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Market Segment Outlook: Gulf Cooperation Council Insurance

For the region's insurers, claims inflation presents a pressing risk, impacting core lines of business

AM Best is maintaining its Stable market segment outlook for the insurance markets of the Gulf Cooperation Council (GCC)–comprising Bahrain, Kuwait, Oman, Qatar, the Kingdom of Saudi Arabia (KSA) and the United Arab Emirates (UAE).

The maintenance of the Stable outlook reflects the GCC insurance market's solid footing entering 2023; however, the weight of headwinds facing the market is increasing.

Among the positive factors are the following:

- Regional resilience to challenging global macroeconomic conditions as buoyant oil prices contribute to continued fiscal surplus across the region
- Opportunities for continued insurance sector growth, as economies strengthen, new insurable risks enter the market and product offerings diversify through the enforcement of mandatory insurance covers
- Resilient investment returns despite global investment market volatility
- Merger and acquisition (M&A) activity becoming a prominent feature of the GCC market and has the potential to improve market profitability and reduce price competition over the longer term
- Tightening regulatory scrutiny—and enhanced market oversight and intervention—leading to a growing focus on risk management amid positive steps to improve governance and market discipline

Near-term headwinds for the segment include:

- Intense competition driving pricing pressure and threatening margins
- Supply chain disruptions and increasing inflationary pressures—principally in the form of claims inflation—present challenges to future profit margins
- Hardening reinsurance market conditions may impact business models and margins for those with high reinsurance utilisation
- Increasing incidences of weather-related losses, particularly from flood events, continue to test insurers' risk management capabilities. Although AM Best notes exposure is not homogenous across the region, the increased frequency and severity of events threatens underwriting margins
- IFRS 17 implementation remains a challenge due to reliance upon regulatory bodies and third-party consultants

Economic Resilience Fuelled by Oil Prices

Despite current global macroeconomic headwinds, AM Best considers the GCC to be well placed to weather this economic uncertainty. In general, the region has entered 2023 with fiscal surpluses thanks in a large part to the buoyant oil price environment of 2022.

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Most members of the GCC are heavily reliant on hydrocarbon activity to support economic growth and fiscal spending power. Fuelled by the post-pandemic recovery and Russia's invasion of Ukraine, the price of Brent Crude exceeded USD 80 per barrel for much of 2022, and at times reached highs of more than USD 120 per barrel. This provided economic relief to the region and supported gross domestic product (GDP) recovery to pre-pandemic levels.

The International Monetary Fund (IMF) estimates GCC current account surpluses to have reached 9.7% of GDP in 2022. Despite a steady decline in oil prices since the highs of 2022, the IMF projects these surpluses will remain at 7.8% of GDP for 2023.

With global geopolitical tensions weighing on supply and demand, economies of the GCC are expected to benefit from continued buoyant oil prices during 2023. As at February 2023, the per-barrel price of oil largely exceeded the estimated fiscal breakeven points of the GCC members. In AM Best's view, increased economic activity and greater governmental fiscal manoeuvrability are positives for the region's insurance markets.

However, AM Best also notes that the member states of the GCC, and the insurers that operate in them, will need to adapt and manage the transition risk presented by global commitments to reduce dependence on petrochemicals and the diversification of economic revenue streams to non-hydrocarbon sources.

While the economic transition is a longer-term consideration, the diversification of fiscal revenues presents near-term operational considerations for insurers. In attempts to reduce the fiscal reliance on hydrocarbons, more countries in the region have begun establishing new revenue streams including the introduction of Value Added Tax (VAT) and corporation taxes.

Insurance Sector Growth Supports Continued Opportunity

AM Best expects resilient economic fundamentals to directly contribute to the demand for insurance products in the near term. Fiscal manoeuvrability linked to the strong oil price environment is expected to support public spending—notably on infrastructure projects—providing premium growth opportunities for insurers in the GCC. A substantial proportion of commercial property and engineering risks underwritten in the GCC is linked to government-backed initiatives.

Furthermore, the implementation and development of mandatory insurance schemes in several markets across the GCC should improve near-term premium growth. In the UAE, repeated collaboration between the insurance industry and government has resulted in the development of innovative mandatory insurance products, creating opportunities for insurers in that market.

Following the roll out of the Workers' Protection Program in the UAE in 2018, 2023 will see the launch of the mandatory cover for the Involuntary Loss of Employment (ILOE) scheme. Oman, Qatar and Bahrain are also planning to unveil long-awaited compulsory medical schemes.

Longer-term, growth may emerge from expanding product offerings, alongside initiatives to boost insurance penetration and support economic development. Additionally, the commitments of the region's oil-exporting countries to reduce dependence on petrochemicals and create economic diversification are expected to channel higher levels of fiscal expenditure into sustainable and other infrastructure projects, providing opportunities for the region's insurance market to support this transition.

Heightened M&A Activity Likely to Continue

M&A activity is heating up across the insurance markets of the GCC for both conventional and takaful players. A significant driver for this activity is the inorganic growth opportunity it brings to increase market footprint, generate economies of scale and/or diversify geographical reach. Increased regulatory requirements, rising operating costs, and competitive pressures, as well as a scarcity of insurance licences available in the region are also contributing to heightened activity.

Consolidation has affected the composition of the insurance markets in KSA, the UAE and Oman. AM Best expects such activity to continue during 2023. GCC insurance markets are characterised by their fragmented and highly competitive nature, with a high number of insurers vying for limited available insurance premiums.

In AM Best's view, further insurance market consolidation is a tailwind for the GCC's insurance markets, potentially improving market profitability and reducing price competition. Successful execution of transactions should provide the acquirers with greater operational scale, enhanced market positions, larger balance sheets and more resilient capital buffers. However, extensive re-underwriting of acquired portfolios may be required before potential performance benefits can be realised.

Investment Strategies Introduce Volatility but Favour Current Conditions

Investment market volatility has affected GCC insurers less significantly than peers in other parts of the world, thanks to the region's economic resilience. For example, the regional S&P Composite Index posted a fall of only 7% for 2022, in contrast to the double-digit drawdowns observed in many other markets over the same period.

The balance sheets of the region's insurers typically carry significant asset risk, with many regional insurers holding a greater proportion of equity and real estate assets than developed market counterparts.

However, current market conditions have allowed companies to take advantage of rallying regional equity markets, the result of strong oil prices. Concurrently, with a lower investment allocation to fixed income securities, many GCC insurers will see a more modest impact to capital from unrealised losses due to rises in interest rates compared to their global counterparts.

Nevertheless, the region remains sensitive to the potential for future earnings volatility from this higher-risk investment strategy, and the investment market outlook will be sensitive to future fluctuations in oil prices over 2023. The majority of currencies in the region are pegged to the US dollar, creating a dependence on the monetary policy decisions taken by the US Federal Reserve.

Inflationary Impacts Are Unavoidable

The GCC is not immune from inflationary pressures – although its experience so far has been less severe than for other regions. Recent International Monetary Fund (IMF) estimates peg inflation rates for the GCC at an estimated 3.6% for 2022 and 2.6% for 2023; comparatively lower than the global estimates of 8.9% and 6.6% for 2022 and 2023, respectively.

Despite energy price reform initiatives across the region in recent years, several GCC countries continue to subsidise fuel and energy costs in the domestic market, reducing the contribution of oil price fluctuations to regional inflation rates. Nevertheless, supply chain disruptions and increased importation costs for agriculture and food products are expected to drive inflation in the GCC.

For the region's insurers, claims inflation presents a pressing risk, impacting the region's core lines of business—motor and medical. Spare part costs and supply chain disruptions leave insurers vulnerable to mounting claims costs. Insurers will need to remain nimble and disciplined in their premium and reserve adjustments to ensure loss cost inflation is adequately covered by premium rates and does not impinge on already thinning underwriting margins.

Competition-Led Pricing Pressures Persist

The highly fragmented insurance markets of the GCC fuel widespread competition for limited insurance premiums. Topline growth is often at the forefront of business strategies, particularly for the most competitive lines—motor and medical—which make up the majority of net written premium in the region, and which have seen pricing compromised. Underwriting margins have become vulnerable to the post-pandemic normalisation of claims patterns and growing claims inflation.

The question of premium rate adequacy has been a concern in the GCC's insurance markets for some time, and while this has attracted the attention of regulators, it continues to impede market performance.

Certain regulators have taken steps to address price adequacy in recent years and to reduce the level of discounting offered in return for customer retention, issuing guidance circulars and formalising conditions as to when discounts can be granted.

In general, AM Best has observed improvements in insurers' pricing tools following these regulatory developments. However, without strict enforcement of—and adherence to—these requirements and/or the maintenance of underwriting discipline, competitive pressures will continue to intensify pricing concerns.

Hardening Reinsurance Markets Prompt Questions About Strategies

Recent global renewal seasons have brought notable changes to reinsurance market conditions, with changes to capital deployment, rate rises and attachment points all at the forefront of discussions.

Insurers in the region are heavily reliant on reinsurance capacity to support participation on large-scale government-related contracts, mainly for commercial property and engineering projects. With insufficient capital to support these risks independently, GCC insurers typically cede a sizeable proportion of premiums to the international reinsurance market. For many insurers in the region, inwards reinsurance commissions from these reinsurance placements form a substantial component of underwriting profitability.

The impact and repercussions of hard reinsurance market conditions may disrupt business models for those heavily dependent on reinsurance support. Insurers' participation on large-scale risks will be dependent on the continued availability of capacity at an acceptable price. In addition, underwriting margins may face negative pressure as ceding commissions from reinsurers come under pressure. In AM Best's view, this will be most pronounced for those insurers who have struggled to cede profitable business over time.

In the coming years, insurers in the region may also begin to face challenges in securing reinsurance capacity if reinsurance partners reduce their appetite for conventional energy risks due to ESG considerations.

Uncertainty Remains Over IFRS 17

The successful implementation of IFRS 17 poses a headwind to insurers operating in the GCC who report under International Financial Reporting Standards over 2023. AM Best has observed varied levels of preparedness across the GCC ahead of the standard's January 2023 implementation date, with companies operating in the region's more mature regulatory environments demonstrating greater readiness for IFRS 17. For example, in KSA, three dry runs under IFRS 17 had been conducted before the end of 2022, of which one required auditing.

A key risk for the region is the reliance upon regulatory bodies and third-party consultants to drive IFRS 17 development and implementation projects, concentrating knowledge and experience outside of the operating insurers. This creates a potential disconnect between internal management engagement and external consultant experience on the subject.

AM Best expects the transition and implementation of IFRS 17 to continue to weigh on management time and insurers' operating expense ratios over 2023. Those insurers with robust transition plans and enterprise risk management processes are viewed as better placed to successfully manage implementation.

GUIDE TO BEST'S MARKET SEGMENT OUTLOOKS

Our market segment outlooks examine the impact of current trends on companies operating in particular segments of the insurance industry over the next 12 months. Typical factors we would consider include current and forecast economic conditions; the regulatory environment and potential changes; emerging product developments; and competitive issues that could impact the success of these companies.

A Best's Market Segment Outlook can be Positive, Negative, or Stable.

Best's Market Segment Outlook	
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We update our market segment outlooks annually but may revisit them at any time during the year if regulatory, financial, or market conditions warrant.

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BEST'S MARKET SEGMENT REPORT

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