

Focus on the Gulf

Over the last three years, the insurance markets in the Gulf states have witnessed remarkable transformation and growth. There are significant repercussions on client, risk carrier and intermediary strategies, both locally and globally. **By John Byrom**

The Gulf Cooperation Council (GCC) states – consisting of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE) – have enjoyed booming economic conditions over the last three years due to the accelerating rise in world crude oil and natural gas prices. These annual economic growth rates range from 5 to 10 per cent per annum. In the case of non-life insurance premiums, the rate of growth is even more extreme (see figure 1).

According to Peregrine Towneley, Chairman of Jardine Lloyd Thompson's Middle East and North Africa (MENA) initiative, the region remains "a key area of ongoing economic growth despite the recent downturn in other areas of the world. Not only that, but current trends suggest that the economic growth divergence between the Middle East and Western countries is more likely to widen than narrow in the near- to medium-term future."

Nagib Bahous, Group Vice President of Arab Commercial Enterprises (ACE), with whom Jardine Lloyd Thompson recently concluded a joint venture (see later), echoes these sentiments. "With the continued rise

in oil prices, government expenditure on developments and projects in the GCC will increase. Economists were forecasting a boom for a minimum period of five years when the oil prices were below \$100 per barrel. With the steep increase in the per barrel oil price, it is envisaged that government expenditure will also increase. This will be reflected in increased activity in all segments of the economy."

Shifting petrodollar investment

Economic growth potential on its own does not account entirely for the remarkably rapid development of all insurance markets

in the region. "Regional government focus is on building modern infrastructure, sustainable and increasingly diverse economies and introducing sophisticated regulatory frameworks to satisfy international investors," Towneley observes. "These factors, in conjunction with the region's increasing interest in forging strategic overseas investments via their sovereign and other funds, are making the area very attractive."

"The region has experienced macroeconomic growth," according to Fareed Lufti, General Secretary of the Emirates Insurance Association, "especially

FIG.1: PHENOMENAL GROWTH

	Annual growth in real GDP (%)			Growth in non-life insurance (%)	
	2005	2006	2007	2005	2006
Bahrain	6.91	6.50	6.70	8.28	21.02
Kuwait	10.01	8.55	6.90	13.24	n/a
Oman	5.74	6.60	5.30	18.91	13.53
Qatar	6.07	9.90	8.40	33.88	n/a
Saudi Arabia	6.05	4.30	3.50	n/a	25.70
UAE	8.20	9.40	7.50	30.41	23.07



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in energy-rich states in the GCC, where we are witnessing large investments in infrastructure and growing international trade."

In contrast to the situation in the 1970s – when the investment of petrodollars was substantially concentrated outside the region – local political and economic strategies have shifted. The focus is now concentrated on local and regional investment to: further develop upstream and downstream oil and gas facilities; improve all forms of infrastructure; encourage diversified industrial and commercial development; promote tourism, leisure and major sporting events; and expand the services sector of the various GCC economies.

In addition, private foreign investment in all sectors of the economy is also being encouraged and facilitated much more than was the case during the late twentieth century. The potential growth prospects in the GCC caused by escalating world oil and gas prices are also clearly significant.

Future price volatility is notoriously difficult to forecast (although currently it appears to be edging upwards rather than downwards), but it is worth noting that

GCC states – Kuwait, Saudi Arabia, Qatar and UAE, in particular – are very mature players in the international energy market. Over the last 30 years, they have demonstrated their ability to prudently manage their state-owned corporations and public finances in both good times and bad.

Sophisticated local market

The enhanced and modernised supervision of key GCC insurance markets has undoubtedly had the effect of significantly boosting investor and consumer confidence in insurance markets in the region.

The establishment of financial centres in Dubai, Doha and Bahrain, for example, is just one indication of serious regional intent to promote and expand the services sector. These cities now offer state-of-the-art regulation in banking, insurance, reinsurance, financial services and other related service industries (such as insurance and reinsurance broking).

By providing a blend of infrastructural facilities, regulatory environment and business development opportunities, they enable the private sector to take advantage of the untapped financial services potential both within the region and elsewhere,

acting within an intermediate time zone between the east and west. "The establishment of international financial centres in some states has attracted large financial conglomerates, created a professional legal environment and is generating much capital market interest," Lufti confirms.

In the last five years domestic insurance legislation has also been thoroughly revised in many of the GCC states. This has taken the form of a transition from outdated and inadequate regulation (in the case of Saudi Arabia, from virtually non-existent regulation) to relatively sophisticated supervisory control.

New and revitalised regulatory legislation has also affected the banking and financial services sectors. One effect has been to stimulate the development of specialised liability insurance (such >>>

OUTSTANDING OPPORTUNITIES

- New large public and private construction projects.
- New infrastructural development projects.
- Rapidly increasing corporate and individual insurance consciousness.
- Employer-funded private health insurance.
- Regulation encouraging financial risk and liability insurance.
- New airlines being established and very rapid development of many existing airlines.



Doha, Qatar

as professional indemnity and directors' and officers' liability) and the potential growth of financial risk coverage in a wide variety of areas, including credit insurance.

According to Mark Drummond Brady, International Chairman of the Jardine Lloyd Thompson Group, the de-monopolised market that is now emerging in Saudi Arabia is generating the need for intermediaries with integrity, expertise and global reach to service the needs of increasingly knowledgeable and selective clients. This is why Jardine Lloyd Thompson recently formed a joint venture with the retail insurance broker and underwriting agent ACE to provide insurance and reinsurance broking in that state.

New forms of insurance

In some states the regulation process has also embraced the introduction of new legally compulsory classes of insurance. Recent examples of the introduction of compulsory classes of insurance include motor third-party in Saudi Arabia and medical expenses insurance for expatriates in Saudi Arabia and Abu Dhabi.

Compulsory medical insurance for expatriates is to be introduced shortly in Dubai, and is under active consideration in Bahrain. In addition, Saudi Arabia's intention to make private medical insurance compulsory for the Saudi national indigenous workforce has been announced by the Ministry of Health.

The effect of these measures has been to significantly boost the national premium income base of the affected countries, both in the short and prospective long terms.

Lufti points out that the recent trend of governments opting to shift the burden of health coverage to the private sector is going to aggressively drive increased retail consumer demand for insurance in the Middle East and therefore immeasurably strengthen private insurance markets.

Islamic compliant insurance, or *takaful*, is also becoming increasingly popular as an acceptable alternative to conventional insurance in the GCC states. This is having the effect of opening up retail personal lines protection and savings insurance opportunities to a new clientele previously either indifferent to the benefits of insurance or unwilling to ever contemplate buying it.

Opportunities for all

"The region is an area of growth for many of our international clients," points out Towneley, "and as such our investment is both an ongoing commitment to those clients, as well as a strategy to create opportunities to serve a rapidly growing indigenous client base."

Many different international companies are operating in the region, from service industry participants (such as banks, insurance companies, insurance intermediaries, loss adjusters, auditors, management consultants and legal firms) through to major energy

companies, which are increasingly forming joint-venture operations with local energy and utility companies.

These firms need a combination of sophisticated multinational insurance know-how, with detailed knowledge of local operational and compliance requirements, such as the provision of appropriate employee benefits to expatriate staff.

The authorities in the GCC states also now prefer to see foreign multinational interests becoming integrally involved in local economies through properly constituted and compliant local offices and facilities, rather than simply offering advice and ad hoc subcontracted assistance from outside the region. All of this has been greatly stimulated in the last five years by the economic boom, encouragement of foreign inward investment, a vastly improved regulatory environment and the establishment of appropriate infrastructural facilities.

The indigenous insurance market is also growing rapidly, including major local energy and utility companies, as well as small, medium and large industrial companies. There are also the overseas investment arms of large public and private entities, such as TAQA (the overseas investment arm of the Abu Dhabi government) and Aramco. Such companies are continuously acquiring key shareholding interests in companies based in a wide variety of countries abroad. (Examples in respect of Aramco include a major shareholding investment in the Philippines National Oil Company and the acquisition of GE Plastics in the United States.)

An increasing number of local public and private equity funds are also seeking investment opportunities overseas, ranging, for example, from department stores in the United States to major cruise line companies and sporting, leisure and property interests.

"The need to combine global knowledge with sensitivity to local conditions is critical," according to Towneley. "This regional growth looks set to continue for some time to come and we wish to play our full part in it, respecting and complementing local businesses and local customs and cultures." **RS**

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Gulf risk rating

Most of the GCC states have relatively benign risk profiles, with only Saudi Arabia having ratings above 5 (in relation to terrorism, contract repudiation and legal and regulatory risk, respectively). In fact the country economic risk assessments for most of the GCC states is actually the same or lower (at around 2-3) than many EU countries, including the United Kingdom. This would appear to indicate clearly the comparatively strong current and ongoing financial position of all GCC states.

In relation to the terrorism risk in Saudi Arabia, Elizabeth Stephens, Political Risk Analyst at Jardine Lloyd Thompson, points out that the huge investment that is taking place in oil infrastructure (for example, Aramco is investing \$9 billion to increase crude oil production capacity from 11.2 million bpd to 12.3 million bpd by 2010) makes the country comparatively wealthy – but coincidentally vulnerable to terrorism. The need for related insurance protection is especially acute with respect to Western managed banks or joint-venture partners, and hotels. "Oil and petrochemical facilities in Saudi Arabia are firmly on the terrorists' radar, demanding fairly high terrorism insurance rates," says Stephens.

She also points out, by way of example, that risks such as hotels owned by Western investors that take a hands-on approach to security attract lower terrorism premium rates than properties with local owners who may not have as objective a view of the risk due to the perception that their properties are not targets. Illustrating the differentials in terrorism rates within the GCC from east to west, Stephens points out that hotels considered to have adequate security in Saudi Arabia attract terrorism rates in the region of 30 per cent higher than Oman, for example, where there are lower threat perceptions.

The risk of expropriation in Saudi Arabia is considered to be low and the main economic risk to foreign investors is the potential renegotiation of government contracts through the use of taxation or other legal reforms. Saudi Arabia is now on the list of top ten countries implementing economic reform, in fact, following accession to the World Trade Organisation in late 2005.

WORLD RISK REVIEW™ RATINGS FOR GCC STATES

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
Strikes, riots and civil commotion	5	4	2	2	5	4
Terrorism	5	5	3	4	7	4
War and civil war	3	3	2	3	5	3
Country economic risk	2	1	2	2	2	2
Currency inconvertibility and transfer risk	2	2	2	2	3	2
Sovereign credit risk	4	2	3	2	2	2
Expropriation	2	2	2	2	3	2
Contract agreement repudiation	5	5	3	5	6	6
Legal and regulatory risk	4	5	4	4	5	4

With regard to corruption, government-to-government deals are often favoured because they eliminate agents' fees and other forms of commission to individuals. At the same time, however, commissions have been standard practice in Arab countries for centuries – including arms deals – and there are vested interests highly resistant to reform.

The legal system in Saudi Arabia has suffered in the past from a lack of consistency and efficiency in settling commercial disputes, which has left foreign businesses feeling discriminated against by the system. Unsurprisingly, alternative dispute resolution mechanisms have been

favoured in these circumstances.

However, Stephens comments that a welcome relaxation of restrictions on foreign investments and a series of legislative changes since 2003 relating to copyright and competition laws and tax reductions for foreign companies have paved the way towards a more investor-friendly environment and transparent legal system.

The Saudi tax system discriminates against foreign investors by levying a corporate tax on their profits, compared to a very modest religious tax levied upon local firms. Nevertheless, the overall tax climate in Saudi Arabia is relatively favourable.

World Risk Review™

The World Risk Review™ provides short- to medium-term assessments of the level of risk associated with a range of political and economic perils that may impact upon business.

The risk review rates nine perils in 197 countries and territories, captured under the broad categories of political violence, the trading environment and the investment environment.

The model is designed to enable companies to

effectively identify the perils that may impact on their business and deliver an understanding of the relative level of risk associated with each peril, using a rating scale of 1 (low) to 10 (high).

The model incorporates independently verifiable data from 53 international sources, drawn from Europe, North America, Australia, Asia and the Middle East. The diversity and breadth of the data sources is intended

to reduce, to the greatest extent possible, cultural bias, political influence and personal interpretation.

This approach contributes significantly to the robustness and integrity of the model and recognises that most country risk ratings available to business have traditionally been heavily influenced by Western bias reflecting the historical dominance of Western foreign investors and trading businesses.

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