Regaining growth momentum

Year 2018 is presenting insurers with a mixed bag of stringent regulations that will fundamentally alter the industry, significant M&A activity that will bring in strong players looking for lucrative opportunities, and innovation & digitisation that will redefine distribution and delivery. Financial reporting requirement will pose challenges and the real test would be the ability to sail through another volatile year of new laws and regulations.

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Rosy growth is predicted for the insurance industry in the Middle East in 2018 and beyond in spite of some expected volatility, after a year that saw bold regulatory measures in a market that remained fragmented.

Insurance markets in the GCC are anticipated to grow at the fastest annualised average pace of 12.1% with the non-life segment projected to clock a rapid CAGR of 11.7% up to 2021.

Insurance penetration in the region is forecast to expand from 1.9% in 2016 to 2.5% in 2021. The expansion is driven by an improvement in penetration of non-life business to 2.3%, while that of life insurance is expected to remain stable at 0.24%. Penetration rates continue to remain below the international average, presenting immense scope for growth, according to a report by Alpen Capital.

The cyclical upswing in the global economy is set to continue in 2018 and 2019, supporting insurance premium growth, according to Swiss Re Institute's Global insurance review 2017, and outlook 2018/19 report.

Global non-life premiums are forecast to grow by at least 3% and life premiums by about 4% in real terms annually in 2018 and 2019.

Emerging markets will remain the driver of global non-life and life premium growth. Non-life premiums in these markets are forecast to rise by 6% to 7% in real terms annually over the next two years, little changed from 2017.

The overall non-life premium growth reflects the stabilising economic conditions in most regions.

"In terms of growth and profitability, 2018 is expected to be in line with 2017 for the insurers, backed by regulatory controlled and actuarially verified pricing on medical and motor business. This will bring more of the regulatory toughness seen in 2017. Other regulations in the pipeline, such as life insurance, family takaful and bancassurance, will keep insurers on their toes," said Mr Sachin Sahni, Credit Analyst, S&P Global Ratings.

"With VAT coming into force from 1 January 2018, apart from operational challenges which seem yet to be resolved, it is expected that insurers' cash flow, liquidity and profitability could come under pressure due to un-provisioned tax liability. While the regulations specify that non-life insurance will attract VAT, whether insurers are able to recover the tax from policyholders is yet to be tested," Mr Sahni said.

Continuing consolidation

There are many contributory factors that will trigger consolidation in 2018. These include regulatory measures, changed market sentiment, pressure on managements, interest of international players and increasing competition.

It is expected that the region will see significant M&A activity within the insurance sector with new entrants seeking potentially lucrative opportunities across the region.

In view of the high cession rates in the GCC and the financial as well as tax incentives offered by autonomous financial centres in Dubai and Qatar, foreign reinsurance and management firms are attracted to these centres to lend their underwriting capabilities.

As the business base grows, new reinsurers are likely to set up branches in these hubs and support the advancement of the insurance sector.

"The last leg of Financial Regulations of 2014, which encompass solvency requirements, could put around one-fifth of the market under the regulator's scanner and could trigger the long awaited consolidation," said Mr Sahni.

"We are seeing a number of international carriers either establishing or using existing UAE offices as a base to manage their African book of business. Interestingly, it is not simply the North African states that traditionally make up a firm's MENA territory but also the various sub-Saharan countries as well," said Mr Tom Bicknell, Partner, Pinsent Masons LLP.

The regulatory measures initiated in 2017 will have spill over effects in 2018 too. Smaller insurers will face moderate credit risks in 2018 as they tend to adapt more slowly to the updated regulatory regime.

Brand strength will be the main driver of M&A in the next three years, reflecting the transition to digital sales which requires a strong and recognisable brand, according to an M&A survey by Willis Towers Watson.

"There are many opportunities for consolidation in the market with emerging competition and new capacities coming into the market. The biggest controlling pattern in this region is ownership, which is one of the barriers to attracting international investment. Many major international insurers interested in this region are keen on acquiring local businesses, but they would need 100% control. Market places that gave 100% international control have seen growth taking place," said Mr Neil B J Irwin, Head of Central & Eastern Europe, Middle East & Africa Region, Willis Towers Watson.

"The GCC insurance sector has started showing signs of consolidation following the strengthening regulatory landscape. The trend is gathering momentum due to stringent reserving and solvency requirements in some countries. The M&A activity in the GCC insurance sector has picked up in the past couple of years as companies are looking for strategic expansion or mergers to form stronger entities," said Mr Siraj Bhavnagarwalla, Managing Director, Alpen Capital (ME).

Impact of regulations

"The new year will be dominated by the impact of regulatory reforms, particularly in the UAE, as more companies begin to align their positions to comply with limitations on exposure to potentially volatile instruments such as real estate and equity capital markets, as well as solvency positions," said Mr Adil Abid, Partner, Financial Services, KPMG Lower Gulf.

The regional debt market looked to attract significant inflow from the insurance sector over the past year. This trend is likely to continue during 2018 and the sovereign debt issuance in the GCC is likely to rise in 2018/19.

The CAT impact on rates

The significant catastrophe losses incurred from Hurricanes Harvey, Irma and Maria, and the sizeable losses from the earthquakes in Mexico and wildfires in California will have a ripple effect in the reinsurance market in the Middle East in 2018, translating into enhanced rates.

"Reinsurers will push pricing increases during the 2018 renewal periods, but there are still a number of unknown variables related to the reinsurance supply/demand equation.

We view that reinsurers, in particular 'Aa'-rated ones, such as Munich Re, Swiss Re and SCOR, to maintain healthy buffers above target capital levels even after these losses," said Mr Mohammed Ali Londe, Assistant Vice President-Analyst, EMEA Insurance, Moody's Investors Service.

The increased awareness and the fires that have occurred over the past 12 months, combined with external factors, will lead to increased rates from 2018 onwards.

"We see that the treaty leaders are imposing restrictions and other limitations. Because of the external factors of natural calamities, plus the greater awareness of the inherent risks in unprotected panelling in high rise buildings, the industry is going to have an awakening which would result in enhanced rates, particularly on the property side," said Mr Walid Sidani, Managing Director and Senior Executive Officer, Kay International AMEA.

"This market is heavily reinsured into the global market. With the kind of losses seen in the US, especially after the natural calamities, there is some hardening of rates in the reinsurance market, (though) not as much as we would like to see. We will not see a downtrend in pricing; instead prices will be stabilised or may go up marginally. Good insurers, as they grow and build their reserves and capabilities, will start retaining more," said Mr Mustafa O Vazayil, Managing Director, Gargash Insurance Services.

Life market to grow

The life insurance market in the region, with a smaller portfolio compared to the global markets, is projected to grow at an annual average rate of 5.3% led by rising population and risk awareness. The long-term demand for life insurance will be driven by the region's population size, rising income and wealth, and the existing significant protection gap.

"The implementation of Financial Regulations 2014 issued by the UAE Insurance Authority is certainly a step in the right direction to steer the insurance sector towards the path of development and protecting the interest of the policyholders," said Mr Rajesh Kandwal, CEO & Managing Director, Life Insurance Corporation (International) BSC.

"The life sector, particularly on conventional products line, needs a helping hand in improving the life insurance penetration which is very low in the region. We look forward to the relaxation in capital requirement, broadening the asset allocation norms and product regulations. Unlike unit-linked products which are high-risk, high-return instruments, conventional products are subject to restrictions on many areas. Some of these restrictions, if relaxed, can help insurers offer more value to customers," Mr Kandwal said.

New lines of business

New lines that hold promise in the coming years include technology-based businesses such as drones and driverless cars.

"By 2022, the commercial drone market in the Middle East and Africa is expected to generate about $200 million in revenue and that, of course, is all going to require insurance," said Mr Vincent Vandendael, Chief Commercial Officer, Lloyd's.

"New guidelines made it mandatory for all commercial unmanned aerial vehicles (UAVs or drones) to obtain insurance coverage. This line of business is set to grow as the compulsory insurance is aimed at protecting both the operator and the companies hiring the facility as well as other parties exposed to risks," said Mr Sidani.

"Insurance companies, reinsurers and brokers have to adapt their products and services in line with the emerging demand for drone insurance. Some leading companies have been utilising drones and the usage is becoming widespread. The liability, particularly third-party liability, as well as business interruption, are the most significant exposures for drones rather than the drone damage itself," he said.

Technology adoption

Though the industry has been criticised for slow adoption of technology, more players will embrace InsurTech and automation.

"We should expect to see more and more insurance companies pushing innovation and digitisation boundaries during 2018, as they seek competitive advantage through the adoption of InsurTech/ FinTech solutions. Blockchain, telematics and wearable technology, for example, provide greater opportunities for the sector, such as understanding their customers better and responding with need-based propositions while improving operational efficiency and financial performance. Company boards are likely to focus on budgets that include spending towards such initiatives," Mr Adil said.

Localisation challenges

The GCC insurers are challenged by a shortage of skilled workforce as well as high staffing cost and attrition rates. The inability to hire candidates with requisite skills could affect the growth of the sector.

"With the new regulations on emiratisation (localisation) in the UAE for 2018, the industry should attract the millennials by making them understand that the insurance industry has elements that make for a successful long career, especially in the age of InsurTech. Regulatory push, digitisation and automation will make the millennials join the club," said Mr Fareed Lutfi, Secretary General, Emirates Insurance Association.

The road ahead

As far as financial reporting is concerned, 2018 poses some potential challenges for local insurers which have to comply with regulations-driven financial disclosures.

The recently announced IFRS 17 accounting standard, which comes into effect in 2021, will change the way insurers present their results and financial position. The new standard is likely to impact product design, IT systems architecture, distribution channels, employee training, budgeting and forecasting positions. Although there is still some time until implementation, 2018 may keep insurers busy with studying the impact and building an implementation plan, after considering the opportunities, threats and challenges of the new standard, Mr Abid said.

There will be pressure on capital and profitability due to technical reserve adjustments, inadmissibility of risky assets in excess of limits, increased cost of compliance with risk management, governance and reporting requirements.

The implementation of VAT in Saudi Arabia and the UAE also poses challenges in terms of aligning accounts, systems and contracts for insurers both with customers and third-party counterparts such as brokers.

The regulatory measures initiated in 2017 will have spillover effects in 2018 too. Smaller insurers will face moderate credit risks in 2018 as they tend to adapt more slowly to the updated regulatory regime. The industry is stepping into the next phase of growth, fuelled by the expanding consumer base, rising insurance awareness, economic revival and infrastructure developments. The maturing and stringent regulatory environment is likely to create strong, stable and sustainable business models.