namely, those in Morocco and Oman, up 4% and 1%, respectively, since their troughs in August, and in Tunisia, up about 14% since June.

It is uncertain how long these countries will take to rebuild, and what the new regimes will look like. Ultimately, their futures rest, in great part, on the face of these post-Arab Spring regimes and the confidence that they can instill in consumers, investors and the business sector. A.M. Best will continue to monitor all relevant country risk factors in the MENA region and update its country risk tiers as warranted.

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