Qatar, Saudi Arabia & UAE Market Review

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Analyst

Vasilis Katsipis, General Manager, Analytics
Tel: +44 207 397 0278
Vasilis.Katsipis@ambest.com

Market Analysis

Yvette Essen, Head of Market Analysis
Tel: +44 20 7397 0322
Yvette.Essen@ambest.com

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Top Middle East Markets Are Poised for Take Off

The insurance markets of the Middle East are widely considered to offer growth opportunities, although A.M. Best Co. expects three countries, in particular, to stand out in the coming years.

The United Arab Emirates (UAE), Saudi Arabia and Qatar are the three largest insurance markets in the Gulf Cooperation Council (GCC). They are also the Middle East's most dynamic markets, with total gross premiums written (GPW) in 2010 for all three countries combined likely to rise by 15%-20%. A.M. Best believes:

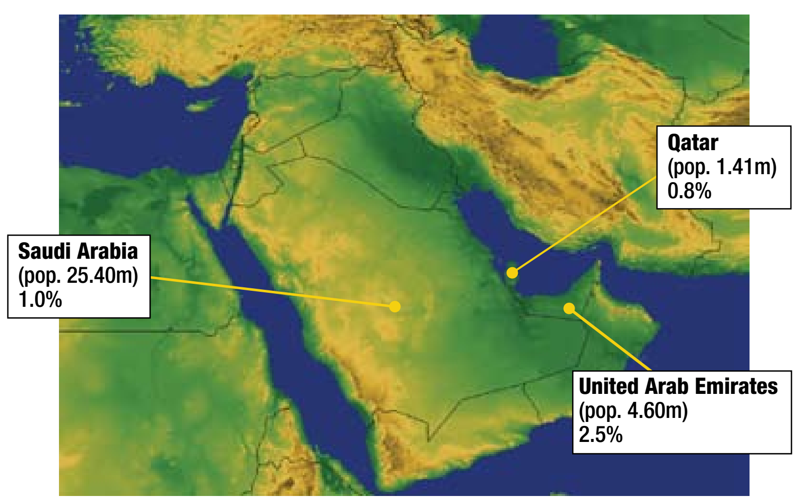
- There are a range of drivers supporting market expansion. These include higher oil prices and increased government infrastructure spending, which will fuel the need for cover in the non-life insurance sector.

- The personal lines segment will show strong growth with the introduction of compulsory health care and motor covers continuing to provide an impetus.

- The introduction of takaful has created an opportunity for protection to be provided to the Muslim population. Takaful has already enjoyed strong take-up, albeit from a low base, and increased demand, particularly for family takaful, will continue.

Notwithstanding the potential for insurers and reinsurers operating in the UAE, Saudi Arabia and Qatar, significant challenges are ahead for market participants. These include greater pressure to focus on achieving technical profits as investment income is expected to continue to remain below pre-crisis earnings levels.

Middle East – Top Markets' Insurance Penetration (2009)
Premiums as % of gross domestic product (GDP).



Source: Swiss Re sigma No 2/2010 and the World Trade Organization

Leaders Grow at Dramatic Pace

A.M. Best tracks 83 life and non-life companies operating in the Middle East, and considers the United Arab Emirates (UAE), Saudi Arabia and Qatar to be three of the most exciting markets in the region owing to their low insurance penetration and dynamic growth. From 2002 to 2009, the UAE and Saudi Arabia each recorded a compound annual growth rate (CAGR) in excess of 20%, while Qatar's CAGR was 17.35% (see **Exhibit 1**). In comparison, the CAGRs for Bahrain, Oman and Kuwait were lower (15.2%, 14.6% and 4.9%, respectively) and for the world, it was 5.6%.

With the exception of Qatar, which experienced a drop in gross premiums written (GPW) in 2009 after GPW climbed 87% in 2008, all three insurance markets have recorded continuous year-over-year growth during the seven-year period.

In the UAE, demand for insurance slowed in 2009 (see **Exhibit 2**). This was primarily a consequence of the well-publicised problems of the economic slowdown in Dubai, which resulted in a sharp decline in construction-related activity in the emirate.

However, the Abu Dhabi market benefited from both a more stable economy and the introduction of compulsory health care insurance in 2008. Despite the impact of the economic crisis and the postponement of 2009's planned compulsory medical insurance programme in Dubai, the UAE market still grew by 2.8% in 2009. The UAE's insurance market was considerably less affected by the economic downturn than the world's more developed insurance markets, which slipped by 3.65% in 2009.

As in Abu Dhabi, the Saudi insurance market has grown strongly, with GPW climbing 34% in 2009. The price of oil has declined from the high levels of 2007, but it has still helped support economic development and spending on infrastructure in the region.

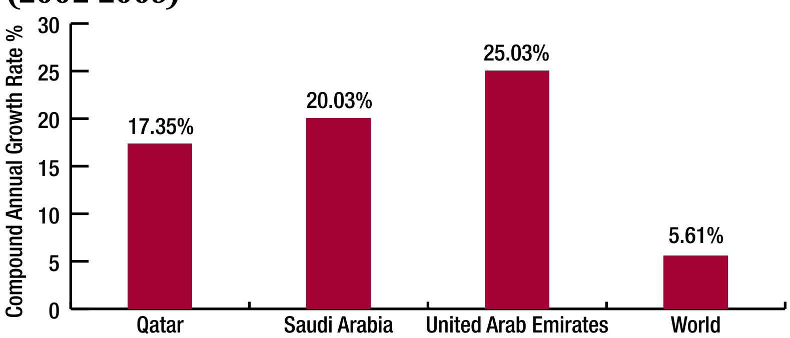
Furthermore, the Saudi Arabian Monetary Agency (SAMA) in recent years has prohibited insurers from operating in Saudi Arabia without being domiciled there. This has created a significant pull toward companies establishing themselves in the kingdom to the detriment of neighbouring insurance centres. The number of insurance companies operating in Saudi Arabia has increased from one to more than 30 in the space of five years.

Personal Lines – a Key Driver

Saudi Arabia, the UAE and Qatar are major oil producers, and growth has historically come from energy, construction and cargo risks. However, motor and medical protection has recently driven the insurance market and is set to increase in significance.

In Saudi Arabia, the market has shifted significantly to personal lines during the past few years. According to SAMA, health care accounted for half of total GPW (50%) in 2009 as a consequence of the large expatriate community, which must have medical expenses cover. Motor insurance was the second most important line of business, making up a fifth (21%) of GPW as third-party motor bodily injury cover was recently made compulsory.

Exhibit 1
Middle East – Top Markets' Growth Rates vs. World (2002-2009)



Source: Swiss Re, sigma reports 2002 to 2009

Qatar's insurance market is focused largely on energy and engineering risks as the country is the world's largest exporter of liquefied natural gas. Motor business, while the most significant personal line, accounts for a small portion of the market despite the fact that motor third-party liability is compulsory as in most of the markets of the region.

A.M. Best notes that while personal lines business is growing, pressure on rates is intensifying. A.M. Best predicts that in the next two years competition will intensify as most of the insurers increase their focus on motor and health care, resulting in insurers facing reduced technical profitability. Some insurers are already experiencing losses on a technical basis on both these lines as a consequence of aggressive pricing.

Greater Focus on Profit Required

While the personal lines segment enjoys continued growth, the property/casualty (P/C) market should also be buoyed by the governmental economic regeneration programmes in the UAE, Saudi Arabia and Qatar that are creating a need for insurance for construction projects, among other things. If commodity prices appreciate, then values of cargo risks are likely to increase, further fuelling the non-life market.

Until recently, domestic companies operating in the three insurance markets have tended to retain a significant proportion of personal lines business, while reinsuring the bulk of large risks. Local companies act as "fronters" for volatile business, particularly for property and energy insurance, where it is common to retain less than 15% of the risk.

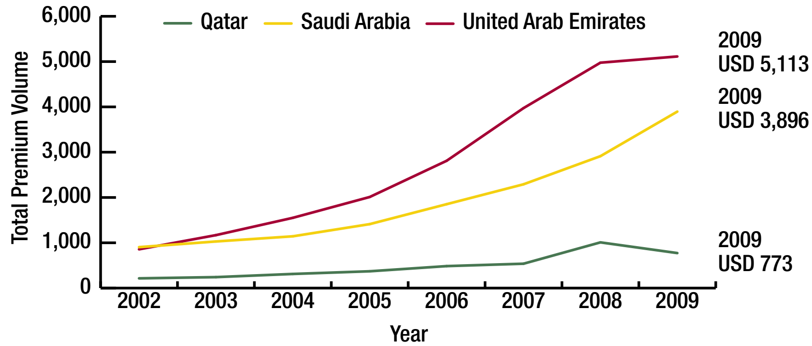
To date, this practice has suited local insurers, enabling them to earn commissions from reinsurers for large risks and achieve technical profits from underwriting personal lines.

The newly obligatory personal lines covers in the UAE, Saudi Arabia and Qatar are expected to accelerate the growth of insurance markets in 2010 to 2012 as they take full effect. However, this shift away from large risks and high volatility business is also likely to reduce overall cession ratios and diminish the significance of reinsurance commissions in the financial results of insurers.

Exhibit 2

Middle East – Top Markets' Premium Volume (2002-2009)

(USD Millions)



Source: Swiss Re, sigma reports 2002 to 2009

A.M. Best believes that the greatest challenge for local insurers lies in their ability to safeguard their profitability in the face of increasing competition and lower investment income. Companies are operating not only in a competitive marketplace, but one that is becoming increasingly fragmented.

This, combined with the reduced reinsurance commissions, means that companies will be operating in a changed marketplace where technical profitability will be the most important factor, but more difficult to attain.

Ratings Issues and Perspective

A.M. Best recognizes the regional business model of low retentions and significant reinsurance purchases although it is cautious of companies that are overly reliant on reinsurance, which may foster a lack of underwriting expertise.

There are a number of other key criteria issues A.M. Best believes insurers, reinsurers and takaful operators face in the UAE, Saudi Arabia and Qatar. These include a lack of diversification in investment portfolios and that enterprise risk management (ERM) is not being fully embedded into company structures. However, ERM adoption is increasing, particularly in response to the global financial crisis, and companies rated by A.M. Best will be aware of the importance of ERM in the rating process.

The majority of companies A.M. Best rates in these countries tend to have stable outlooks, indicating there are more likely to be affirmations than upgrades or downgrades in the next 12 to 24 months.

Demand for Takaful Set to Continue

In recent months the details of takaful products and their reinsurance arrangements have been receiving greater attention.

The UAE's recent decision to establish a national Shari'a board is intended to help create a more stringent environment. Together with the work of several local regulators and the Islamic Financial Services Board, an international standard-setting body, guiding principles are being established for local regulators. A number of issues remain surrounding takaful structures – namely the segregation of the takaful fund and the shareholders' fund.

Takaful has opened up and provided protection to Muslims who have been unwilling to purchase traditional insurance products. A.M. Best, which has a separate methodology for rating takaful operators, anticipates takaful offerings should enjoy ongoing growth, increasing the penetration of a market that previously was not insured using current models.

The demand for this type of product can be seen in Saudi Arabia, which operates a similar concept of "cooperative" insurance. However, takaful operators are competing against traditional insurers to build a market presence, whose key differentiator is often price. Some takaful operators have posted significant losses, and A.M. Best expects competition to intensify before it stabilises at a more technically viable level.

A.M. Best expects some operators will continue to post technical losses in 2010 and may only be in a position to begin recording technical profits in 12 to 24 months. The expansion of family takaful may provide a greater opportunity to reach this goal as this segment is still less competitive.

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A.M. BEST COMPANY
WORLD HEADQUARTERS
Ambest Road, Oldwick, N.J. 08858
Phone: +1 (908) 439-2200

NEWS BUREAU
830 National Press Building
529 14th Street N.W., Washington, D.C. 20045
Phone: +1 (202) 347-3090

A.M. BEST EUROPE RATING SERVICES LTD.
A.M. BEST EUROPE INFORMATION SERVICES LTD.
12 Arthur Street, 6th Floor, London, UK EC4R9AB
Phone: +44 (0)20 7626-6264

A.M. BEST ASIA-PACIFIC LTD.
Unit 4004 Central Plaza, 18 Harbour Road, Wanchai, Hong Kong
Phone: +852 2827-3400

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