

**11<sup>th</sup> 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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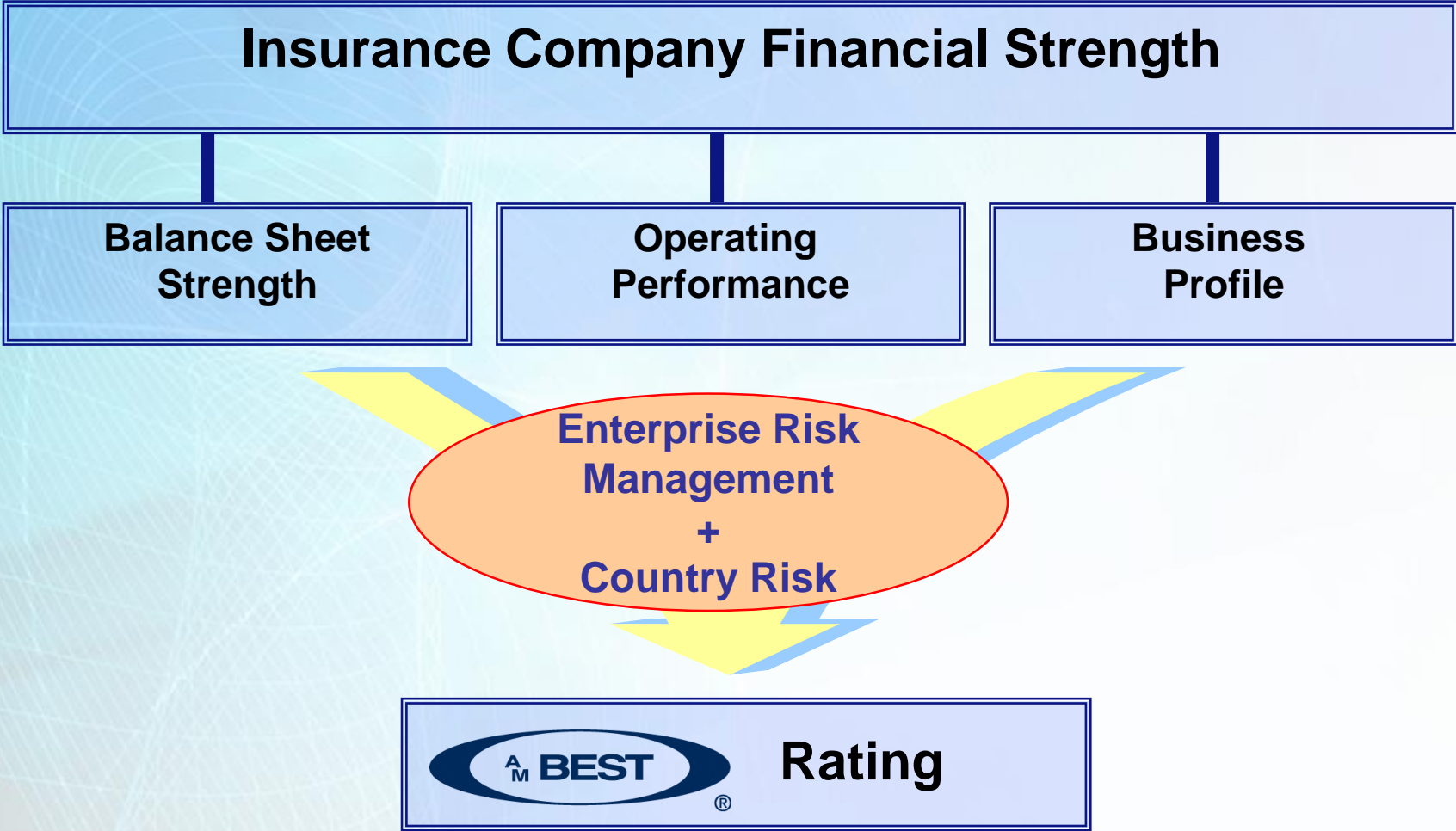


**1. Assessing financial strength**

**2. The MENA market**

**3. Role of ratings**

# A.M. Best rating methodology – key rating components



# Agenda

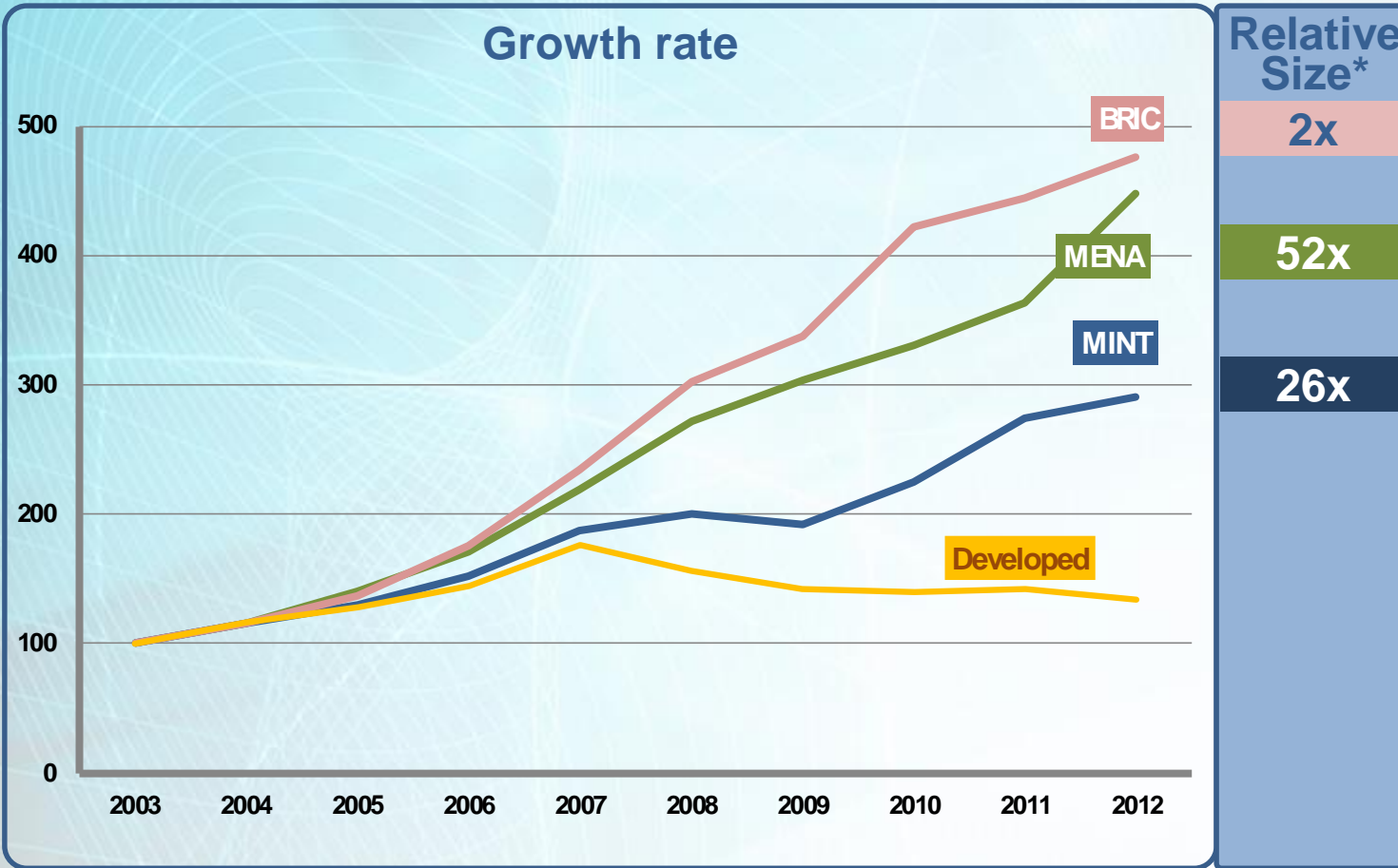


1. Assessing financial strength

2. The MENA market

3. Role of ratings

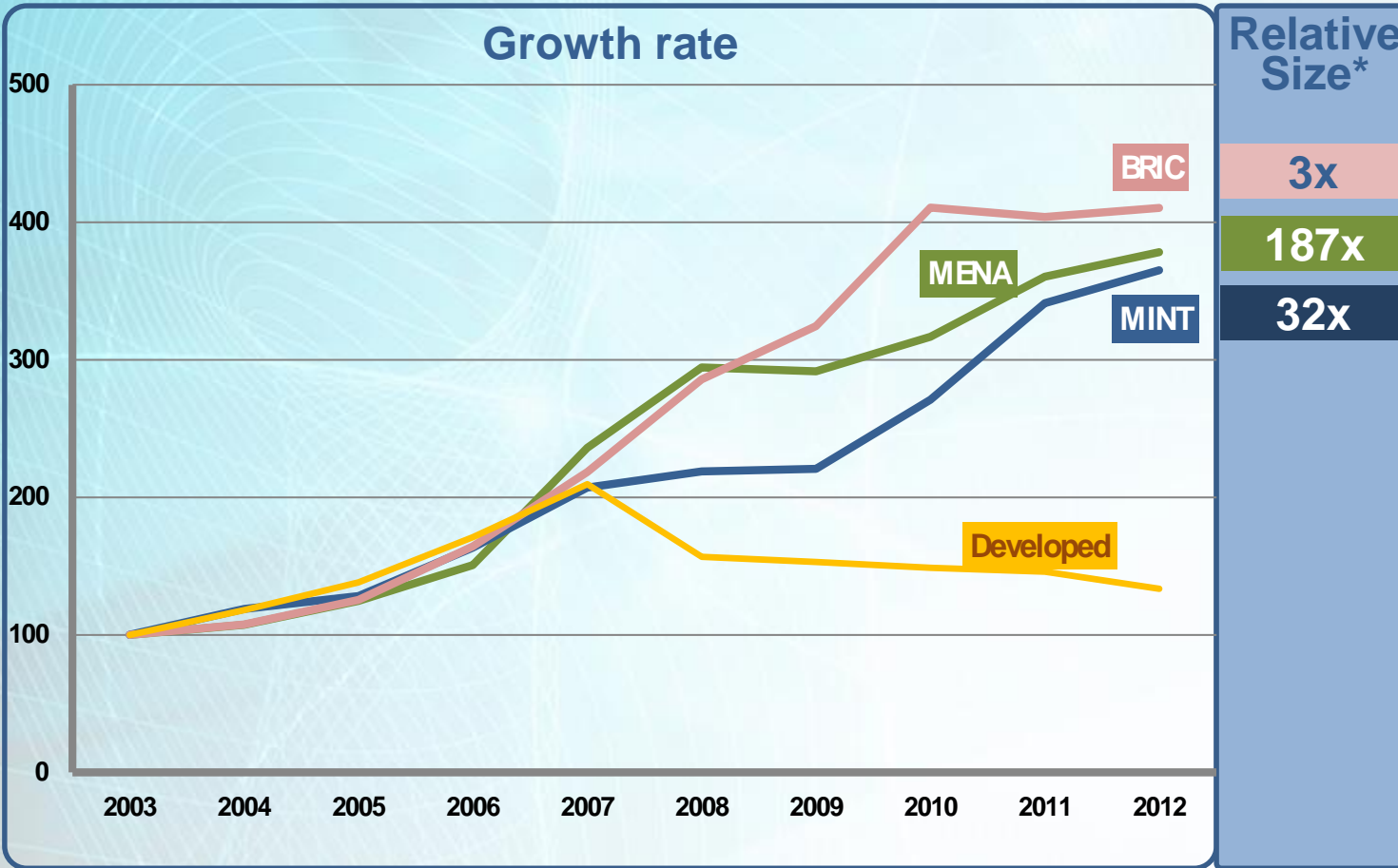
# MENA: Among the fastest growing emerging markets



- 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

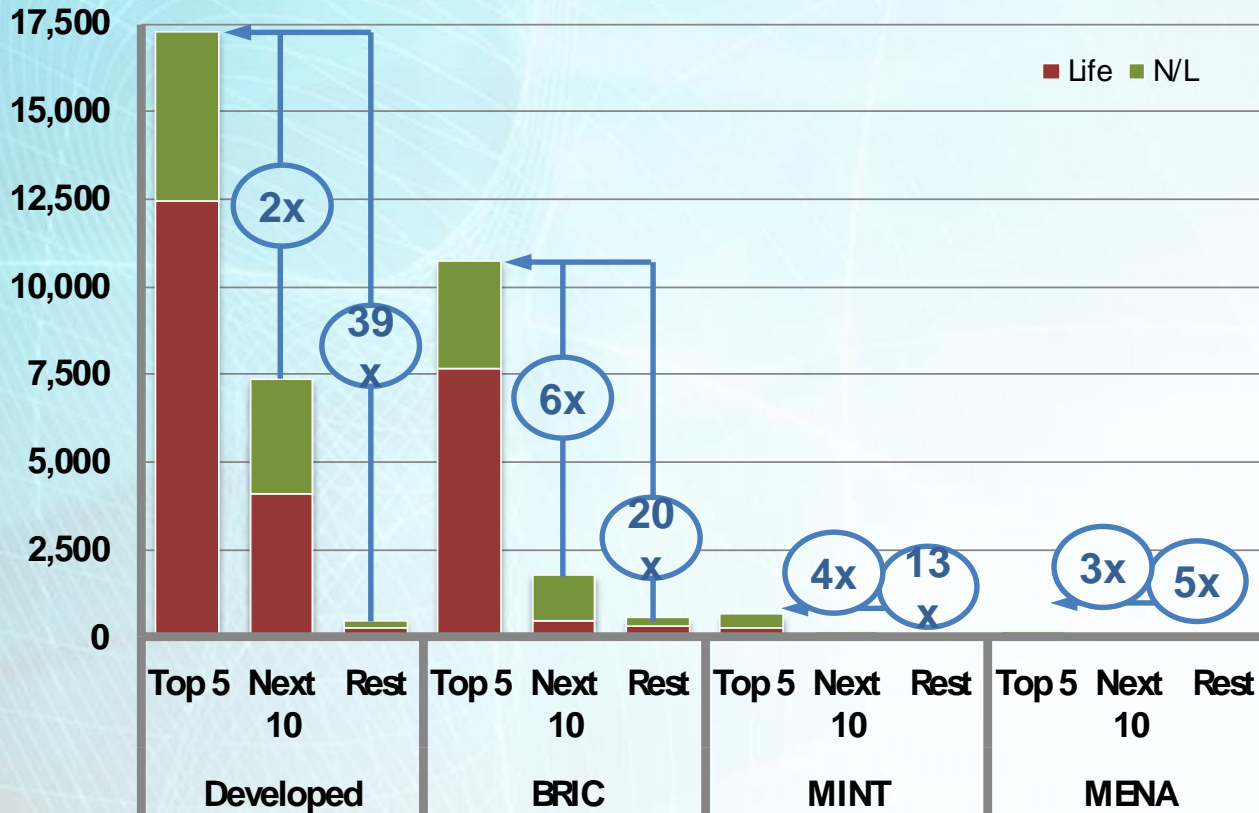
\*Relative size= Indicates how many times the market is smaller than the “developed” markets in the analysis



# Lack of specialisation leads to intense competition in smaller markets



Average GWP (USD millions)



- 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

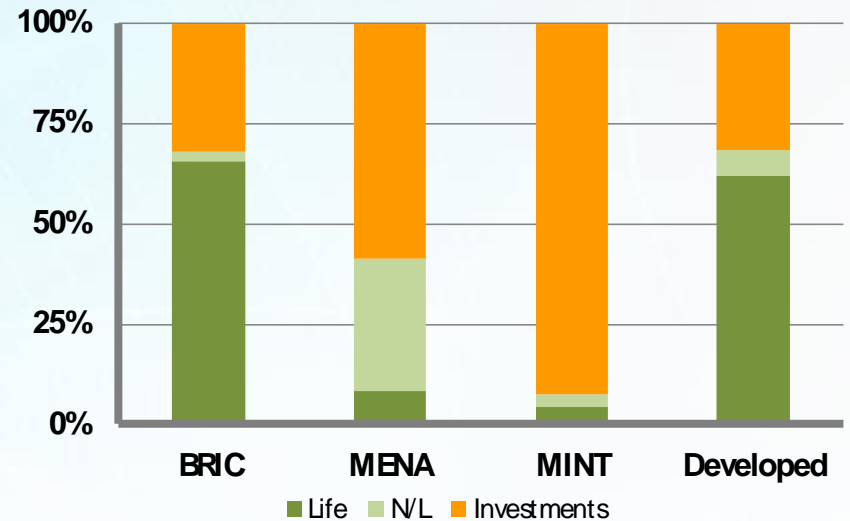


Cumulative pre-tax profits (USD millions)  
2006 - 2012



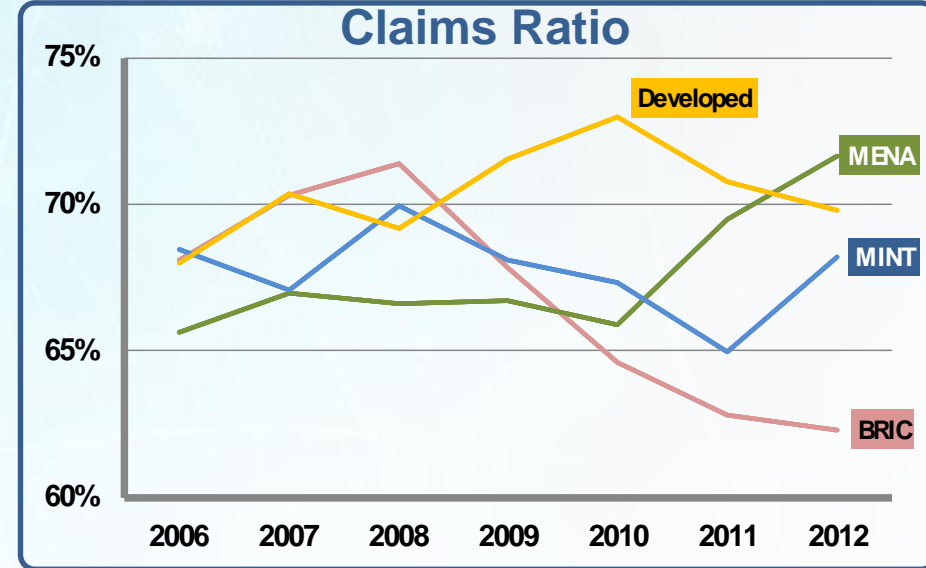
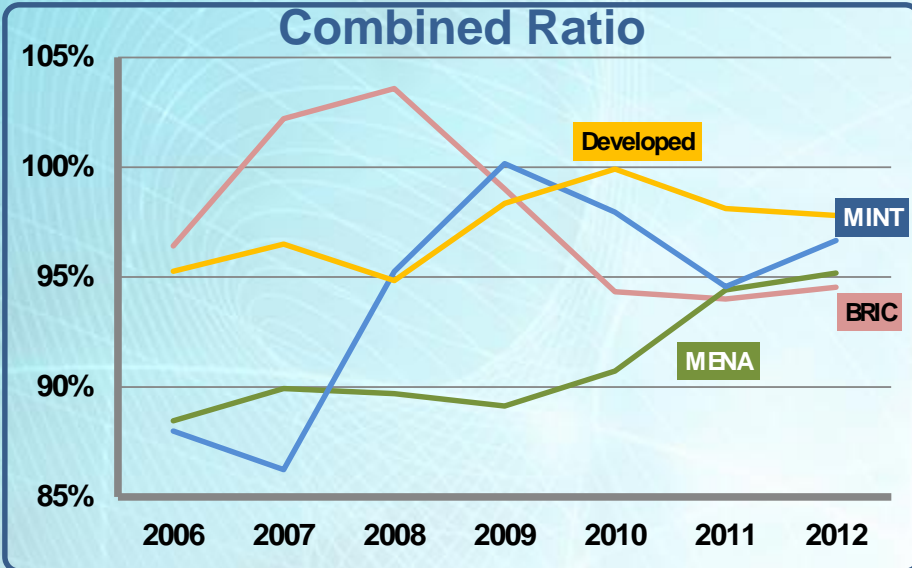
- Overall profits are lower than those of other markets examined
- Overall profitability very good considering relative size of the market

Profit composition  
2006 - 2012



- Heavy dependence of MENA companies on investment income
- Non-life business has been the second most important source of profit

# Technical profitability is deteriorating . . .



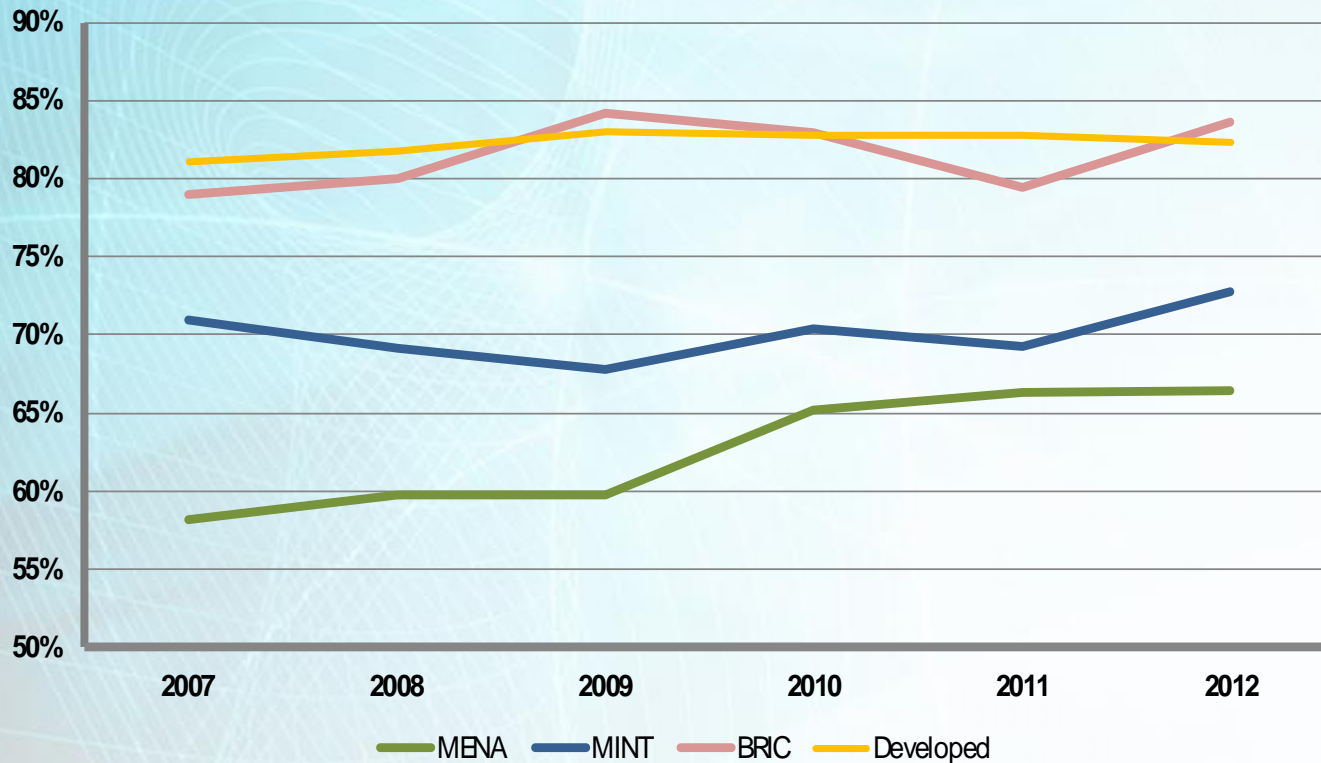
- Combined ratio has consistently been increasing
- Currently at historical high levels
- Current combined ratio at comparable levels with other emerging markets despite lack of catastrophic exposures

- 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



### Non Life Retention Ratio

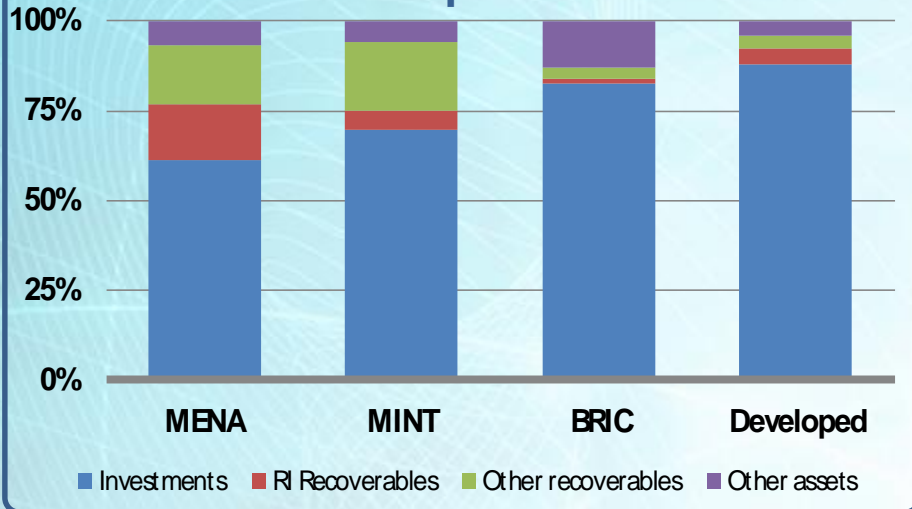


- MENA is the market with the highest reinsurance dependence
- Retention levels have been increasing over last 7 years
- This impacts levels of reinsurance commissions

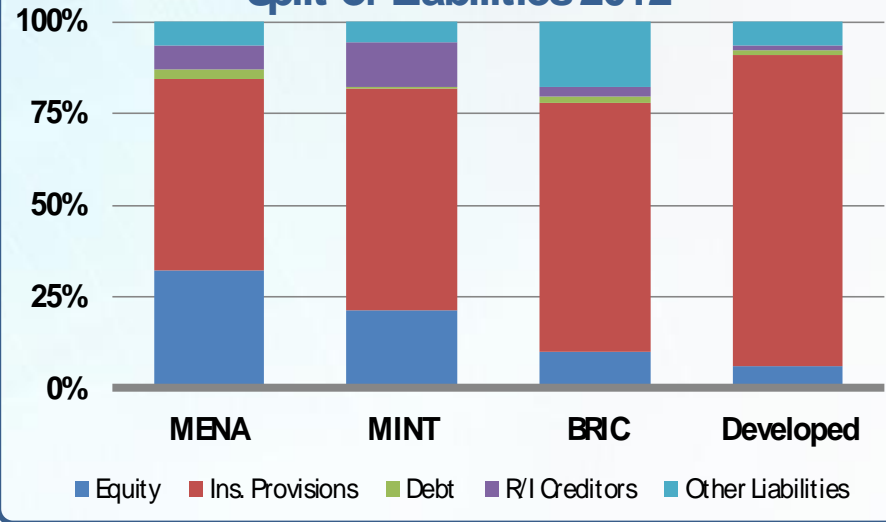
# MENA: companies tend to be well capitalised but with high operating leverage



Asset Split 2012



Split of Liabilities 2012



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

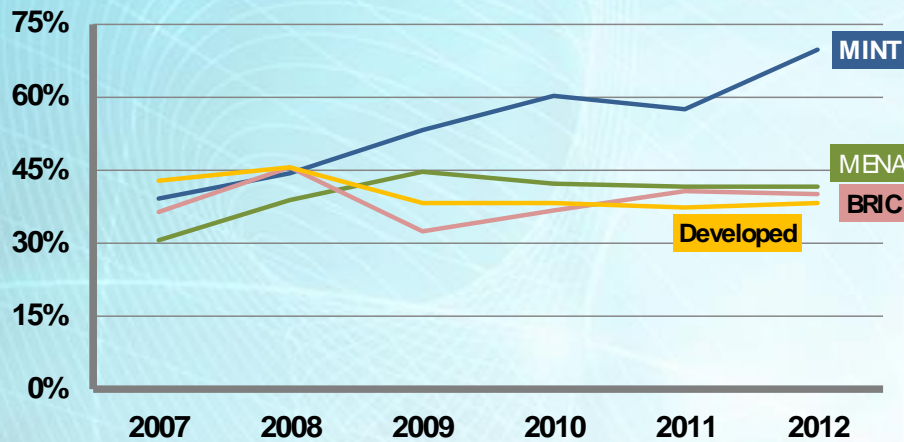
- Highest levels of capital in MENA
- Low level of debt but high operating leverage\* in emerging markets

\* Creditors / capital and surplus

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

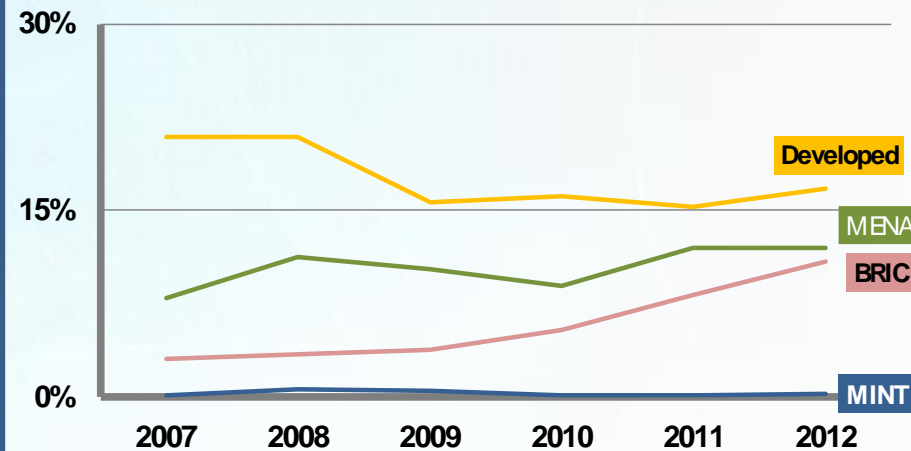


Balance Sheet Leverage\*



\*Debt and Creditors / Adjusted Capital & Surplus

Financial Leverage\*\*



\*\*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

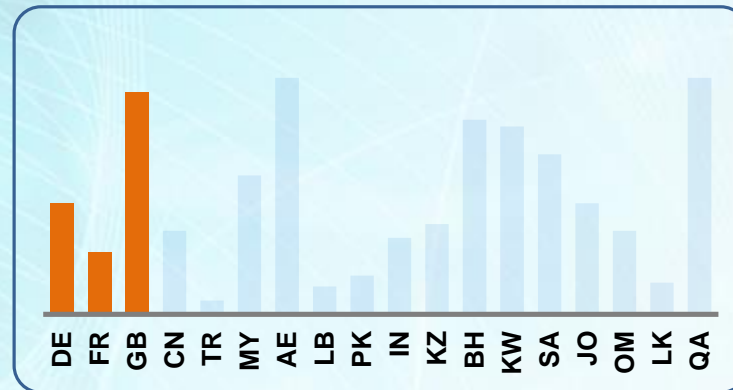
- Significantly lower levels of financial leverage in emerging markets
- BRIC and MENA with increased financial leverage following financial crisis
- Negligible debt among MINT companies

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# Drivers of demand for ratings: developed markets



## MAIN DRIVERS

1. Transaction of international reinsurance business
2. Issuance of debt
3. Insurance of large risks

## BENEFITS

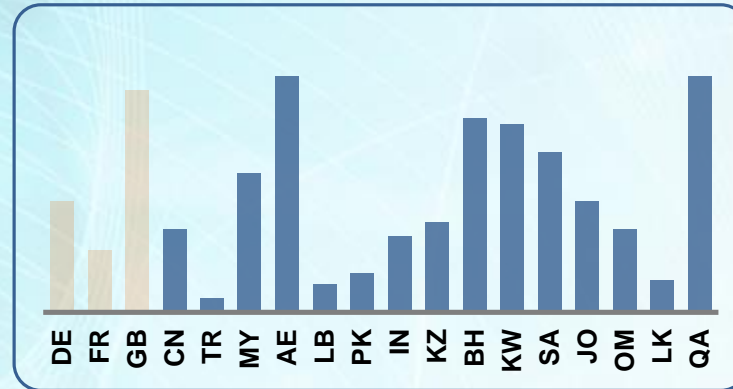
- Ability to compete
- Ability to select risks rather than being selected by cedents
- Lower cost of capital
- Reduction in cost of financing
- Access to large industrials
- Source of income from foreign markets

## KEY MARKETS

- UK
- Germany
- UK
- Germany
- France
- UK
- Germany
- France



# Drivers of demand for ratings: emerging markets



## MAIN DRIVERS

1. Insurance of large risks
2. Regulatory pressures
3. Competition with large international insurers
4. Competitive pressure

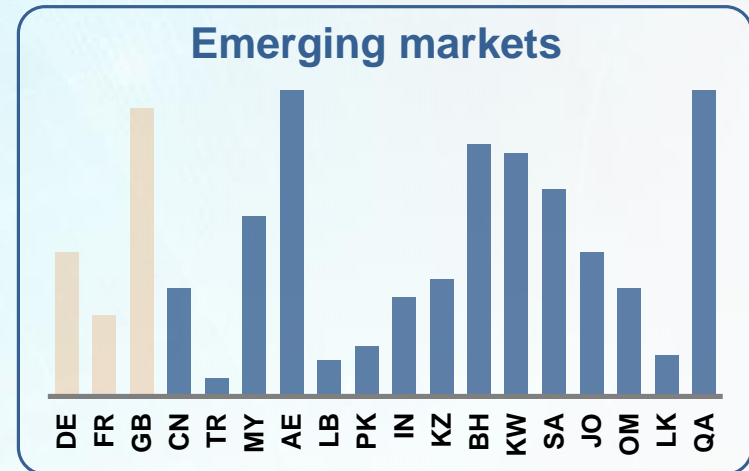
## BENEFITS

- Ability to accept / front large risks
- Increased reinsurance commissions
- License to continue operating
- License to operate or write specific lines of business
- Access to profitable business channels e.g. bancassurance
- Enhanced credibility
- Exhibit relative strength of the company

## KEY MARKETS

- GCC countries
- India
- Pakistan
- Kazakhstan
- All markets
- GCC

# Ratings fulfil different needs in different 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**

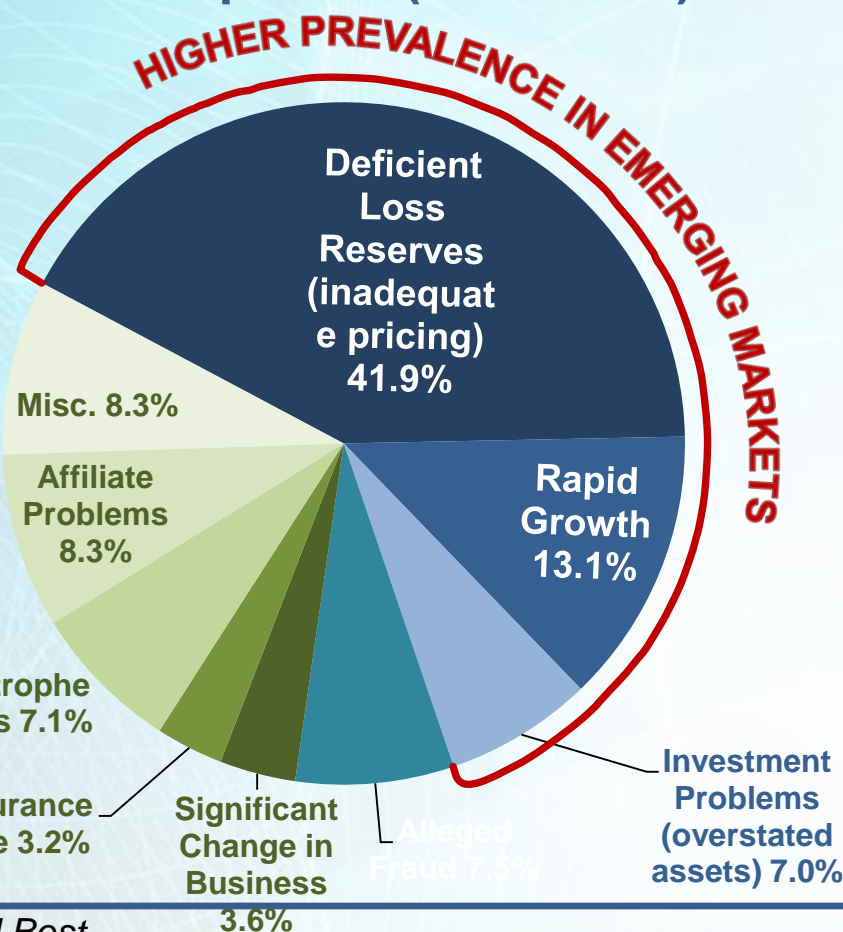
1. Regulatory approval
2. Access to fronting business
3. Increased reinsurance commissions as a result of (2) above
4. Better competitive positioning

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

# Many of the causes of impairment are most prevalent in MENA



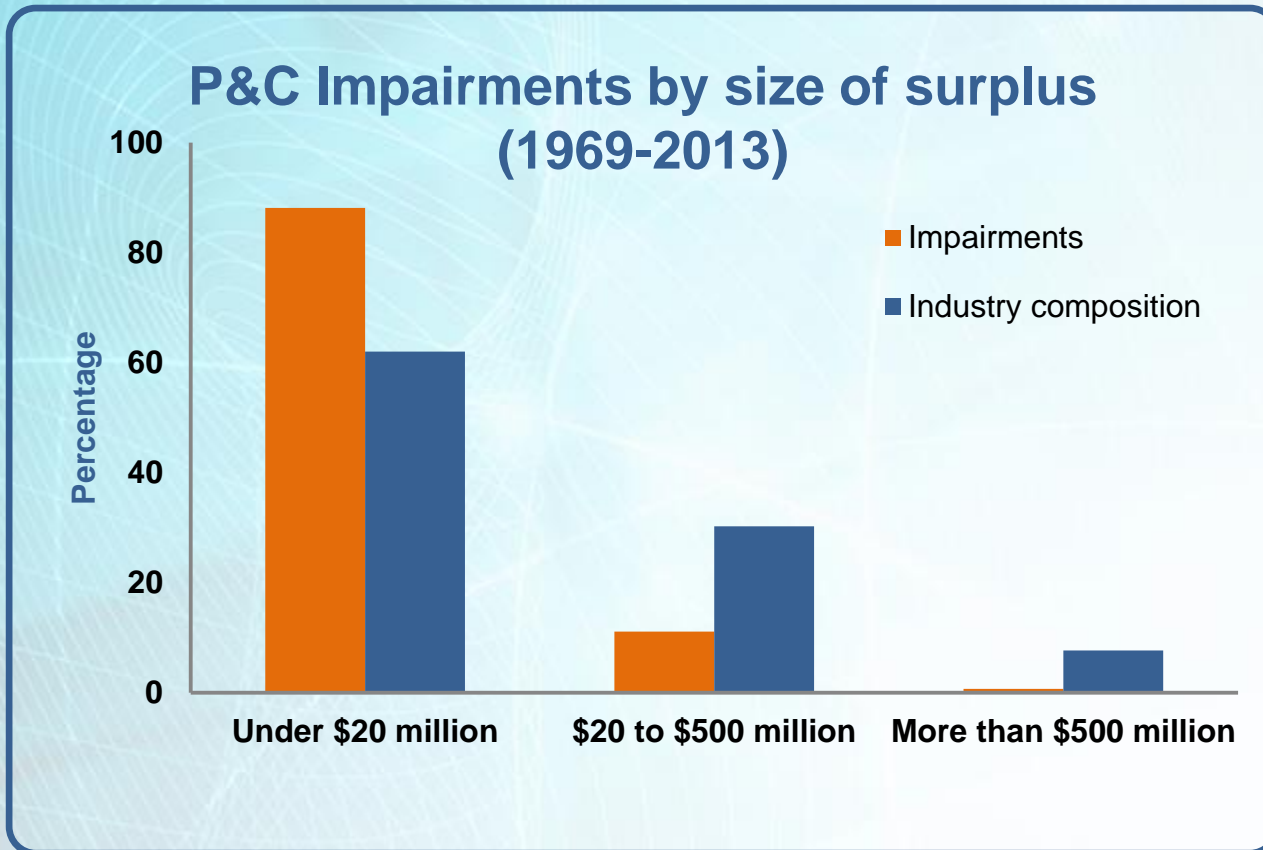
## Primary causes of impairment of US P&C companies (1969-2013)



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**