11th Middle East Insurance Forum

Assessing & Improving the Strength of the Regional Insurance Industry

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Agenda

1. Assessing financial strength

2. The MENA market

3. Role of ratings

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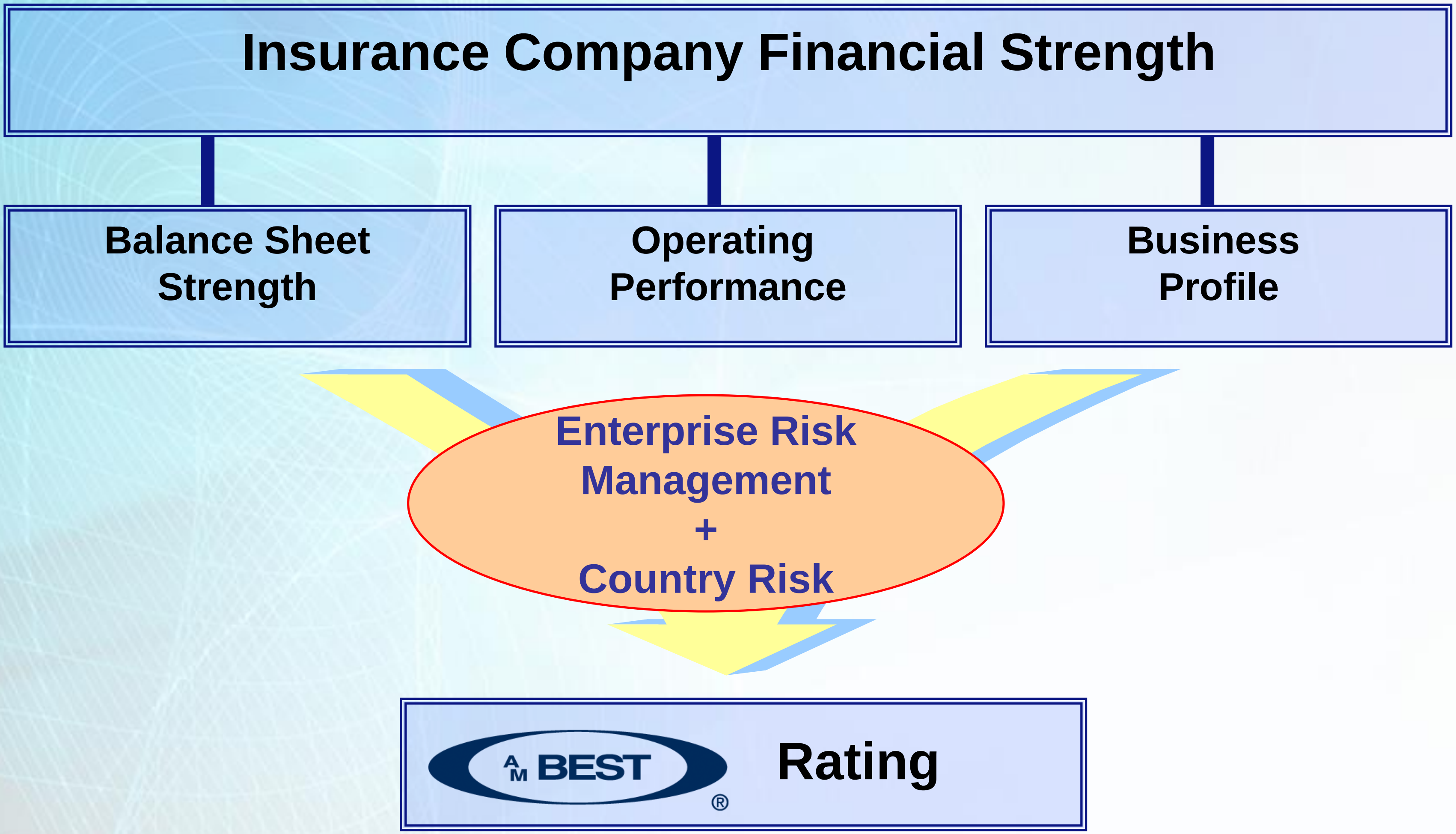
1. **Assessing financial strength**

2. **The MENA market**

3. **Role of ratings**

A.M. Best rating methodology – key rating components



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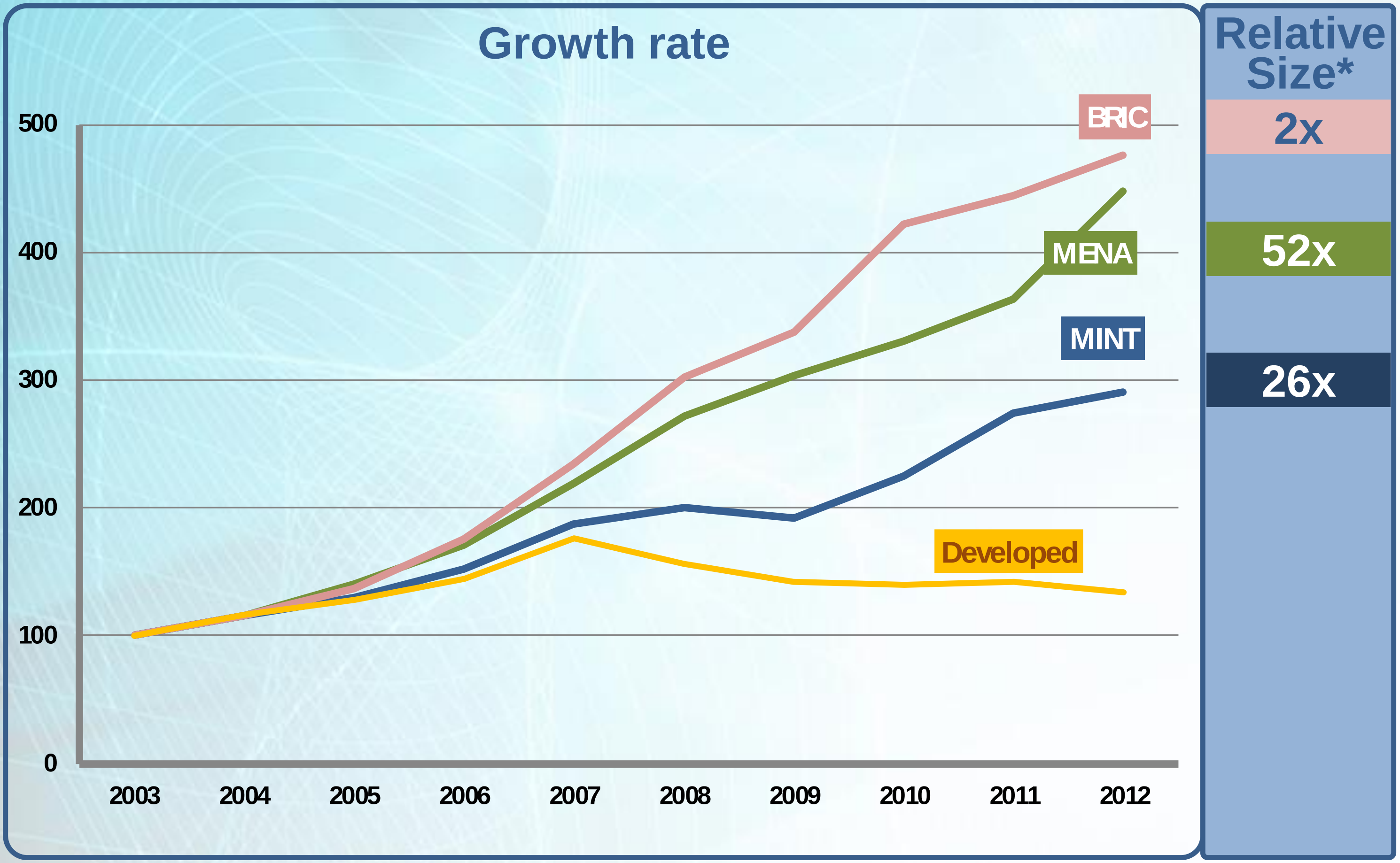
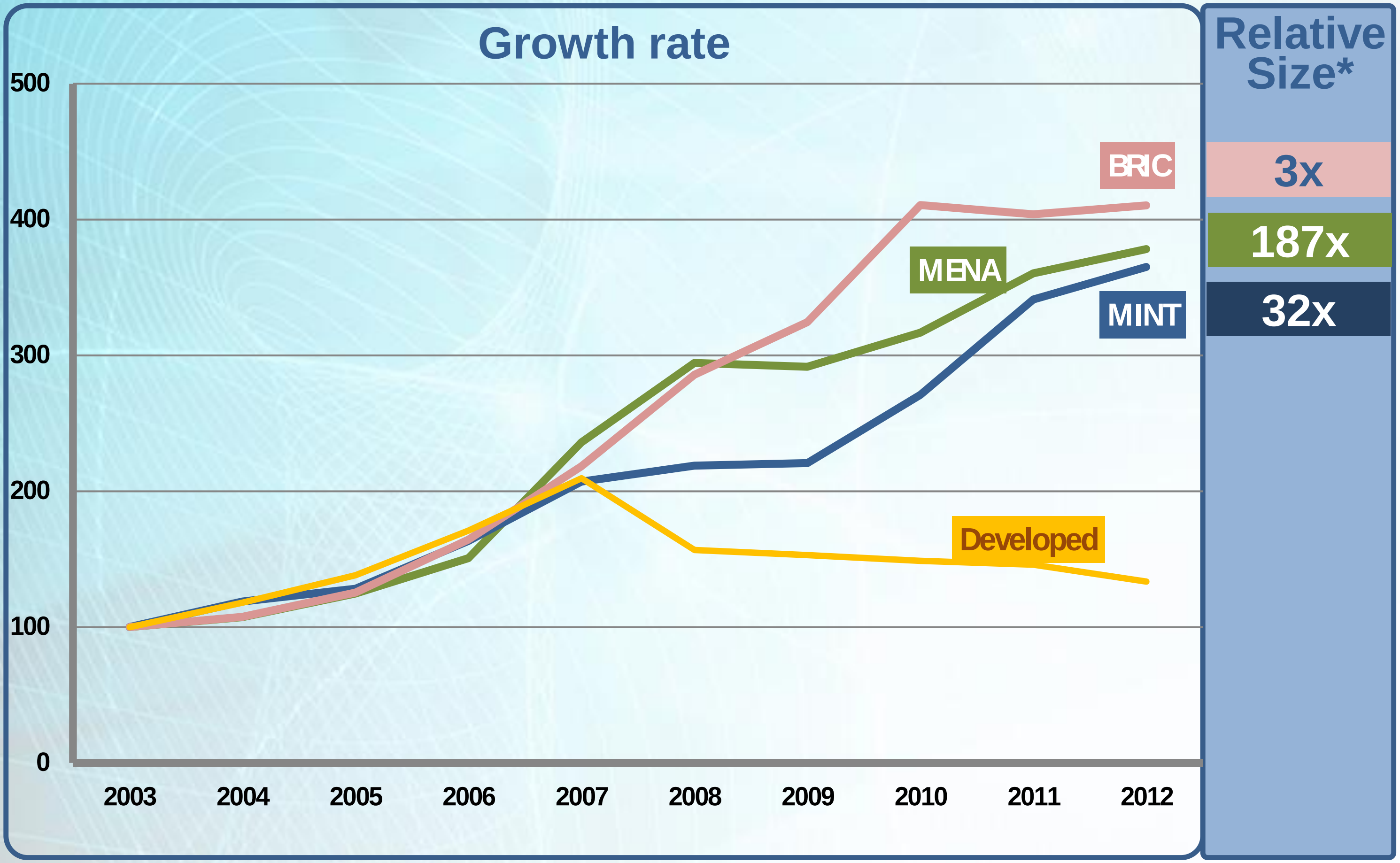
MENA: Among the fastest growing emerging markets



- Significant difference in growth between developed and emerging markets
- Increasing penetration and new compulsory covers drive growth
- Emerging markets continued to grow despite recent crises (global economic, Arab spring)
- Great difference between relative size of emerging markets

**Relative size= Indicates how many times the market is smaller than the "developed" markets in the analysis*

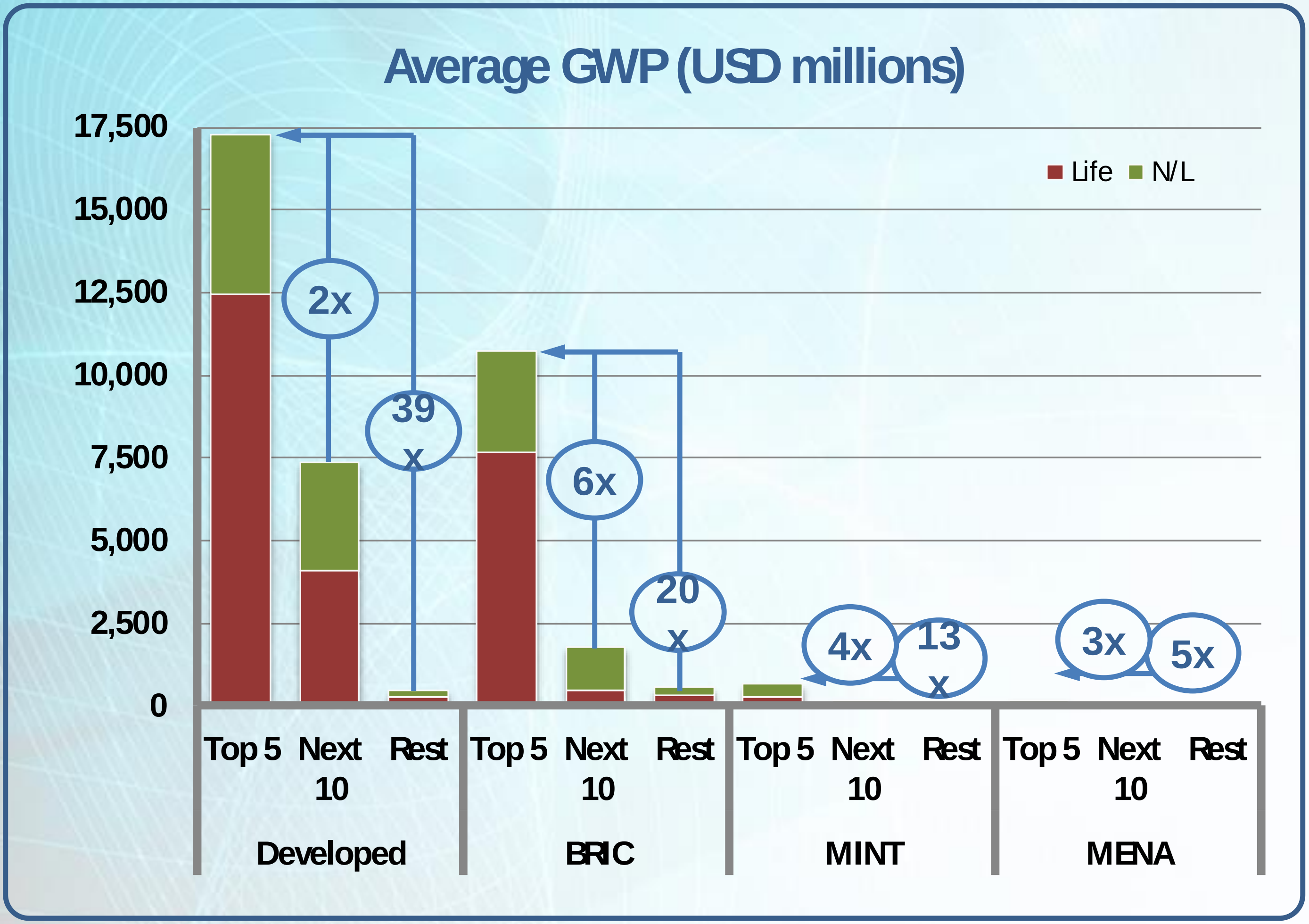
But growth in life business is lagging behind



- Life business in MENA growing slower than non-life
- Slow-down is further accentuated in Middle East markets (while North African markets have continued growth at moderate rates)
- Relative size far behind those of other emerging markets

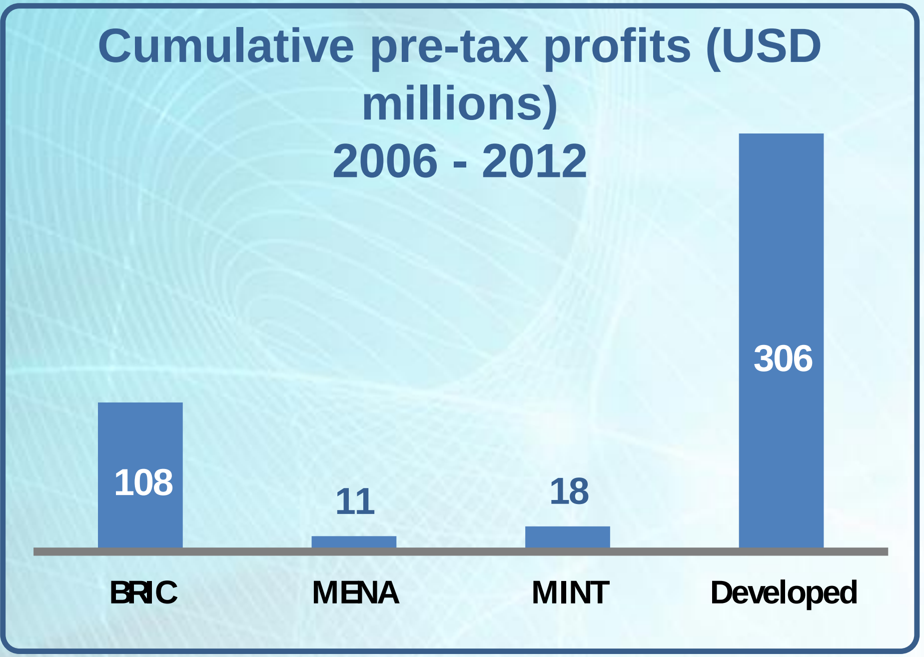
**Relative size= Indicates how many times the market is smaller than the "developed" markets in the analysis*

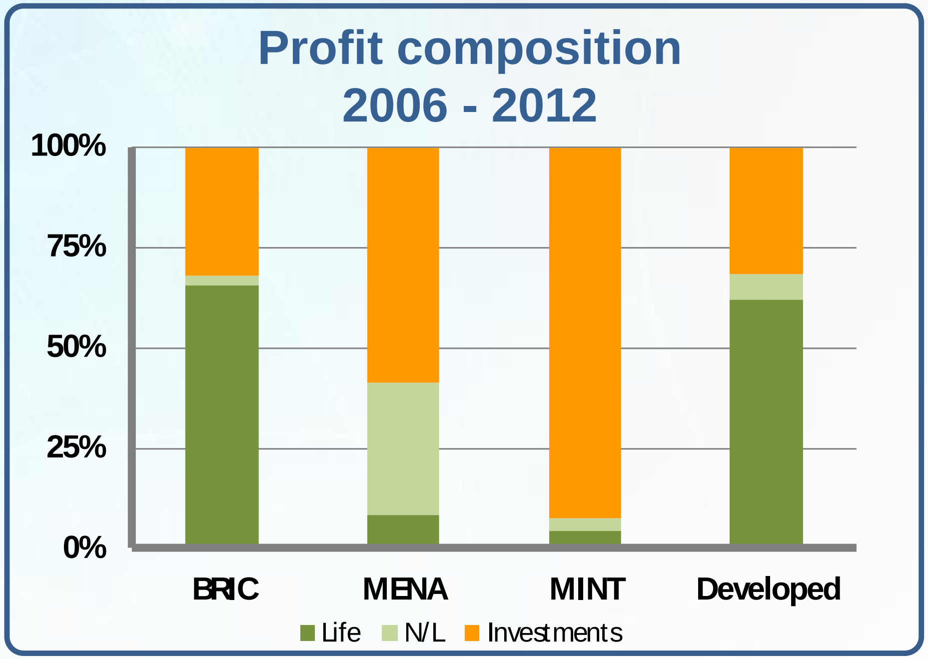
Lack of specialisation leads to intense competition in smaller markets



- Relative size of segments varies by market
- In emerging markets the gap between larger and smaller companies is directly related to the size of the market
- Competition in smaller emerging markets more intense

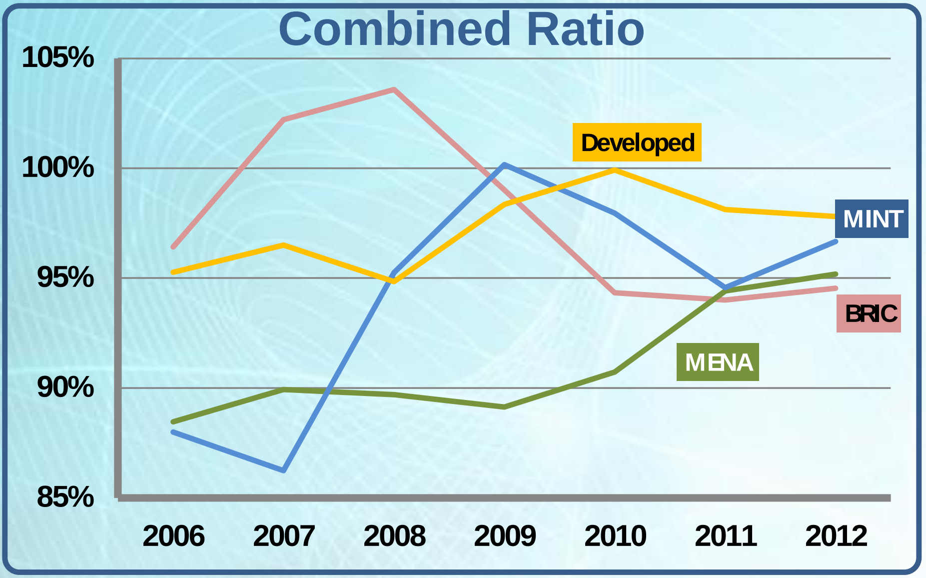
MENA: good profits emanating from investments and non-life business

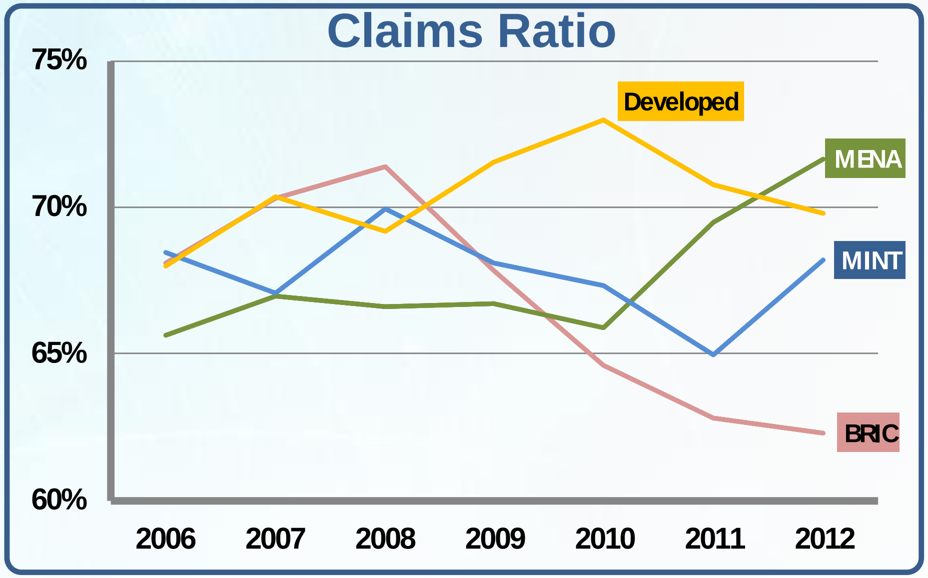




- Overall profits are lower than those of other markets examined
- Overall profitability very good considering relative size of the market
- Heavy dependence of MENA companies on investment income
- Non-life business has been the second most important source of profit

Technical profitability is deteriorating . . .

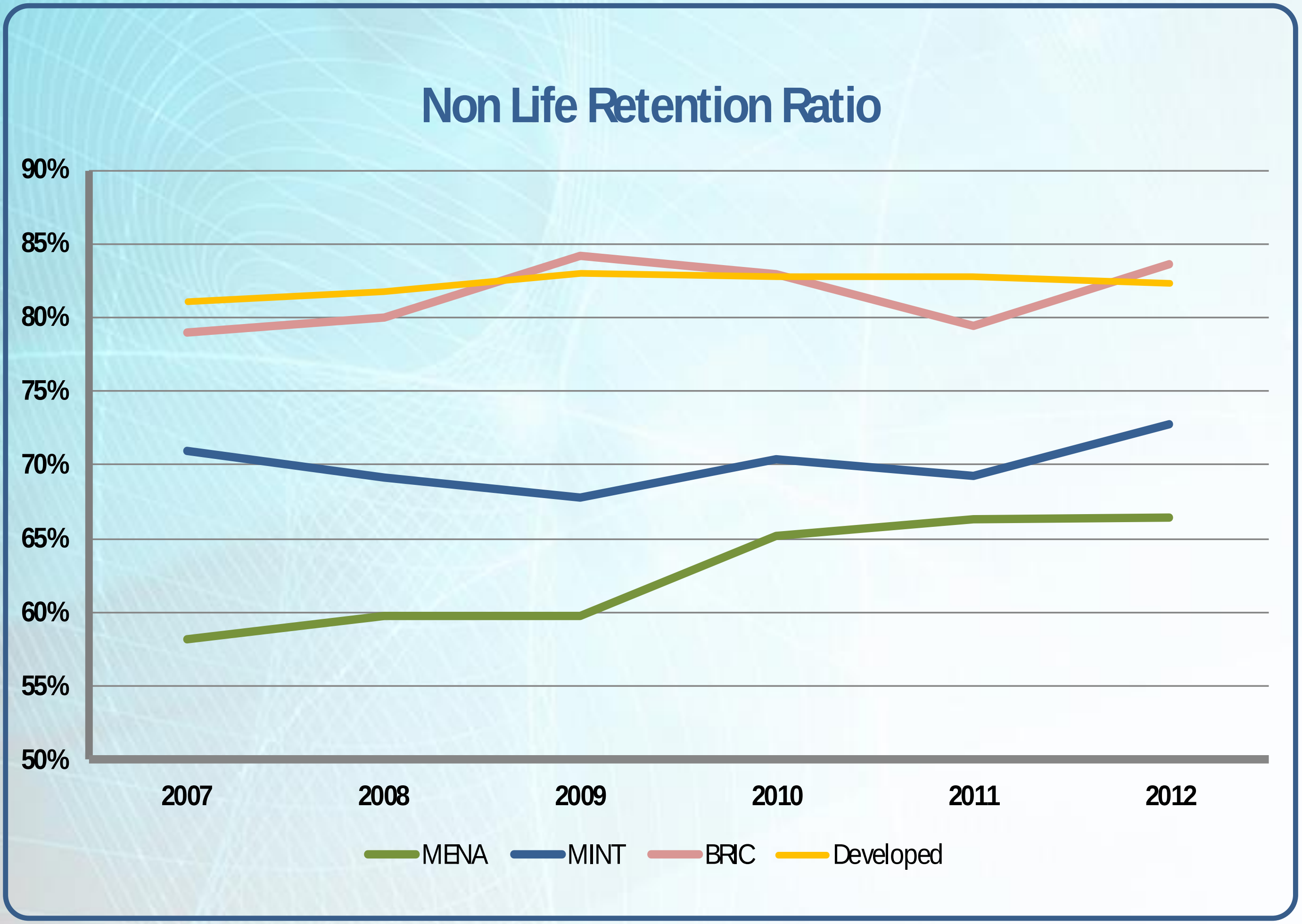




- Combined ratio has consistently been increasing
- Currently at historical high levels
- Current combined ratio at comparable levels with other emerging markets despite lack of catastrophic exposures

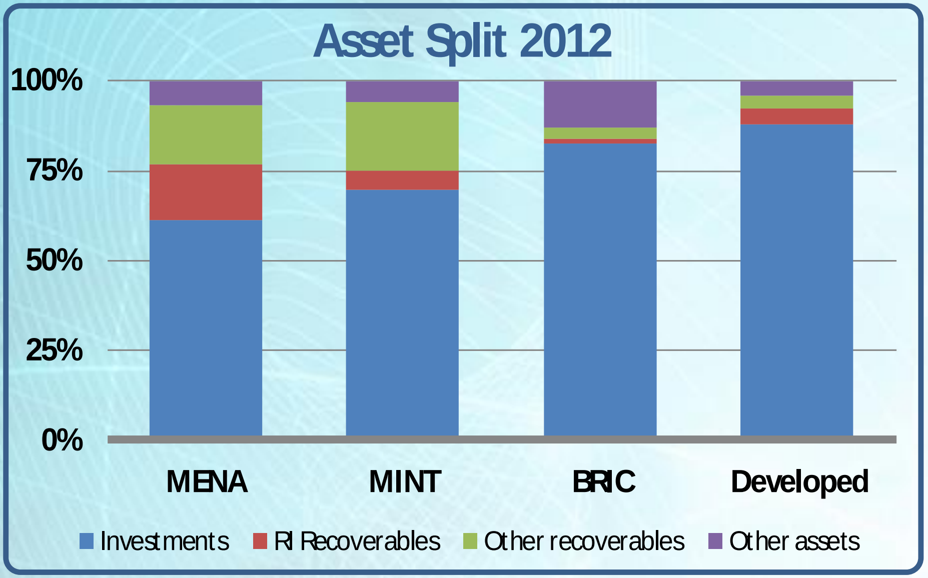
- Claims ratio has been increasing over the last 3 years
- Highest among other emerging markets
- Pointing towards the decline in reinsurance commissions as the key driver for combined ratio increase

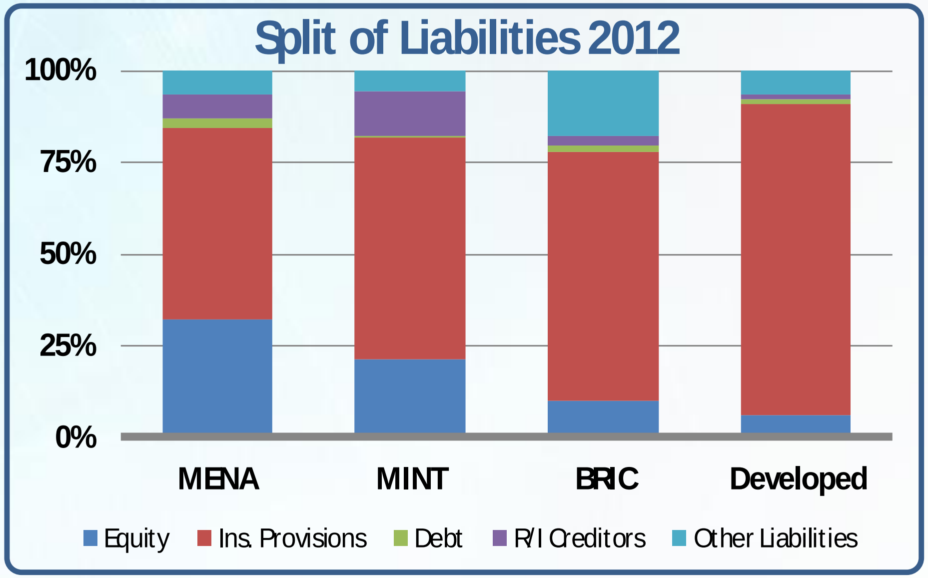
. . . as reinsurance cessions are reduced



- MENA is the market with the highest reinsurance dependence
- Retention levels have been increasing over last 7 years
- This impacts levels of reinsurance commissions

MENA: companies tend to be well capitalised but with high operating leverage



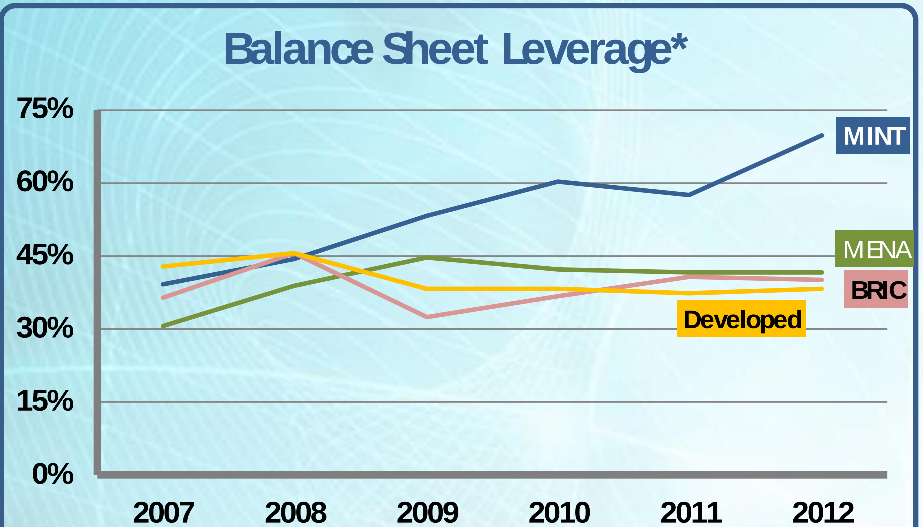


- MENA with the highest levels of recoverables in emerging markets
- Result of slow premium collection and high reinsurance sessions

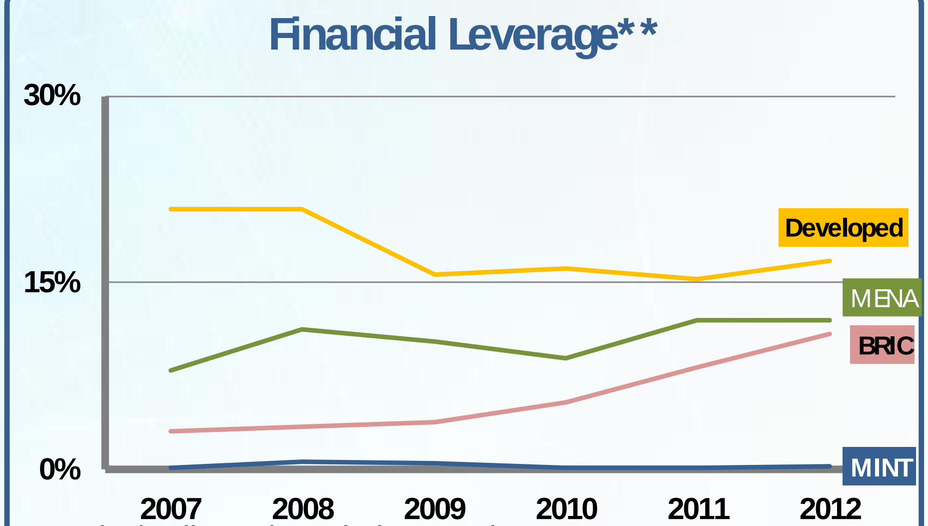
- Highest levels of capital in MENA
- Low level of debt but high operating leverage* in emerging markets

* *Creditors / capital and surplus*

Emerging markets: lower levels of debt but same levels of leverage



*Debt and Creditors/ Adjusted Capital & Surplus



**Debt / Adjusted Capital & Surplus

- Most markets with similar Balance Sheet leverage
- Leverage levels stable throughout years of financial crisis
- Leverage of developed markets under-represented due to the exclusion of some ultimate holding companies

- Significantly lower levels of financial leverage in emerging markets
- BRIC and MENA with increased financial leverage following financial crisis
- Negligible debt among MINT companies

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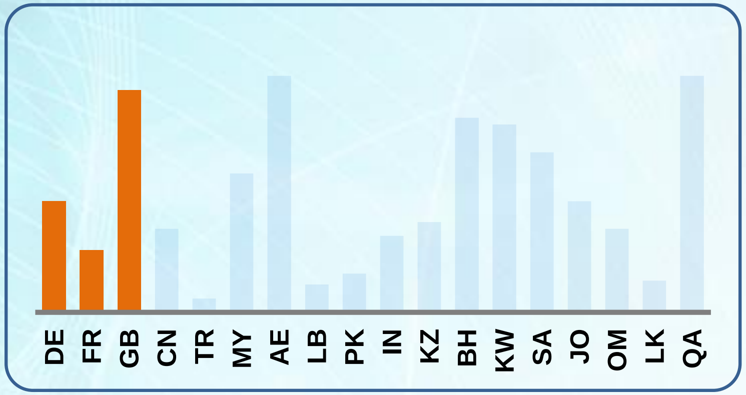
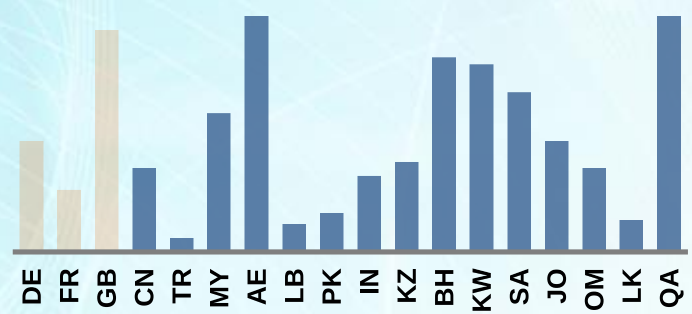
Drivers of demand for ratings: developed markets



MAIN DRIVERS	BENEFITS	KEY MARKETS
1. Transaction of international reinsurance business	• Ability to compete • Ability to select risks rather than being selected by cedents	• UK • Germany
2. Issuance of debt	• Lower cost of capital • Reduction in cost of financing	• UK • Germany • France
3. Insurance of large risks	• Access to large industrials • Source of income from foreign markets	• UK • Germany • France

Drivers of demand for ratings: emerging markets



MAIN DRIVERS	BENEFITS	KEY MARKETS
1. Insurance of large risks	• Ability to accept / front large risks • Increased reinsurance commissions	• GCC countries • India • Pakistan
2. Regulatory pressures	• License to continue operating • License to operate or write specific lines of business	• Kazakhstan
3. Competition with large international insurers	• Access to profitable business channels e.g. bancassurance	• All markets
4. Competitive pressure	• Enhanced credibility • Exhibit relative strength of the company	• GCC

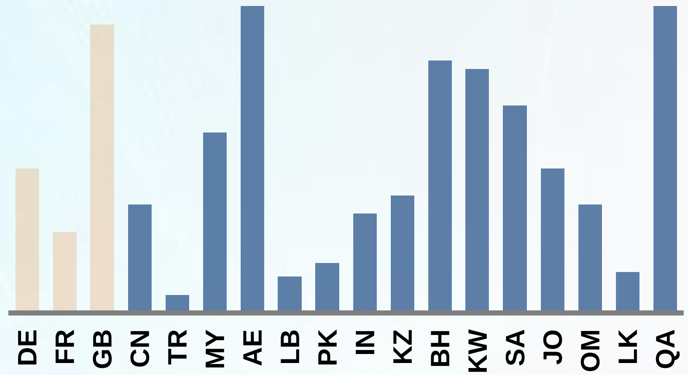
Ratings fulfil different needs in different markets

Developed markets

1. Access to large profitable segments:
    - Commercial lines
    - International reinsurance
2. Improved financial flexibility and reduced cost of capital through raising of debt

Ratings as tools for **financial flexibility** and access to **international lucrative segments**

Emerging markets

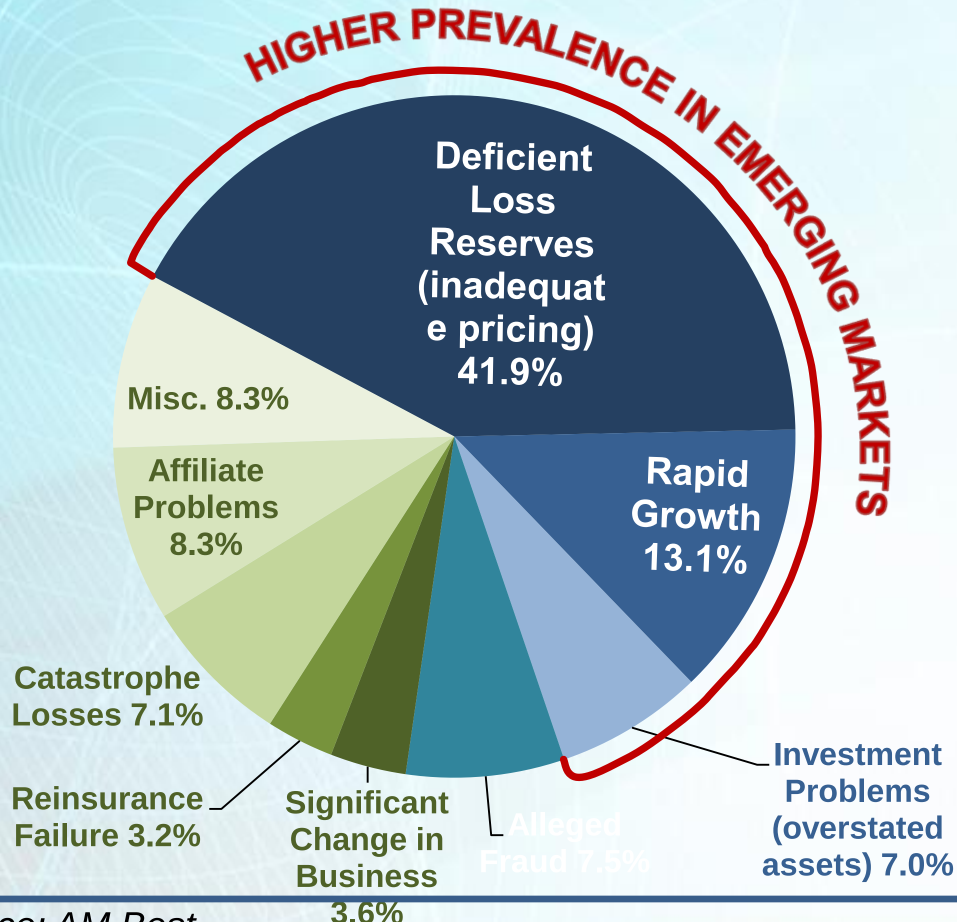


1. Regulatory approval
2. Access to fronting business
3. Increased reinsurance commissions as a result of (2) above
4. Better competitive positioning

Ratings as tools for **competitive positioning** and **improved operating performance**

Many of the causes of impairment are most prevalent in MENA

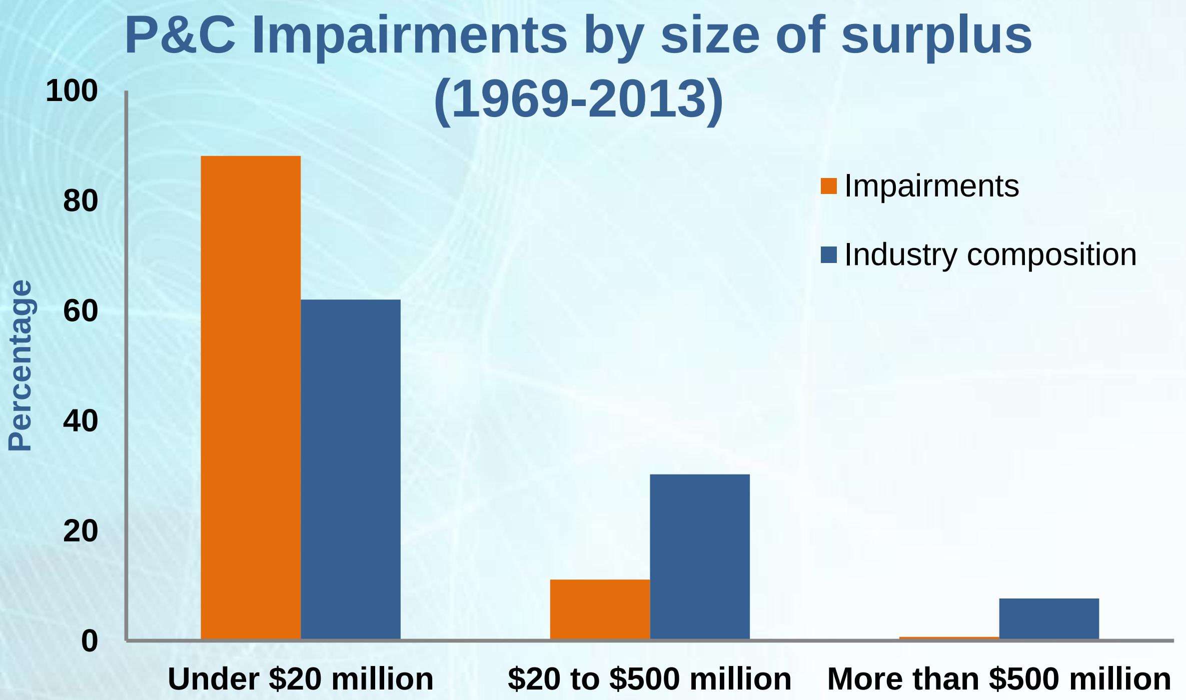
Primary causes of impairment of US P&C companies (1969-2013)



Source: AM Best

- Main reason for impairment is **inadequate pricing** resulting in deficient loss reserves
- Often insufficient external oversight of reserves in emerging markets
- **Rapid growth** can mask problems until it is too late to act
- **Valuation of assets** is questionable in many emerging markets
- These 3 factors account for almost 60% of impairments in the US

Size: big is better



- Size of surplus is important
- Great majority of impairments emanate from the smallest companies in the market
- Small companies are more prevalent in emerging markets
- Ability to withstand adverse developments is reduced among smaller companies

Source: AM Best

In some cases the “side effects” of obtaining a rating are equally important

1. External scrutiny of company’s operations and strategy
2. Promulgation of ERM practices
3. Assistance in adopting international standards

- Agencies which rate many insurers in the same market have unparalleled overview of the market and understanding of strategies implemented
- Rating agencies have been in the forefront of encouraging the adoption of better ERM practices
- Rating agencies are assisting in the development of standards that are both sensitive to market requirements and close to international standards

Thank You

Q&A