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The Insurance Sector in the Middle East and North Africa

Challenges and Development Agenda

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Abstract

This paper studies the causes of the low development of the insurance sector in the Middle East and North African (MENA) region, particularly for long term insurance. The paper shows that life and non-life premiums, as well as assets, are very low relative to expected levels given per capita income and demographic characteristics, and examines the causes of such poor performance. There is a wide range of factors constraining the development of the industry, including the absence of mandatory insurance in key areas, the predominant presence of the state in some countries, gaps in regulation and supervision, unsupportive tax regimes, fragmented market structures, a chronic lack of suitably skilled people, as well as the absence of products that conform with cultural/religious preferences, especially in the case of life insurance.

The lack of development of the insurance sector is a matter of concern, as research shows that the sector can contribute to both financial and economic development. Key recommendations to accelerate the development of the sector include wider introduction of mandatory insurance lines that have clear positive externalities, continuing the privatization process for government owned insurers, employing non capital techniques to force rationalization of insurance sectors with too many small and inefficient players, removing tax distortions, taking steps to stabilize motor third party liability markets (typically the largest line of business), strengthening reporting and disclosure, regulating banc-assurance, improving consumer protection, further developing Takaful long term insurance ('Family Insurance'), and establishing regional centers of excellence for skills development.

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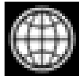
Produced by the Research Support Team

The Insurance Sector in the Middle East and North Africa: Challenges and Development Agenda

Rodney Lester*



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* This paper draws on reports from AXCO, Swiss Re Sigma, the Middle East Insurance Review, discussions with national insurance supervisors, and World Bank and IMF assessments and economic databases. The author benefitted from onsite visits to most of the countries referenced and discussions with Willis (Reinsurance brokers) and Moodys in London. The author is also grateful to Roberto Rocha for extensive comments and contributions to the text, to Dimitri Vittas, Serap Gonulal and Martin Buehler for comments and suggestions, and to Diego Sourrouille for competent research assistance.

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1. Introduction

The insurance sector can play a critical role in financial and economic development. By introducing risk pooling and reducing the impact of large losses, the sector reduces the amount of capital that would be needed to cover these losses, encouraging additional investment, output, innovation, and competition. By introducing risk-based pricing for insurance protection, the sector can change the behavior of economic agents, contributing to the prevention of accidents, improved health outcomes, and higher efficiency gains. As financial intermediaries with long investment horizons, insurance companies can contribute to the provision of long-term finance and effective risk management. Finally, the sector can also improve the efficiency of other segments of the financial system, such as banking and bond markets, by enhancing the value of collateral through property insurance and reducing losses at default through credit guarantees. Research shows that the insurance sector contributes to long-run growth (Arena (2008)).

The insurance sector remains undeveloped in the Middle East and North Africa (MENA) region, even after controlling for income levels and demographic characteristics. This is a matter of concern, as the sector could make an important contribution to financial and economic development. The paper shows that the slow pace of development of the sector is due to a number of factors, including the lack of compulsory insurance in key areas, the predominance of state companies in some countries, weaknesses in the regulatory and supervisory regime, inadequate tax rules, lack of professional skills, and cultural factors. Policy reforms and product innovation could go a long way in fostering the development of this important sector in the current decade and beyond.

This paper reviews the status of the insurance sector in the MENA region, identifies the main factors that have hindered the sector's growth, and proposes an agenda for faster development. The paper is structured as follows. The second section provides an overview of the size of the sector by comparison with other countries. The third section examines the main business lines. The fourth section examines the structure of the insurance industry. The fifth section examines the main regulatory and supervisory issues. The sixth section identifies the stages of development by main country groups. The seventh section examines the particular case of Morocco, the MENA country that has made most progress in developing the sector relative to potential. Finally the eighth section provides a roadmap for the sector's development in MENA.

2. The Insurance Sector in MENA: An Overview of Development Patterns

2.1. The Small Size of the Insurance Sector: Basic International Comparisons

The insurance sector in MENA, and especially the life sector, remains undeveloped. As shown in Tables 1 and 2, most MENA countries have low penetration levels (measured by the ratio of gross premiums to GDP) compared to international benchmarks. The non-life sector (average premium of 0.9% of GDP) is roughly comparable to those in East Asia and Eastern Europe, but smaller than those in the new EU accession countries and Latin America, and substantially smaller than the non-life sectors of OECD countries. There are significant differences across MENA countries, with some countries displaying very low penetration ratios (Algeria, Egypt, Yemen, and several GCC countries), and only three countries showing ratios

above 1.5% of GDP (Jordan, Lebanon, and Morocco). MENA's life insurance sector is even smaller, with an average penetration ratio of only 0.3% of GDP and is an outlier by comparison with other regions. Only three countries (Lebanon, Bahrain and Morocco) display penetration ratios comparable to those in other emerging markets. Bahrain's penetration level reflects its historical regional role and significant health insurance portfolios.

Table 1: Insurance Premiums and Assets (% of GDP) 2009[1]

Country[2]	Non-Life Premium (% of GDP)	Life Premium (% of GDP)	Assets (% of GDP)
Algeria	0.60	0.05	0.8
Bahrain	1.43	0.70	12.1
Egypt	0.42	0.37	3.9
Jordan	1.53	0.21	4.8
KSA	0.46	0.07	-
Kuwait	0.34	0.09	1.8
Lebanon	2.18	0.98	7.2
Libya	0.48	0.01	-
Morocco	1.54	0.89	19.0
Oman	0.97	0.20	2.4
Qatar	0.67	0.01	2.7
Syria	0.92	0.01	0.0
Tunisia	1.38	0.25	0.6
UAE	1.34	0.28	3.1
Yemen	0.24	0.02	-
MENA	0.97	0.28	5.3
GCC .	0.87	0.23	4.4
Non-GCC	1.03	0.31	6.1
Oil	0.80	0.16	3.8
Non-Oil	1.22	0.45	7.1

Sources: AXCO Reports, Swiss Re. Sigma, IMF/WB databases, national sources

Table 2: Average penetration rates and assets (% of GDP), MENA and other regions

	MENA	East Asia & Pacific	New EU-10 Countries	Other Europe & Central Asia	High income OECD	Latin America	South Asia
Average non life premium	0.97	0.8	1.7	0.9	2.3	1.3	0.5
Average life premium	0.28	1.6	1.1	0.1	4.0	0.7	1.2
Average Assets	4.9	14.8	5.2	2.7	45.0	4.9	6.4

Source: Swiss Re. Sigma, AXCO Reports, WB calculations

In terms of the ratio of insurance assets to GDP, the region would seem to compare better, but this result is due to very few countries. Excluding only one country (Morocco) the MENA average would drop to 3.5% of GDP, below the average of other emerging regions. Excluding Bahrain the average would drop further to 2.7% of GDP.[3]

[1] Separately identified health insurance is not included in the following econometric analysis – see Box 1.
[2] Iraq has not been included because results are affected by conflict. Djibouti has not been included because of lack of data.
[3] Bahrain's assets reflect its expatriate population.

2.2. The Small Size of the Insurance Sector: Controlling for Income Levels and Demographics[4]

MENA's relative position does not change significantly controlling for income levels. As shown in Figure 1, only Jordan, Morocco, and Tunisia have larger non-life premiums than those predicted by their levels of per capita income. Lebanon and Syria's non-life sectors are close to their predicted levels, but most other MENA countries have much smaller non-life sectors than predicted by their income levels. Regarding the life sector (Figure 2), only Morocco's penetration ratio is above the predicted level, albeit by a small margin. Lebanon's life sector is only slightly below the predicted level, but most other MENA countries have life sectors which are much smaller than those predicted by their levels of development. The same general pattern holds for the ratio of assets to GDP (Figure 3). Morocco is again the only exception, reflecting in part the greater role of employer provided benefits including group life and pensions. Pensions are tax effective for employers in Morocco and together with personal savings products (largely sold through bancassurance channels) account for nearly 60% of life premiums. Egypt, Jordan and Lebanon are close to the predicted levels, but the insurance assets of most other MENA countries are much smaller than predicted by their income levels.

The relative position of MENA countries remains essentially the same after also controlling for basic demographic factors and inflation (Figures 4, 5 and 6). Besides income, basic demographic factors such as the size of the population, population density, and the age dependency ratio may also affect significantly the demand for insurance products. Likewise, inflation may have an impact on the demand for insurance products, especially life products.[5] However, the relative position of MENA countries does not change significantly after controlling for all these factors. As shown in Figure 4, Jordan, Morocco and Tunisia are the only countries that have non-life sectors above their predicted levels, Lebanon, Syria and Iran are close to their predicted levels, while most other MENA countries are below their predicted levels.

In the case of life insurance, the differences between actual and predicted values declines somewhat when accounting for demographic factors, but Morocco remain the only positive outlier in the region. The somewhat better fit in life insurance reflects the small populations and low population densities of several MENA countries, as well as their relative youth. Egypt, Jordan, Lebanon and Tunisia are closer to their predicted values, but only Morocco remains significantly above. The same pattern holds for assets under management. The countries that have larger life sectors tend to have larger assets, reflecting the larger technical provisions and reserves required for longer terms contracts written in this subsector. Again, Morocco remains the positive outlier in this area.

[4] This section draws on the panel regression models developed in Feyen, Lester, and Rocha (2010).

[5] Population captures the potential for economies of scale and population density captures the scope for distribution efficiencies. Age dependency is relevant for life insurance and captures the demand for life cycle financial products (e.g. education and retirement). See Feyen, Lester, and Rocha (2010).

Figure 1: Non-Life Penetration (% of GDP) and GDP Per Capita

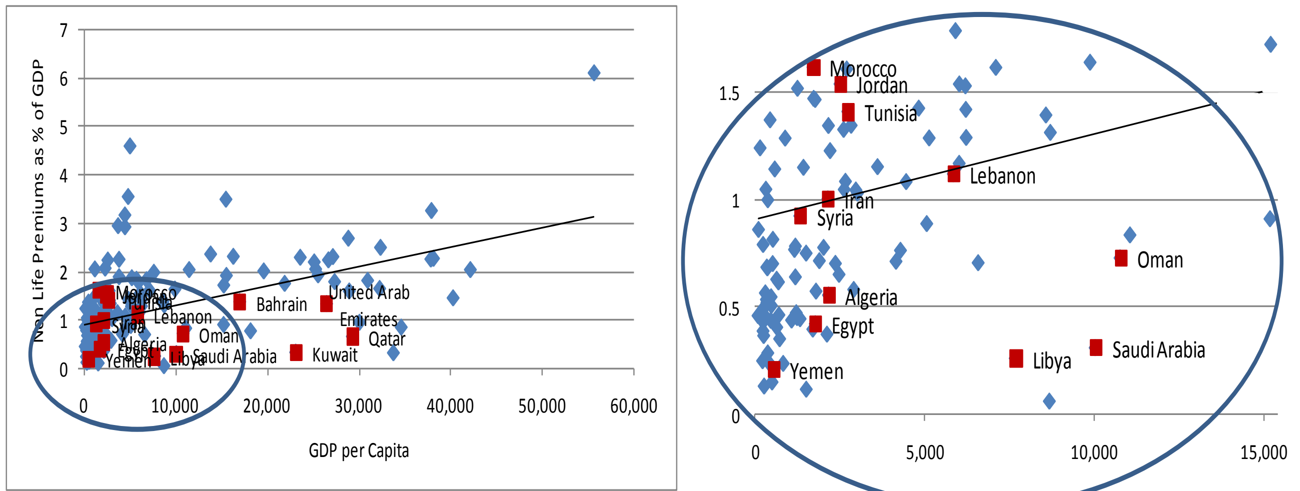


Figure 2: Life Penetration (% of GDP) and GDP Per Capita

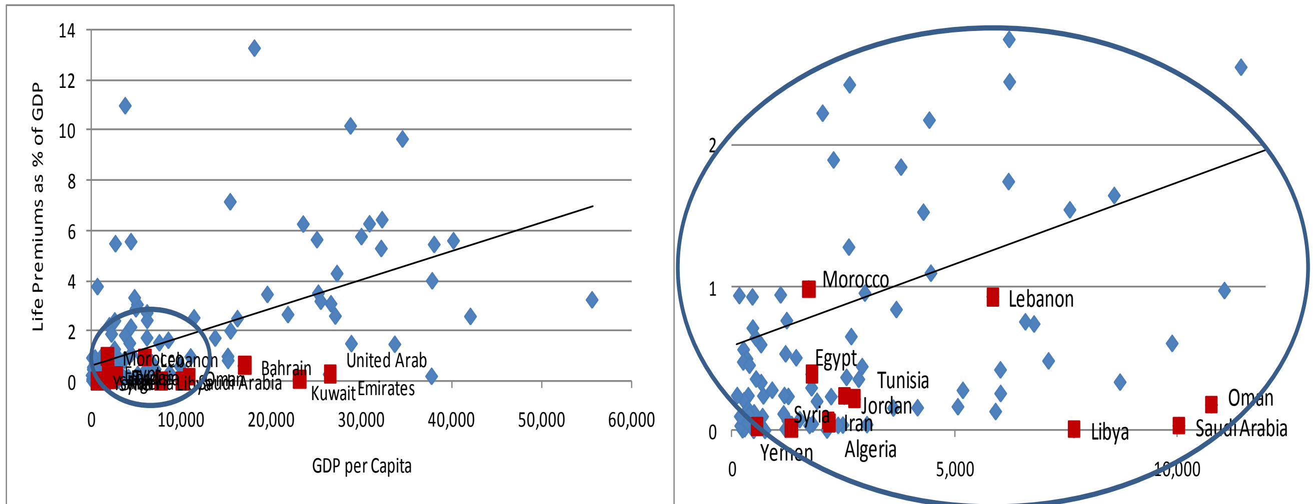


Figure 3: Insurance Assets under Management (% of GDP) and GDP Per Capita

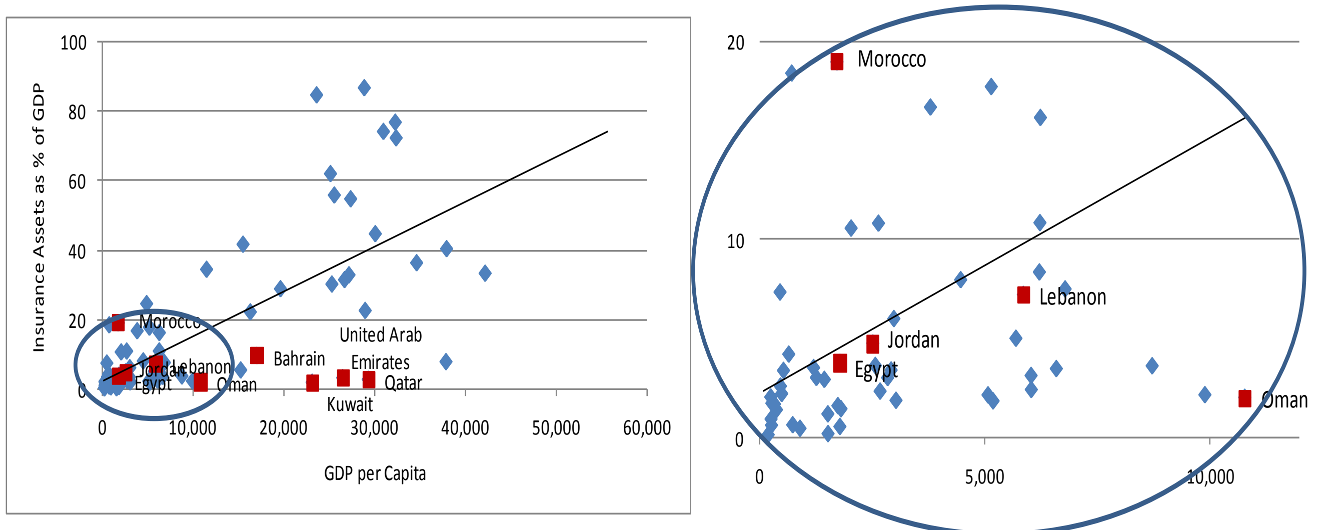


Figure 4: Non-Life Penetration Ratio (% of GDP): Actual and Predicted Levels

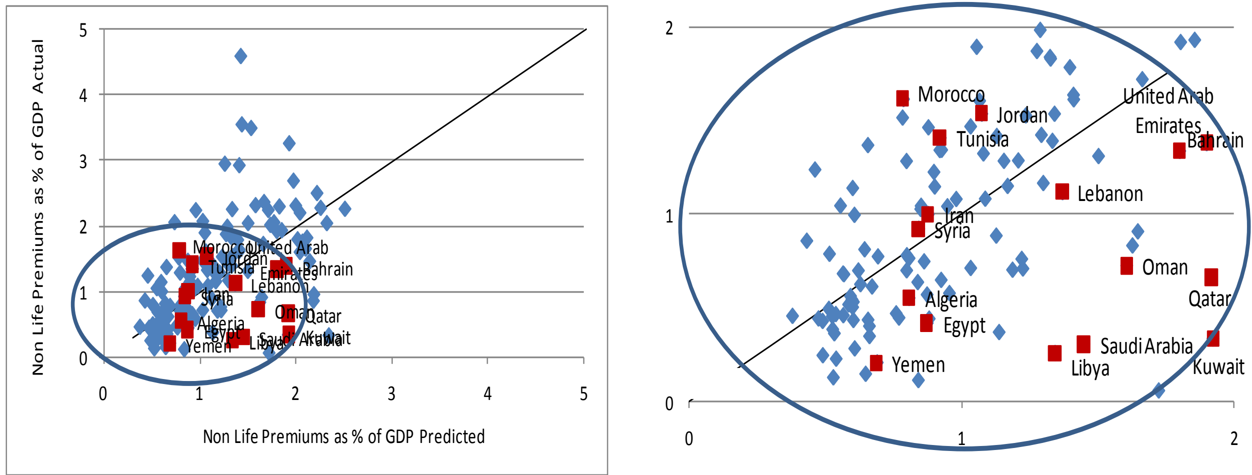


Figure 5: Life Penetration Ratios (% of GDP): Actual and Predicted Levels

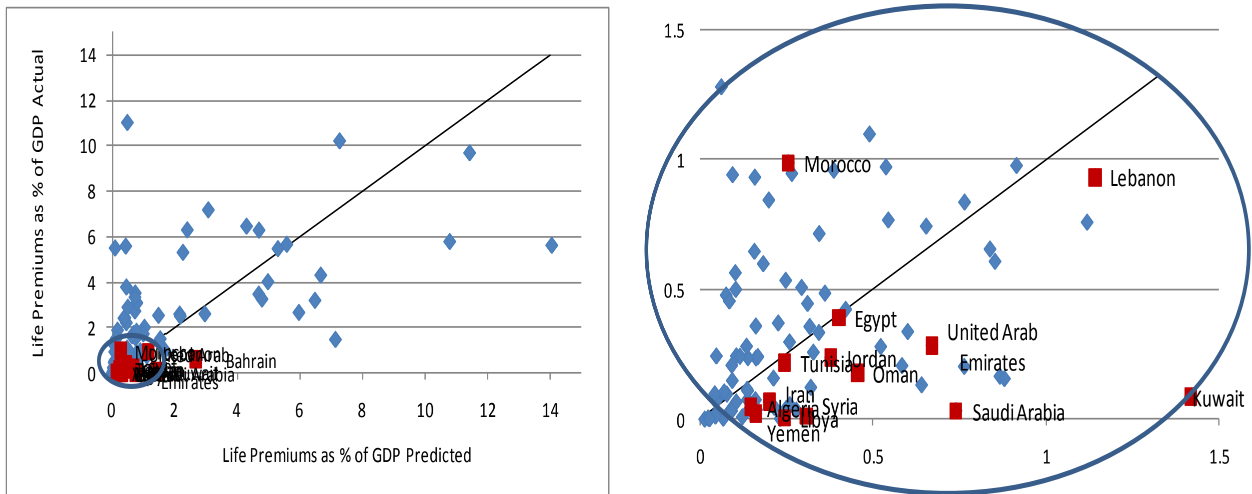
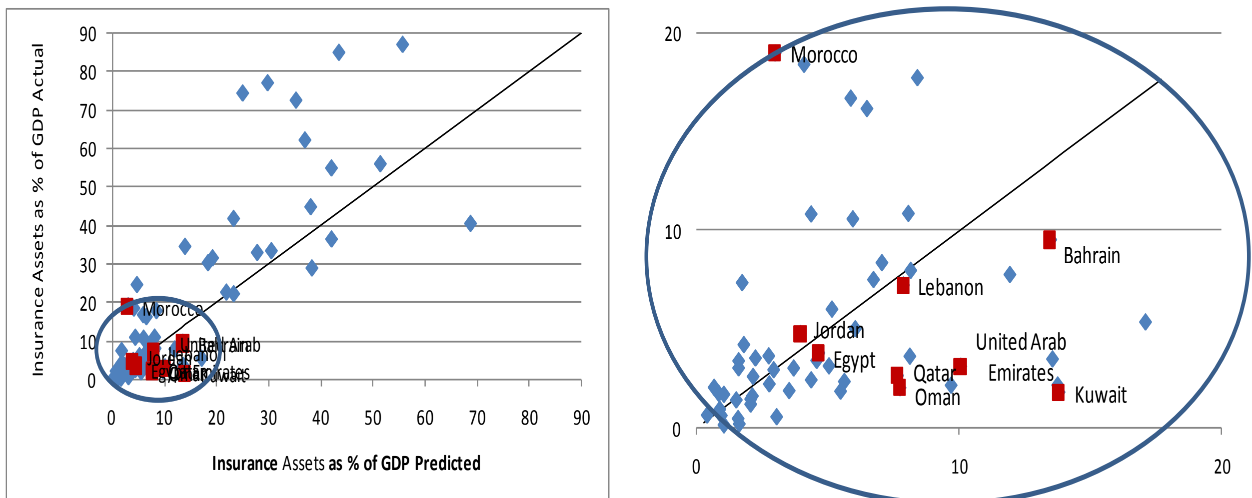


Figure 6: Insurance Assets under Management: Actual and Predicted Levels



2.3 The Small Size of the Insurance Sector: Identifying the Constraining Factors

The slow development of the insurance sector in MENA is due to a wide variety of factors, including regulatory factors, market structure, lack of development of other segments of the financial sector, social/human development factors, and culture/religious factors. Some of these factors have been identified and tested in recent empirical research. Other constraining factors are less amenable to measurement and empirical testing, but will also be discussed in the sections below. Most importantly, some of the constraining factors are out of reach of policy makers or can only be changed very gradually, while other factors can be addressed over shorter period of time. The sections below make an effort to examine all the potential constraining factors, in order to identify a roadmap for the development of the insurance industry.

Recent empirical research (Feyen, Lester, and Rocha (2010)) shows that the insurance sector is driven by a broad range of factors and explains in part why MENA insurance sectors remain undeveloped. For example, this research shows that insurance sectors are less developed in countries with Muslim majorities, due to the lack of compliance of conventional insurance products with Shariah rules. This result is relevant for most MENA countries. Research also shows that the demand for insurance is partly driven by the existence of retail credit markets (mortgage loans, personal loans), which are not yet well developed in many MENA countries. Also, the dominant presence of state insurers tends to slow down development, a result which is relevant for at least four MENA countries which are transitioning from a historical legacy of state monopolies (Algeria, Egypt, Libya, and Syria).[6]

There are other factors which are more difficult to measure and test empirically, but that have been powerful impediments to the growth of the sector. For example, several MENA countries have been slow to introduce compulsory insurance in key areas such as occupational injury and health. Also, MENA countries generate limited premium revenues from car insurance, despite a large fleet of cars per population. This is due to several specific problems, as shown below. The excessive fragmentation of insurance markets in MENA may also have hindered the sector's growth – many insurers do not have critical size to build adequate risk pools, underwrite contracts and innovate. The lack of professional skills in the industry has been another major deterrent. Finally, weaknesses in regulation and consumer protection (resulting inter alia in lack of transparency and lack of trust) have also hindered the development of the sector. These issues are examined in the following sections.

3. Main Business Lines

The analysis of the main business lines sheds further insights on the slow pace of insurance development in the MENA region. This is because the development of the insurance sector generally follows some well defined patterns. The non-life sector is more important in the early stages of development. In the very initial stages, development is driven by coverage of transportation and trade risks. In the next stage, households acquire motor vehicles and governments make motor third party liability insurance compulsory. Thereafter, mortgage markets develop and household insurance becomes more common. Eventually, a middle class

[6] Annex Table 5 provides an illustration of research on the drivers of the insurance sector, with the share of insurance assets to GDP as the dependent variable (see Feyen, Lester and Rocha 2010).

develops and life insurance becomes attractive for life cycle planning, including pension-like products. In many developed countries, the life sector plays a critical role in social protection, as public schemes mature and fiscal pressures mount. (Annex Table 3 provides a stylized description of the stages of development).

The breakdown of insurance premiums in MENA by business lines only partly conforms to the typical pattern of development. Table 3 provides a breakdown of non-life premiums, showing that transportation related insurance (Marine, Aviation and Transit or MAT) accounts on average for a small share of the totalnon-life premium and is broadly unrelated to income levels. Motor insurance account for the largest share of the insurance business in most countries but also bears little relationship to incomes. Construction related insurance tends to be higher in the oil and gas rich countries, but there is no consistent pattern. Life insurance (not shown in Table 3) is undeveloped, especially in the higher income countries, also implying a deviation from usual patterns.

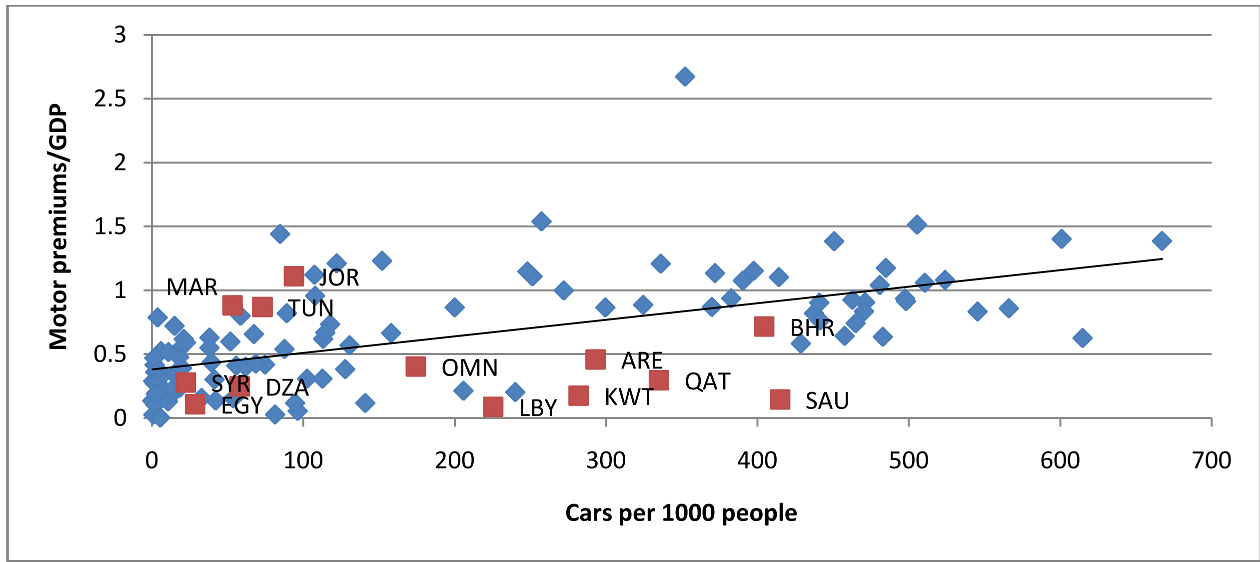
Table 3: Breakdown of Non-Life Premiums by Major Line of Business, 2008

	Breakdown of Non-Life Premium (% of total)			
	Motor	**Property and Construction**	**Maritime, Aviation and Transit (MAT)**	**Other**
Algeria	47	42	9	1
Bahrain	48	39	7	7
Egypt	33	25	32	10
Jordan	60	20	10	10
KSA	46	26	18	10
Kuwait	40	15	16	29
Lebanon	51	19	9	21
Libya	31	41	21	6
Morocco	56	12	7	25
Oman	54	19	9	18
Qatar	21	31	14	34
Syria	65	19	12	6
Tunisia	59	9	10	22
UAE	35	13	15	37
Yemen	33	20	22	25
MENA	45	23	14	17
GCC	41	24	13	23
Non-GCC	48	23	15	14
Oil	43	27	13	16
Non-Oil	49	18	15	19

Source: AXCO Reports

Motor insurance accounts for the largest share of the non-life premium, but MENA countries still collect small aggregate motor vehicle premiums considering the size of their car fleets. As shown in Figure 7, motor premiums are well below the levels that would be predicted by the number of cars (scaled by the population), with the exception of Jordan, Morocco, and Tunisia. All but the least developed MENA countries have introduced mandatory Motor Third Party Liability Insurance – MTPL (Annex Table 3).

Figure 7: Motor vehicle premiums versus ratio of cars per 1000 persons



Source: Axco, WDI

There are four main factors limiting motor premium revenues in MENA: lack of compliance, understatement of provision for outstanding claims, price controls in some jurisdictions, and predatory price competition. The level of compliance with compulsory motor insurance seems low. Large segments of the population do not seem to understand the importance of this insurance and regard it as a tax [7]. While most countries require evidence of insurance before registering motor vehicles, this has not been a successful mechanism for raising compliance levels in MENA. False policy documents not issued by insurers, poor validation procedures, and misclassification of vehicles all contribute to avoidance strategies by drivers, who prefer to "settle in the street", no matter how expensive relative to the formal insurance process.

A second reason for inadequate motor premium income is the chronic understatement of motor third party claim provisions by insurers combined with price controls. Claims provisions feed directly into the calculation of premium levels and if understated will result in inadequate pricing. This is particularly evident in the countries where the legal profession plays a significant role in the claims negotiation process and claims can take many years to settle.

This understatement of claims costs (and hence technical premiums) is an even more serious issue where MTPL rates are approved by the government (often the Ministry of the Interior) and have a political aspect. Examples of rates not being adjusted for many years can be found in numerous countries, including Kuwait and, until recently, Egypt.

The fourth major cause of inadequate motor third party premiums in several countries is predatory price competition sometimes in the belief that investment returns will cover underwriting losses. Motor third party insurance is cash rich and funds can be invested quickly. This attracts entrepreneurs who understate claims provisions and often adopt poor claims

[7] Anecdotal evidence suggests that some drivers throw their policies away, considering the payment to be a tax.

handling practices. Under-pricing by small companies is often combined with under-reserving, leading to prolonged disputes and settlement delays. This affects the reputation of insurers and contributes to pervasive public mistrust. Competition for market shares in a small market can ultimately result in pyramidal structures, leading to larger losses and even insolvency. Table 4 shows MTPL loss ratios in countries for which the data is available on a net incurred basis.

Table 4: MTPL Loss Ratios (%) in Selected Countries[8]

Country	2004	2008
Egypt	292	316
Jordan	87	101
UAE	76	89
Tunisia	114	87
Morocco	84	75

Sources: AXCO, Supervisors Reports

Property and construction is the second most important line of business, is clearly larger in oil producing countries and clearly associated with coverage of risks in oil and gas extractive industries. Interestingly, revenues are larger in the oil producing countries outside the GCC. It is also noticeable that agriculture does not yet generate a substantial income stream in the relevant countries (Egypt, Morocco, Syria).

Transportation (MAT) premiums account for a relatively low share of the non-life premium in all sub-groups. Not surprisingly, it is larger in the countries that have a major international airline, such as Egypt, the KSA and the UAE. The strategic location of these countries between the Western and Eastern hemispheres is being exploited with a number of successful international airlines being established. The resulting hull and liability insurance business contributes to premium income, although most of this risk is reinsured internationally.

Seven countries have shares in excess of 10% under the 'Other' heading. In the case of the oil and gas producing countries this reflects partly liability and engineering business arising from oil and gas extraction and a requirement (particularly in GCC countries) that employers cover for occupational injuries. Workman's compensation is compulsory for expatriates in some states. In the case of Morocco, compulsory workman's compensation is handled through the private sector.

All in all, the insensitivity of non-life and life premiums to income levels suggests that insurance penetration in MENA is still primarily driven by large enterprises, compulsory insurance, and effective enforcement, rather than voluntary purchases by the private sector. This is true for both the non-life and life sectors. The countries with partially developed life insurance sectors have historical European connections (Jordan, Lebanon, Tunisia and Morocco). Most of the remainder has virtually non-existent life markets despite, in some cases, very high income levels.

Finally, health insurance is becoming an important line of business in some MENA countries, although growing from a low base. Health insurance is becoming a sizable industry

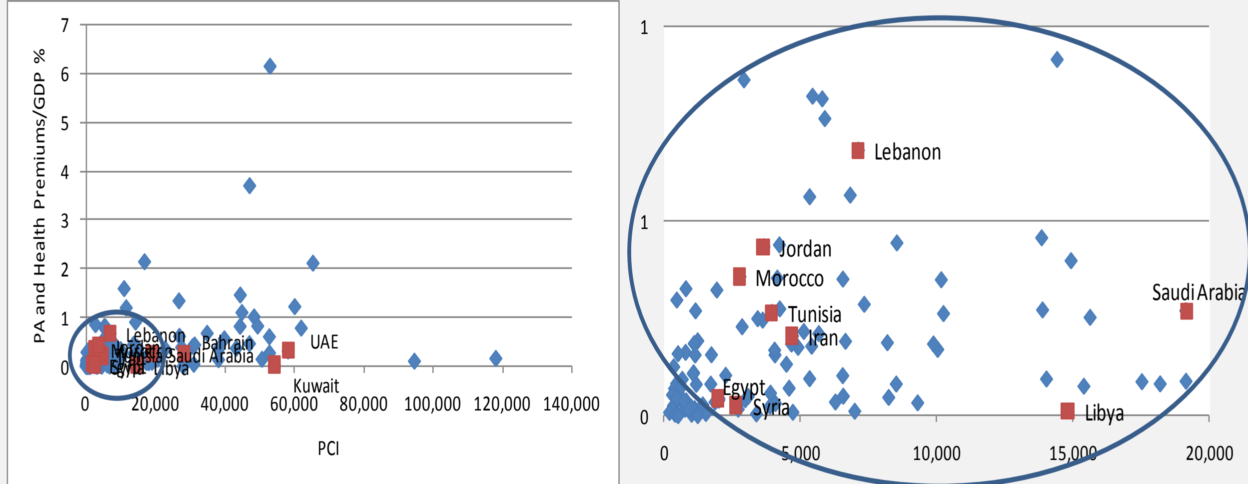
[8] The Tunisian ratios reflect an effective reform program while the Egyptian ratios reflect a significant upgrading of claims provisions in the state owned insurers.

in some countries, and is also growing in MENA, although from a low base. Because health insurance is largely idiosyncratic, it has not been included in the econometric or business line analysis (Box 1).

Box 1 - Health Insurance

Health insurance shows little correlation with income levels or structural variables. As shown in Figure 8, health insurance appears to be driven by idiosyncratic factors and path dependencies. The decisions of the KSA and Abu Dhabi to require expatriates to take out private health insurance (and the consideration other GCC countries are giving to this) reflects the high levels of their expatriate populations and a desire to deal with attendant fiscal pressures. The relatively high penetration levels in the Francophone countries and Jordan reflect gaps in the social insurance system.

Figure 8: Health insurance penetration versus income levels



Source: AXCO reports and World Bank analysis

4. Industry Structure and Performance

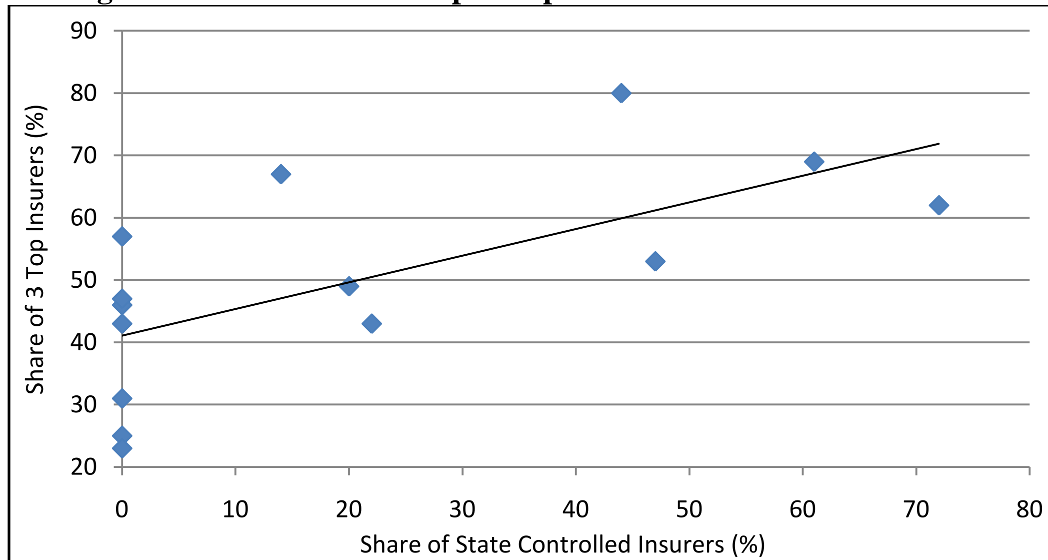
4.1. Overview of Market Structure

There are on average 25 licensed insurers per country, the bulk of which licensed as non-life insurers or composites (Table 5). The small number of life insurers reflects the low development of this sector in the region. Some countries do not license composites any longer but the existing composites have been so far grandfathered. The average market share of the three top companies is about 52%, but there are wide variations across countries, and some markets seem very concentrated. State insurers still hold a significant share of the non-life market in 4 countries. As shown in Figure 8, there is a positive correlation between the share of state insurers and the share of the three largest companies. This is not surprising, reflecting the historical legacy of state monopoly in these countries, exercised through large companies.

Table 5: Indicators of Industry Structure

Country	Number of insurers				% of non-life market held by the top three insurers	Share of State-Controlled Companies	Formal Bancassurance
	Total	Non Life	Life	Composite			
Algeria	15	-	1	14	62	72	
Bahrain	36	29	3	4	43	0	
Egypt	28	15	10	3	69	61	Y
Jordan	28	10	1	17	25	0	Y
KSA	26	N/A	N/A	N/A	43	22	
Kuwait	29	14	2	13	46	0	
Lebanon	54	18	5	31	31	0	Y
Libya	9	-	-	9	80	44	
Morocco	18	8	1	9	47	0	Y
Oman	23	12	2	9	57	0	Y
Qatar	9	6		3	95	0	
Syria	13	9	9	13	53	47	
Tunisia	17	3	2	12	49	20	
UAE	57	N/A	N/A	N/A	23	0	
Yemen	12	2	-	10	67	14	
MENA Av.	25	11	4	11	52	-	-
OECD Av.	179	40	106	33	-	-	-

Figure 9: Share of Three Top Companies and Share of State Insurers



Non life distribution in MENA tends to be dominated by direct sales and brokers while life insurance is divided between tied agents for individual business and brokers for group life. However banc-assurance is now also becoming a significant distribution system, particularly in the Francophone countries (Annex Table 6). Insurers have had relationships with banks for some time, largely to place industrial risks for bank-funded projects, but this relationship is strengthening as banc-assurance becomes more prevalent. However, banc-

assurance is only formally regulated in Egypt, Jordan, Morocco, Oman, and Tunisia. It accounts for 95% of the sales of the major life insurers in Egypt (on a non annual equivalence basis), 70% of life and assistance sales in Morocco and close to 30% of all insurance sales in Lebanon. In other Francophone countries such as Algeria, banc-assurance is also beginning to appear, with the three dominant state-owned insurers all having established deals with the major state-owned banks. The first bancassurance arrangement was recently agreed in UAE.

The relationships with banks may provide other channels for the growth of the insurance sector. Insurance premiums will grow with the requirement for borrowers to insure cars and other goods purchased with personal loans. Mortgage lending is still not well developed in the MENA region, but for those countries where mortgage markets are developing, mortgage insurance can be driven by lending. In addition, there is generally a greater trust of banks than insurers in emerging markets and savings and investment products sold via bank branches are often more acceptable to the consumer.

Outside the Francophone zone there is a growing link between Islamic banking and Takaful insurers. In the GCC, Bahrain has specifically supported the development of banc-assurance and new arrangements are appearing in the UAE.

4.2. Signs of Excessive Fragmentation in MENA's Insurance Markets

MENA's insurance markets seem excessively fragmented in some countries and this may have also hindered the sector's development. There seem to be too many companies sharing very small markets. As a result, insurance companies seem unable to generate scale, retain a sufficient volume of premiums, build meaningful risk pools and underwriting capacity, and innovate. Many insurance companies seem to act simply as brokers or front offices, reinsuring most of the business. The volume and levels of human capital also remains weak in most countries, also hindering the sector's development.

A number of key indicators suggest that most countries are experiencing a serious problem of overcapacity, both in terms of capital and number of competitors. As shown in Table 6, the average ratio of net premiums (gross premium minus reinsurance fees) to capital is only 78% in MENA, significantly lower than the average ratio in the OECD (310%). The MENA ratios reflect the abundant availability of capital in MENA, and the significant entry of new companies in insurance markets despite relatively high capital requirements and the small size of these markets. The global insurance pricing cycle has shown that excess capital can lead to predatory price competition, particularly in lines of business such as MTPL, medical and small property risks. The reported loss ratios in MTPL and other lines tend to confirm this syndrome (see MTPL discussion above).

Table 6: Indicators of Industry Capacity Utilization

Country	Net Premium/Capital[9] (%)	Gross Premium per Insurer/PCI	Retained Non-Life Premium (%)	Minimum Non-Life Capital US $mill.
Algeria	N/A	1.4	67	2.3
Bahrain	105	0.1	57	13.3
Egypt	75	2.4	49	10.6
Jordan	83	0.4	60	11.3
KSA	106	0.3	64	26.7
Kuwait	38	0.1	N/A	17.4
Lebanon	185	0.2	72	1.5
Libya	53	0.2	50	7.5
Morocco	74	4.5	84	5.5
Oman	89	0.1	48	13.0
Qatar	32	0.2	43	10.0
Syria	98	1.5	N/A	15.4
Tunisia	52	1.0	67	7.0
UAE	55	0.2	55	27.3
Yemen	56	0.0	30	2.0
MENA	**78**	**0.8**	**57**	**11.4**
OECD	**310**	**1.6**	**83**	**5.9**
Emerging	**-**	**-**	**-**	**4.4**

The low average premium per insurer in MENA also suggests an excessive number of players. As shown in Table 6, the average ratio of gross premium per insurer (adjusted for per capita income) is half of the average ratio in the OECD, and some individual countries have extremely low ratios. On the basis of this measure there is a clear dichotomy, with some Arabian Peninsula countries having issued too many licenses given potential demand. Combined with heavy minimum capital requirements this can lead to either excessive competition or the existence of faux fronting[10] insurers that are really brokers and/or investment houses in disguise (see Box below).

Finally, the average retention ratio (ratio of net premium to gross premium) is low in MENA, suggesting lack of underwriting capacity[11] and the presence of brokers and/or investment houses in disguise among licensed insurers. A retention ratio of zero suggests that the company is essentially a broker, while a retention ratio of one indicates that the company is doing traditional insurance. Only a few MENA countries have retention ratios close to 70 percent or above. This reflects to some extent market fragmentation, as the retention ratio increases more than proportionately with size. Small companies do not have the capacity to build adequate risk pools, take risk internally, underwrite contracts, and innovate. Therefore, the current market fragmentation may have been one of the key factors hindering the development of the sector in the MENA region.

[9] The Egyptian figure is overstated as a significant part of premiums represent single premium investment contracts.
[10] Much of the original fronting was carried out legitimately by captives of major international firms engaged in the extractive industries and seeking international capacity. This is becoming a less relevant sub sector under non admitted insurance rules and with the larger local insurers tending to handle this business (albeit with low retentions).
[11] The apparent contradiction between high minimum capital levels and limited capacity reflects the very large peak risks in the region associated with the extractive and refining sectors and tourism related construction activities.

Box 2: How many insurers?

While fronting is legitimate for highly specialized peak risks, if it is the entire activity of an insurer there must be questions as to whether the entity is really a broker in disguise. A syndrome found in a number of MENA countries involves a large number of small insurers owned by family-controlled financial and industrial groups. These groups write business from their affiliates and pass on the risk to international re-insurers who actually do the underwriting. These affiliates often receive generous fronting commissions (typically 5% to 15%) and are able to maintain small overhead costs. Where capital is plentiful, as in a number of GCC countries, such structures lend themselves to becoming essentially investment vehicles providing employment for members of the controlling families. This in turn adds to supervisory load. In such a rich capital environment, a strategy of rationalizing the sector by increasing minimum capital requirements is likely to fail.

A new source of small insurers has been the blossoming of interest in Takaful insurers in the MENA region. A number of these are associated with Islamic banks. These insurers can be justified if they open new markets but can add to excess competition if they are merely competing with an already adequate number of established market players. This tends to be the case in the non life and health sub sectors. Takaful probably has more of a genuine developmental role to play in the life ('Family Insurance') sub sector if outstanding Shariah issues can be resolved.

4.3. Lack of Professional Skills in the Industry

The lack of qualified professionals has also hindered the development of the insurance sector in MENA. This arises from the fact that some countries have been through periods of nationalization and are now liberalizing, others were in practice dominated by brokers (or fronting insurers) and some were treating insurers as investment companies. Most MENA countries now have updated insurance laws and supervisory regimes and have begun to realize the benefits of running insurers correctly as risk underwriters. This is placing enormous strains on the available skill base and in some cases leading to income disparities that can discourage investment in training by players and supervisory offices (as they will immediately lose the staff concerned). Numerous small insurers are 'key man dependent'.

The lack of technical skills can be illustrated by pointing out that only 2 MENA countries, Egypt and Lebanon, are represented in the 85 Full and Associate members of the International Actuarial Association. However even between these two there is only one Fellowship level IAA accredited consultant under the age of 60 in active practice. Most countries require actuarial determination of life mathematical reserves and there will be an increasing need to apply actuarial techniques to long tail claims provisioning (and MTPL in particular) to avoid the periodic formation of cash flow pyramids. The lack of skills is also chronic in the areas of accounting and auditing (see the section on regulation below). **While foreign insurers, expatriate management and reinsurers can take on part of the training role there is an urgent need for local capacity**. The challenge is well appreciated throughout the region and regional centers of excellence are beginning to emerge, with Bahrain taking on the leadership in basic insurance training in the Middle East through BIBF (which has

translated CII diploma and certificate level material into Arabic under a partnership arrangement), IFID having a similar role on the Maghreb and Cairo University producing approximately 30 actuarial graduates each year under a partnership arrangement with Kent University in the UK. Approximately 10% of these go on to do the UK professional exams[12] and as a practical expedient Associates of the leading international actuarial bodies with some years of experience are now being certified to do actuarial work.

5. Main Regulatory and Supervisory Issues

5.1 Regulation

Entry Requirements

Minimum capital requirements in MENA are in most cases high by international standards, but this has not prevented entry in a capital rich region. Minimum capital requirements are a traditional supervisory tool to screen the number and quality of applicants in insurance and other sectors, but as noted above, in MENA it has not prevented a situation of excessive number of insurers in some markets, some of which are playing only a marginal role.

Licensing requirements in most MENA countries generally follow international norms, including a business plan and fit and proper information on the senior management. However, fit and proper information on Board directors and owners is less frequently required. It is also unclear why these fit and proper rules have not been able to screen applicants more effectively and prevent the entry of insurers which may not be able to play a meaningful role in the marketplace. Also, most MENA countries allow composites to operate but enforced separation of assets and accounts is not always required.

Licensing requirements include several restrictions on cross-shareholdings, branches, and foreign investments. Some MENA countries apply limits to cross shareholdings (e.g. banks in Algeria may not hold more than 15% of an insurer) and to the amount that can be held by any one entity (e.g. 40% in Syria). In addition a number of MENA countries do not allow branches to be established (Egypt, Libya, Morocco, Qatar, KSA, Syria, Tunisia) and/or still restrict the percentage of a local insurer that can be held by non nationals (Table 7). Some of these restrictions may be justified for prudential reasons, while others seem questionable.

Table 7: Limits on foreign shareholdings in insurers

Algeria	Egypt	KSA	Libya	Qatar	Tunisia	UAE	Kuwait	Oman
70%. Existing insurers are grandfathered	10% but exemptions are usually granted	49%	40%	None for national, but foreigners can invest in listed companies	Subject to approval	25%	Subject to approval and initial performance	70%

Sources: AXCO and WB on site research

[12] American University also has an actuarial course but it provides no exemptions from US actuarial examinations.

Mandatory Insurance

Mandatory insurance lines have been a significant source of growth for the insurance sector in many emerging markets. Motor third party liability (MTPL) insurance is typically the first insurance class to be made compulsory in most countries. This is often followed by other liability coverage where the general public is exposed to the risk of enterprises, with Contractors All Risks (CAR), various public transport risks, and certain professional liabilities being the most typical.

The number of mandatory insurance lines has been growing in MENA, although they are still limited and not always effectively enforced. MTPL insurance is now compulsory in all MENA countries. However, this line of insurance is not effectively enforced in many MENA countries as noted above. In addition to MTPL insurance, the most common mandatory requirements in MENA are workman's compensation (WCA), and insurance brokers and medical professional indemnity (PI). CAR is required in some MENA countries where government projects are involved but is not always enforced.

Some GCC countries have introduced compulsory health insurance for expatriates. This is meeting an important social objective and should boost premiums and the growth of the sector. Libya has recently announced that compulsory health insurance for all residents will be provided through the market. Kuwait has a blended voluntary system for expatriates with the private insurers acting as distributers. It is now planning a single specialist health insurer (owned jointly by the government, then public and the insurers) to handle all health insurance.

Preferences

MENA countries have exercise preferences in three major ways: (i) mandatory placements of certain risks with government insurers or locally owned insurers; (ii) mandatory placements of reinsurance cessions to local or regional insurers; and (iii) placements of in house risks to insurers owned by industrial groups (which in turn are often controlled by family groups). Table 8 describes mandated placements in selected countries.

Government business still tends to be placed with insurers in which the government has a significant interest, but this is gradually breaking down (Table 8). Mandatory placement of government business in declining as governments realize the benefits to be obtained from modern risk management technology available through the international brokers, and the fact that they have been cross subsidizing loss making classes.

Forced coinsurance and facultative placement within local markets to maximize use of local capacity is also losing favor, largely because of the difficulties of keeping track of peak and catastrophe risk accumulations and increasingly stringent rules placed by reinsurers on the capacity allocated to such business. A more effective means of raising local capacity is to reduce the level of fragmentation in a market.

Table 8: Mandated Placements and Preferences

Country	Rules
Algeria	Compulsory shares of the premium ceded must be placed with the CCR (the state reinsurer), such as 10% for industrial, chemical, petrochemical, mechanical, and electronic, and 5% for other cessions. All compulsory catastrophic risk is reinsured through CCR.
KSA	Mandatory 30% cession to local reinsurers unless a waiver is obtained.
Morocco	10% obligatory cession to SCR (the state reinsurer) of some non life classes. This is to be removed in the next few years. Facultative loss reserves due from foreign reinsurers have to be held locally.
Qatar	Risks arising from government owned energy enterprises must be placed with local insurers. A tri-annual tender is held.
Syria	Compulsory shares of premium ceded must be placed with the UAR (the state reinsurer). Additional facultative placements must first be offered to AUR and at least 2 other local insurers.

Source: AXCO and WB on site research

Solvency, guarantee funds and wind up

The solvency regime in most MENA countries broadly follows the original EU Solvency 1 regime, with some countries modifying the premium and claims weightings according to the class of business. Two countries (Jordan and Syria) have adopted a modified US risk based capital approach, which implicitly allows for a graduated response to deteriorating insurer solvency. KSA has also implemented such an approach in the context of a modified European solvency formula. Two countries (Lebanon and Oman) have flat solvency requirements that are low by international standards and one country (Yemen) has no solvency requirement.

A number of countries have old fashioned general reserve requirements, often related to minimum capital, presumably a carry-over from an earlier generation of regulation. As a result, minimum capital has taken on a default solvency role in some countries, although its main purpose should be to help create an efficient industry structure and cover establishment costs. In the case of Takaful operators, most MENA countries have specified modified minimum capital requirements, as they have for pure mutual insurers. Bahrain has instituted an interesting approach which allows a Takaful fund 5 years to build up adequate risk capital before the operator is required to provide funds from its own resources.

Reserving (a significantly more important issue than solvency margins) tends to be rules-based where it is premium related, but most countries apply a principles based approach to claims provisions. This can undermine the solvency regime if the reserves are not determined by qualified individuals who can adjust for inadequate case estimates and incurred but not reported claims. Some more modern laws such as in KSA and Egypt require actuarial input for long tail (i.e. liability) claims provisions. Life mathematical reserves almost inevitably require actuarial input.

Wind-up rules in the region tend to assume liquidation rather than earlier interventions. However, regulations in some countries such as the UAE do allow for enforced portfolio transfers and pragmatism under general powers has been applied in cases where insurers have failed and where specific powers have not been present. An increasingly common response to wind up risk has been to require that insurers establish joint policyholder protection funds, usually with an annual levy of between 0.5% and 1% being applied to premium incomes.

Accounting and Auditing Standards

A majority of MENA countries still follow national accounting standards although an increasing number require listed companies and banks to follow IFRS. However, many insurance companies are non-listed, and the frequent presence of family and financial and industrial groups in the insurance sector raises a number of transparency and governance issues (e.g. related party transactions). Therefore, the standards and the level of professional oversight will need to be strengthened if non-listed financial sector insurers are to gain public trust.

The quality of accounting and auditing is limited by lack of skills in these areas. Most MENA countries have undergraduate level accounting programs and the big 4 international firms (which are present in most MENA countries) have active in house training programs offering ACCA accreditation. However they have limited resources relative to the specialized demands of the insurance sector. This has led to a situation where sole traders are being authorized to carry out audits of insurers. This is an absurdity as a full modern insurance audit requires governance and internal controls/ risk management overview and requires at least a week and a team of experts, including systems specialists – in practice the sole traders sometimes sign off on the work of larger firms. It is also noteworthy that some accounting bodies in MENA countries are not yet members of the IFAC, including Algeria, Libya, Qatar, Syria, UAE and Yemen.

Banc-assurance

As noted above, only a few countries have formally regulated banc-assurance, but an increasing number of countries are aware of the importance of the relevant market conduct issues. Some countries are taking a careful line with Kuwait and Qatar forbidding banks from accepting commissions from insurers and Egypt effectively placing a temporary ban on new arrangements until an acceptable set of rules is agreed. In Jordan new rules allowing for banc-assurance have recently been promulgated although there is some resistance from leading agency based insurers. Oman has also introduced formal requirements, although these are principles rather than rules based. In the absence of specific rules the bank regulators in most MENA jurisdictions have banned bundling of bank and insurance products, which is in line with emerging international best practice. The handling of long term insurance classes in particular need enhanced market conduct rules as consumers can otherwise believe that they are purchasing a bank guaranteed product.

Consumer protection

The main issue addressed in regional consumer protection requirements is recourse in the event of disputed claims. A number of countries require that insurers have internal dispute resolution mechanisms in place and most jurisdictions specify that the insurance supervisor is the next step if resolution cannot be achieved. As shown in Table 9, a few MENA countries have set up alternative dispute resolution procedures including mediation and arbitration mechanisms (although the latter are more applicable to commercial coverages as personal lines policies rarely contain arbitration clauses).

Table 9: Alternative dispute mechanism initiatives in MENA

Country	Mechanism
Syria	Insurance dispute resolution committee within supervisor with ombudsman powers
Qatar	The Ministry of Business and Trade has ombudsman powers.
Oman	The supervisor has issued code of practice for insurers and acts as mediator.
Lebanon	Insurance arbitration council for motor and medical claims under US$50,000.
Jordan	Insurance Disputes Resolution Committee has ombudsman powers up to US$35,000

Source: World Bank country visits and AXCO Reports

Tax policy

Insurers in MENA are subject to direct taxes, levies to support supervisors (generally significantly less than 1% of turnover) and levies to fund guarantee funds/ nominal defendants. Tax regimes are illustrated in Table 10. While the taxes on non life classes are high in some cases, they are not out of alignment with those in industrial countries. A more serious issue is the turnover taxes applied to life insurance premiums and zakat applied to policyholder funds. These are a direct penalty on the savings components of mainstream products such as endowment assurance, and the whole of life and universal life. The economic reasons for introducing such taxes are hard to fathom. Algeria applies a combined VAT and premium tax of 19% to all insurance classes, including life. This more than any other factor probably accounts for the virtual non existence of a genuine long term life insurance sector in that country. Similarly a 3.25% tax on capitalization policies in Morocco has effectively killed that market.

Table 10: Significant Premium Taxes in MENA (Selected Cases)

Country	VAT/ GST	Stamp Duty	Premium Tax	Other
Algeria	17% on all classes-including life	5% prem. MTPL	2% on all classes – including life	
Egypt			1% life, 5% non life except mandatory insurance	
Jordan	16% of all non life except PA/ med	1% prem. all classes		
Lebanon			5% non marine, 3% marine	6% municipal tax - non life
Syria		3% prem. all classes		5% prem. all classes
Tunisia			10% prem. all non life except export focused, agriculture and decennial 5% on marine and aviation	

Source: AXCO and country visits

5.2. The Supervisory Framework

Many insurance supervisors in MENA do not enjoy adequate levels of legal, administrative and budgetary independence. As shown in Table 11, insurance supervision is still conducted by units inside government ministries in eight MENA countries. Very rarely, these units or departments operate with sufficient administrative autonomy and have the conditions to attract and retain qualified personnel. Morocco is probably one of the few exceptions in this regard, but Morocco is also passing a new law introducing a new and independent insurance supervisor

agency. Some countries have instituted a separate supervisory agency (e.g. Jordan, Syria, Tunisia), some countries have placed insurance supervision inside the central bank (Bahrain, Saudi Arabia), and other countries have merged insurance supervision with the capital market authority or other non-banking regulators (Egypt, Oman).

Table 11: Insurance Supervision Structures in MENA

Country	Supervisor
Algeria	Ministry of Finance
Bahrain	Central Bank of Bahrain
Egypt	Egyptian Financial Supervisory Authority
Jordan	Insurance Commission
KSA	Saudi Arabian Monetary Authority
Kuwait	Ministry of Commerce and Industry
Lebanon	Ministry of Commerce
Libya	Public Committee for Economy Trade and Investment
Morocco	Ministry of Finance
Oman	Capital Market Authority
Qatar	Ministry of Business and Trade
Syria	Syrian Insurance Supervisory Commission
Tunisia	Comité General des Assurances
UAE	Ministry of Economy Planning
Yemen	Ministry of Industry and Trade

Supervisory capacity varies considerably over the region. Leading established supervisory jurisdictions include Bahrain, Jordan, Morocco, and Tunisia. Egypt and Libya are in transition in parallel with their market liberalization programs. These countries have all benefited from strong government support. Newly formalized markets that have rapidly demonstrated a strong intervention capacity include KSA and Syria although these countries are still building their resources and supervisory models. Most catch up work is required in some oil and gas rich countries where to date insurance development has been seen as a secondary issue.

At the same time, Financial Sector Assessments (FSAPs) conducted by the World Bank and the IMF in MENA countries have identified several common weaknesses in supervisory practices:

- Weak financial reporting – problems in obtaining consistent, accurate and timely statistical, financial and reinsurance information;
- Lack of adequate enforcement of claims provisions and premium levels for MTPL insurance;
- Lack of early intervention and enforcement actions at industry and insurer levels;
- Weak corporate governance;
- Problems in dealing with illegal and excessive payments to agents and brokers while allowing them to operate commercially;
- Problems ensuring that bancassurance products and distribution rules meet adequate market conduct standards;
- Lack of functional consumer protection mechanisms;

- Absence of transparent and informative web windows to the public – Egypt, Morocco, and Jordan provide good examples of web sites that provide useful information to the public and the sector;
- No provisions for wind up or bankruptcy under the insurance supervisor and limited legal protection of policyholders in such circumstances;
- Dealing with Takaful – in practice most supervisors to date have applied normal supervisory methodologies, while allowing a Shariah board to deal with product issues (see Appendix).

Insurance industry associations are still underutilized. The World Bank's work in the region has shown that strong industry bodies, working closely with the supervisor and government can have a significant impact on public trust and awareness, and in ensuring that the sector operates in an optimal fashion (i.e. properly balances competition and the public good). Best practice case studies can be found in Syria and Morocco (see case study below).

6. Stages of Insurance Development in MENA: A Preliminary Classification

The analysis above enables the identification of three broad groups of emergent markets in MENA as well as one relatively unique case (Lebanon). These groups include:[13]

Jordan, Morocco and Tunisia: These countries have been able to develop the insurance sector at a faster pace. Supervisory and regulatory capacity is generally more developed. The industry is led by the private sector – government control is non-existent or minor and concentration levels are not excessively high (the Jordanian market appears a little fragmented and may need some consolidation). Bancassurance may have contributed to the growth of the life sector, while cultural factors do not seem to have hindered excessively the growth of the sector[14]. The industry in these countries is overcapitalized, but capital usage is more efficient than elsewhere and the sector contains an efficient number of insurers. Retention levels are still low by international standards (except for Morocco) but are not unreasonable for emerging markets with large peak risks and undeveloped household markets.

Algeria, Egypt, Libya and Syria: These countries have insurance sectors that are in transition from long periods of nationalization. They tend to have reasonably efficient numbers of competitors but high levels of concentration, reflecting dominant market shares for the government insurers in some lines such as government property, MAT and extractive industry, as well as retail lines such as MTPL, where under-pricing and losses have been chronic. Retention levels tend to be higher than for the more conventional markets reflecting abnormally high levels of capitalization and residual government guarantees.

Bahrain, KSA, Kuwait, Oman, Qatar, UAE: These resource rich GCC countries have very small populations (KSA excepted), significant numbers of expatriates, high average income and generous social transfer systems. They are anxious to diversify their income bases, and look for this in the financial services, education, tourism, and property sectors. They tend to have too

[13] Yemen is a low income country and its industry structure reflects limited demand and scale. The major insurer is associated with the leading local trading group and as would be expected, local retention levels are low.
[14] Lebanon, Morocco and Tunisia entered this market first in MENA, with French technical assistance.

many insurers for the size of their markets, although with the exception of UAE and KSA[15], concentration levels are at healthy levels (implying two tier systems with relatively efficient leaders and numerous small fronting, struggling or inactive insurers). Retention levels average 50%, reflecting a compromise between relatively high capitalization and a number of very large peak risks. In contrast to UAE, Qatar has a strong preference system and 95% of premium is placed with the 3 largest national insurers, exacerbating the competitive level amongst the smaller players. The Kuwaiti government self insures which effectively puts a good part of potential premium flows out of the reach of the market[16].

Lebanon: Lebanon has had an unregulated market for over 60 years and has provided much of the insurance expertise and investment in the Levant and KSA as new formally regulated markets have opened up[17]. The insurance legislation is very outdated and the supervisor has had to cope with a hostile sector in trying to introduce a modern risk based approach[18]. Low entry requirements led to a fragmented and marginally efficient structure (including a significant number of inoperative licenses and 'brokers in disguise'). At the same time, the industry has benefited from business from contiguous countries such as Syria and from a health system with large coverage gaps. However these sources of business offer limited scope for future growth and some insurers are considering moving to other countries with stronger supervisory regimes.

7. The Case of Morocco

Morocco should have one of the lowest insurance penetration levels in MENA given its income level and demographics. Instead, it is the clear out-performer in the region. While there are still a number of issues to be addressed in Morocco, the following factors help explain why the country has been able to develop the insurance sector at a faster pace:

- A capable supervisory office enjoying a relatively unique working relationship between its counterparts in the government and the industry;
- A regulatory regime that has tracked EU developments[19] and supports a technical approach to insurance management;
- A private-led insurance sector, and the regulator willingness to allow significant (and high quality) foreign holdings in leading local insurers;
- A stable and effective industry structure following a series of mergers;
- The existence of well regulated and policed mandatory insurance classes – including motor third party liability, workman's compensation (WCA), some professional liability coverage, and mortgage related coverage;
- The historical role the sector has played in providing comprehensive health insurance;

[15] The KSA and the UAE have recently been discouraging applicants for new licenses.
[16] This is likely to gradually change under a proposed privatization program.
[17] KSA had a largely unregulated and poorly regarded market until 2007 when the system was formalized and supervision put under SAMA. It has since made rapid progress.
[18] A well reviewed best practice draft law has been awaiting submission to parliament for more than 4 years.
[19] However the Moroccan supervisor plans to carefully assess the applicability of Solvency II and the planned IFRS 4 update to an emerging market context.

- The rapid emergence and growth of life banc-assurance with a significant savings component;
- A significant role for life insurers in the provision of supplementary pensions;
- A developing mortgage market;
- A still developing but viable capital market, supplemented by some scope to diversify portfolios internationally (10% of funds off-shore).
- Removal of nearly all risk placement preferences, with the last remaining compulsory cession to the national reinsurer due to be removed shortly.

The next phase of the partnership between the industry and the government involves a 'Contrat Programme', which was officially launched early in 2010. This entails a document laying out the commitments and roles of the various parties. The contract has been coordinated by the Ministry of Finance and as a starting point a report was commissioned from a consortium of an American consulting firm and a French actuarial practice, that lists 75 measures covering product development, compulsory classes, prudential controls, investment rules, internal controls and risk management, internationalization and an implementation process.

8. Roadmap for Developing the Insurance Sector in MENA

As shown in the preceding sections, the factors affecting insurance development in MENA can be broadly divided into those which are out of control of policy makers and those that can be influenced by policy actions. Moreover, some of the obstacles to market development can only be dealt with over a considerable length of time, while others can be addressed over shorter time periods. Within this broad policy framework, the sections below provide recommendations for the development of the insurance sector in MENA. It goes without saying that the following recommendations will need tailoring to the conditions prevailing in each jurisdiction. Some countries may already be well advanced in implementing a number of these headings.

8.1. Introducing additional compulsory insurance and enforcing the existing ones

There is some justification for introducing compulsory insurance that generates positive externalities and supports fiscal rectitude. Most MENA countries make employers liable for injuries and illnesses in the workplace but not all require mandatory insurance when there is no social insurance mechanism in place. The introduction of such a requirement would both substantially increase premiums and generate a social good. Other classes of insurance that would have these dual benefits include the liabilities of enterprises that interact with the general public including construction companies, public transport providers and certain professions. Catastrophe insurance is another category of insurance that is being made compulsory in some countries outside MENA, particularly when associated with the exposures to natural disasters of credit grantors (e.g. mortgage lenders). Some GCC countries could consider introducing health insurance for expatriates and eventually, as fiscal pressures rise, to their own domestic populations (as has already recently happened in Libya).

There is also scope for generating more premium revenues and growth from existing compulsory insurance lines. This is the case of MTPL and Contractors All Risk (CAR)

insurance. Again, enforcement would not only result in larger premiums but could also provide additional benefits, such as reduced accidents and injuries: the regulatory section provides further details.

A desirable associated developmental step is increasing consumer awareness of insurance and its role. This should be a joint industry governmental program to educate the public about the role of insurance and to generate greater trust in the sector. The implementation of effective consumer recourse mechanisms are an intrinsic part of such a program.

8.2. Reducing the share of State-owned Insurers

As shown above, research shows that reducing the participation of state insurers would contribute to faster market development. A number of MENA countries are still dealing with the legacy of heavy state involvement in the insurance sector and working through the liberalization process, including Algeria, Egypt, Libya, and Syria. A prerequisite for effective liberalization is the establishment of an effective prudential regime and an adequate consumer protection and education infrastructure. In addition, human resources need to be developed in accounting, investment, actuarial, underwriting, and claims assessment. Moreover, state insurers may need to go through full financial and operating audits and plans developed for corporatization and eventual privatization. Putting state owned insurers onto a full market basis may take years and different models can be applied to the eventual privatization. In MENA a common approach has been to introduce private shareholders through direct placement (STAR in Tunisia) and/or an IPO (Libya Insurance in Libya).

8.3. Strengthening Regulation and Supervision

Entry Requirements

Licensing rules should be more rigorous in examining the fit and proper status of directors and owners of insurers. In addition supervisors should be allowed to consider the impact of issuing new licenses on the stability and development of the market. In MENA this may prove more effective in ensuring the entry of applicants able to contribute to market development than minimum capital requirements. As a general rule branches of foreign companies should only be allowed if assets covering liabilities and required solvency are held locally and the parent company has very high claims paying and credit ratings.

Consolidation of Market Structure

MENA supervisors should also consider measures to consolidate the industry and remove weak and small players that generate losses and do not contribute to market development. A common theme in MENA countries is too many small insurers (including Takaful funds and managers). The most common approach to forcing consolidation in other markets has been to raise minimum capital, but this approach may not prove effective in MENA. One potentially more powerful technique used in some countries is to give the supervisor the power to encourage the exit of faux market players by requiring all insurers to satisfy certain minimum efficiency and legitimacy conditions. Aside from the enforcement of prudential requirements (having adequate provisions and reserves in particular) these can include a requirement that minimum

market shares be achieved within a reasonable period in mandatory lines such as MTPL and medical (and thereafter sustained), and that a minimum aggregate premium retention level of say 30% to 40% be maintained (to remove the disguised brokers). Finally, the insurance sector could be required to publish efficiency benchmarks, such as premium per employee, combined ratio and net expense ratio.

Box 3: Competition – why insurance is different from banking

There is a large amount of empirical evidence that scale economies apply to the insurance sector up to a relatively large size of operation. For non life insurance this is partly an overhead spreading issue but the credibility of claims data also increases (roughly to the square root of the number of claims) with size. Thus large non life insurers can price more accurately. Smaller insurers often follow the leaders' pricing structures and attempt to compete on some other basis.
Unfortunately there is little credible data in new insurance markets and insurers will typically not know the real cost of their product for some years. Thus under the pressure of too many competitors it is relatively easy for insurers to under-price and undermine the financial position of the whole sector (consumers tend to be efficient at finding the cheapest insurance price). This will be exacerbated if investment returns are high and some insurers believe that they can cover underwriting losses. Under-pricing combined with under-reserving leads to prolonged disputes and settlement delays and adversely affects the development of the sector.
For life insurers scale is important because of the enormous investment that is required in building and retaining marketing and distribution capacity (typically up to 70% of total costs). Thus a start up life insurer can expect to be making accounting losses for some time, even if its intrinsic value (i.e. NPV) is increasing. However the underlying processes tend to be more stable than for non life insurance and the actuarial profession usually provides a control mechanism.

Composite insurers

While the IAIS insurance core principles require that life and non life activities are preferably handled in separately licensed entities (to pre-empt cross subsidies and adequately secure the assets covering life insurance policy liabilities) there is an exception if the supervisory authority is 'satisfied that the insurer has satisfactory processes requiring that risks be handled separately on both going concern and winding up bases'. If MENA supervisors decide to grandfather the existing composites (for example to leverage limited human resources), it is essential that the life insurance assets are clearly identified, cannot be charged or lent, are held by a custodian and are otherwise completely ring fenced.

Solvency regimes and guarantee funds

A desirable approach to developing a risk based supervisory model is to initially have relatively simple but modern solvency requirements and first focus on ensuring that proper information is being provided. It is also essential to ensure that supervisors' analytical and intervention capacity is up to necessary standards. Developing markets that have taken this approach typically seek technical assistance in producing relevant operating manuals and in performing the initial full scope on site inspections. Supplementary general reserve requirements where they exist bear no relationship to an insurer's risk levels and would be better replaced with

some simple weightings related to asset structures. While actuarial resources are thin on the ground in most MENA countries a more rules based approach could be taken to the setting of non life claims provisions, including IBNR allowances. Long tail claims (MTPL aside) are infrequent and reinsurer support could be sought here.

Guarantee funds, other than for compulsory insurances and life insurance in the absence of strong ring fencing requirements (see composites) should be discouraged as they create moral hazard in the absence of strong risk based supervisory regimes. A better approach is to ensure that policy provisions and reserves are properly matched by secured and appropriate assets and that the supervisor has the power to take prompt corrective action (including taking possession of assets and enforcing portfolio transfers) in the event an insurer gets into trouble.

Bancassurance

Bancassurance has the potential to produce a quantum jump in the penetration of long term insurance markets in all MENA countries. This is largely because this business model enables insurers to short circuit the time it takes the population to understand their role and gain trust in their products. Thus a delicate balance needs to be achieved between the comfort the bank provides and the need for the consumer to understand that they are not buying a bank product. Best regulatory practices are being developed outside the region and some countries within the region have already drawn on these. One possible role for regional education or development organizations is to develop a best practice set of rules that could be adapted to the different MENA legal jurisdictions.

Consumer protection

A number of innovative approaches that efficiently establish ombudsman or near ombudsman structures within existing institutions have been developed within newly emerging MENA insurance markets. In addition a number of countries require insurers to set up internal dispute resolution processes and attendant reporting. These mechanisms recognize the importance of trust when populations are not well versed in insurance concepts.

MTPL Insurance

Policy makers and regulators must address the causes of limited premium generation in MTPL insurance, by improving compliance (i.e. through more aggressive enforcement measures), addressing understatement of claims provisions by insurers, relaxing price controls, and consolidating the industry. There are a number of examples of innovative and strong actions that are being taken in some countries to deal with these issues. For example,

- *Tunisia* has introduced clear compensation guidelines for MTPL claims and enforced better claims settlement practices on the part of the insurers (including immediate settlement for claims below a defined level). Results have already improved dramatically.
- *In Egypt*, the Egyptian State Insurance Holding Company, working with the supervisor (EFSA), has installed actuarial capacity to properly value outstanding claims provisions and this has been reflected in a series of significant increases in premium rates. In addition Egypt

has capped serious claims. It is also considering options to establish a central statistical underwriting and claims database.

- *Saudi Arabia* is building a professional MTPL claims assessment firm jointly owned by the insurers to prevent claims fraud and mis-allocation. Such firms can limit the need for police involvement except in the most serious accidents. An alternative is to remove liability and allow individual drivers to claims against their insurer.
- *Syria* has centralized the pricing and allocation of MTPL renewals, capped claims and applied a no fault approach to maximum payouts. It is about to introduce electronic renewals. This has resulted in a significant jump in premiums which are now approaching sustainable levels.

Reporting standards

Possibly one of the most serious regulatory flaws in the region is the lack of consistent, timely and high quality data available to supervisors and those sections of the general public and the industry who need such information. This partly reflects the newness of some insurance markets and supervisory entities, but also is a manifestation of a desire by family and financial and industrial controlled groups to not reveal such information. This attitude is not acceptable for financial institutions collecting funds from the public and taking on contractual liabilities and all insurers should be required to submit financial and statistical information to supervisors in electronic form according to agreed templates, timetables and definitions. If an insurer cannot accomplish this there are good reasons to question their ability to be in business.

Supervisory structures and independence

As insurance markets develop they gain political power and supervisors eventually need to be given the resources and independence to act according to the public good rather than the requirements of special interests. As noted, one solution is to place the insurance supervisor in the central bank and this may be a next step for a number of supervisors in small MENA countries. An alternative is to establish an integrated supervisor with independent funding sources and transparent appointment and removal processes for senior personnel.

8.4. Improving the Tax Regime

Many countries at all levels of development see the insurance sector as a reliable source of taxation revenues. While the economics of this approach are questionable if direct taxation of premiums become egregious (i.e. the premium can become larger than the potential policyholder's risk aversion) the ready availability of relatively reliable turnover numbers and an assumption that insurance is a luxury good often drives policy. In practice some level of taxation of risk premiums may be justified as value is being added, this is generally a small sum relative to the sum insured and claims payments are not taxed.

However the taxation of the savings components of long term savings contracts (pensions and life insurance[20]) is a direct attack on thrift and implicitly involves a supertax, as premiums are normally paid out of after tax income. Increasingly policy is to tax any excess

[20] Life insurance is called Family Insurance in the Middle East.

of a cash surrender value over premiums paid when this is taken early (e.g in less than 8 years after policy inception). Continued up front taxation of contractual savings implies a national policy of favoring the banking and securities sectors or an attempt to impose a narrowly focused wealth tax. Neither of these policies has proved to be developmentally justified and a number of countries (e.g. Egypt) have ceased taxing life insurance premiums.

8.5. Developing Takaful Insurance

Takaful insurance is potentially a solution to make insurance acceptable to religious and cultural tradition. However, several insurance sector officers and supervisors throughout the region believe that to date it is more of a marketing tool than a genuine attempt to create a product that is consistent with Shariah law. The KSA has recognized this by banning the use of the word Islamic in any insurer's branding. Numerous challenges still exist in creating a truly Islamic product and reconciling this with modern prudential and consumer protection requirements. While there has been an extraordinary amount of publicity, discussion and licensing activity the Takaful sector still accounts for less than 3% of global insurance premiums and is still very much a minority subsector in MENA, although there has been rapid growth from a small base in some countries (The Appendix provides additional information).

Operationalizing and harmonizing the principles of Takaful insurance remains a challenge. Licensing more Takaful insurers is likely to add to the supervisory load (possibly more than proportionately given the complexity of Takaful hybrid structures). However, given the size of the global conservative Islamic population, not to mention non Muslims who prefer mutual structures, and the increasing evidence of the role of insurance in development, there is much to be said for persevering. However the current fragmented global approach is not helping, with numerous interpretations and hybrid structures, a number of which are replicas of traditional commercial insurance structures. For this reason, there is much to be said for a more rigorous and coordinated approach to developing a genuinely acceptable model. This in turn may involve greater centralization of Shariah guidance, new structures for the capital support required by modern risk based prudential standards and innovative approaches to consumer protection.

8.6. Developing Human Capital

While the lack of technical skills issue is widely appreciated throughout the MENA region[21], especially as technical underwriting becomes more important in an uncertain investment climate, there has been little regional cooperation. In fact a number of countries appear to be trying to become the regional center of excellence in a number of disciplines when leadership has already been de facto established.

The IFID and Bahrain (insurance skills and knowledge) and Egyptian (creating a stream of candidates for IAA level qualification) models have already created potential centers of excellence in the Maghreb and Middle East and consideration could be given to expanding their sub regional roles. While the major accounting firms have made a significant contribution there could also possibly be a center of excellence established for training in accounting and

[21] Even in a relatively advanced market like Tunisia it is estimated that no more than 25% of insurance staff are fully technically qualified.

auditing principles for the financial sector – an existing training institute such as that established by SAMA could form the platform for such a program.

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Annex Table 1: Income Levels and Demographic Characteristics

Country	Per Capita Income US$ 2009	Population millions	Share of Muslims	Share of Expatriates	Population Density	Age Dependency Ratio
Algeria	4029	34.6	99	-	14.7	46.9
Bahrain	28240	0.7	81	32	1114.8	40.1
Egypt	2269	80.5	90	-	82.9	58.4
Jordan	3829	6.4	92	48	156.8	34.4
KSA	14540	25.7	100	19	67	61.6
Kuwait	54260	0.7	85	48	12.7	54.6
Lebanon	8157	4.1	60	-	406.1	48.4
Libya	9714	6.5	97	-	3.6	52.4
Morocco	2795	31.6	98	-	71.6	50.9
Oman	21649	3.0	>90	17	9.2	52.5
Qatar	62451	0.8	78	80	121.6	20.6
Syria	2474	22.2	90	-	113.9	61.8
Tunisia	3792	10.6	98	-	63.8	42.8
UAE	58272	5.0	96	58	55	25.2
Yemen	1118	23.5	>95	-	44.7	85.7
MENA	18506	17.2			155.9	49.1
GCC	39902	6.3			245.0	37.9
Non-GCC	4242	24.4			96.5	56.5
Oil	28403	11.3			178.0	43.2
Non-Oil	3660	26.1			122.7	58.0

Sources: Axco Reports, US Census Bureau, IMF WEO, World Bank analysis

Annex Table 2: Relevant Policy Variables

Country	Yearly Avg Inflation (%)	Contribution to PAYG scheme	Credit (% of GDP)	Share (%) of State-controlled Insurers	Major International Airline	Formal Bancassurance
Algeria	3.0	17	12.6	72		
Bahrain	1.6	12	75.4	0		
Egypt	7.4	30	43.6	61	Y	Y
Jordan	3.8	14.5	88.7	0		Y
KSA	2.0	18	41.8	22	Y	
Kuwait	3.4	17	60.1	0		
Lebanon	3.0	8.5	73.5	0		Y
Libya	-0.4	14.25	6.1	44		
Morocco	1.9	11.89	78.4	0		Y
Oman	2.9	13	39.4	0		Y
Qatar	5.5	15	45.9	0		
Syria	4.8	21	15.7	47		
Tunisia	3.2	15.5	63.2	20		Y
UAE	6.7	20	73.8	0	Y	
Yemen	10.5	19	7.2	14		

Sources: AXCO,

Annex Table 3: Stylized Non Life Insurance Development Model

Stage	**Need**	**Class of Insurance**
Early development	Transport Trade Agriculture	Marine, aviation, transport (MAT) Trade credit Crop, rainfall
Mid development	Motor vehicle accident Motor vehicle credit coverage Construction Industrial	Compulsory motor vehicle liability Motor vehicle loss/damage Construction liability (sometimes compulsory) Fire, boiler, etc
Late development and transition	Mortgage debt Commercial and industrial Health/ medical Motor vehicle Catastrophe	Household fire, mortgage lenders risk Fire, loss of profits, workman's compensation Health and accident insurance, group medical Comprehensive motor vehicle Flood, earthquake
Industrial	Tort exposure Households Consumer credit purchases	General and professional liability Multi coverage householders insurance Consumer credit insurance, warranties

Annex Table 4: Compulsory Insurance Lines

	Algeria	Bahrain	Egypt	Jordan	KSA	Kuwait	Lebanon	Libya	Morocco	Oman	Qatar	Syria	Tunisia	UAE
Expat. Med Expense					x									x
Fire and Explosion	x													
Cat. cover	x													
Property														
Registered entities												x	x	
Marine cargo imports								x				x	x	
Vessel and aircraft hull	x											x		
Public Liability														
Hotels and restaurants				x								x		
Registered entities												x		
CAR												x		
Petrol stations												x		
Third Party Liability														
Motor liab.	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Public sector contractors	x													
Lifting devices	x												x	
Excursion /campsites	x											x	x	
Product f	x													
Hunters	x								x					
Goods and passenger carriers	x													
WCA		x					x		x	x				
Light aircraft testing			x											
Pleasure craft						x								
Professional Liability				x										
Construction professionals	x								x					
Engineers											x			
Blood med.	x												x	
Property decenial	x												x	
Medical					x			x		x				
Accountants.									x				x	
Lawyers														
Insurance consultants	x	x	x		x	x			x	x				x
Port operators													x	

Annex Table 5: Development Drivers of the Life Insurance Industry

Annex Table 5: Development Drivers of the Life Insurance Industry (Source: Feyen, Lester, and Rocha (2010)
The dependent variable is the logarithm of the volume of life insurance premiums as a fraction of GDP. The sample consists of annual data for the period 2000-08. All regressions are estimated using pooled Ordinary Least Squares. Year-fixed effects and a constant were estimated but are not reported. LSCHOOLING, LLIFE_EXP, LINCOMETOP20, and LCONTRIB_RATE are sample period averages. In all regressions, White's heteroskedasticity-consistent (clustered) t-values are given in parentheses (brackets). ***, ** and * represent significance at 1, 5 and 10% level respectively.

	1	2	3	4	5	6	7
LGDPPC	1.06	0.96	0.92	0.61	0.37	0.29	0.43
	(16.9)***	(14.4)***	(12.8)***	(12.5)***	(9.03)***	(4.99)***	(3.63)***
	[6.04]***	[5.32]***	[5.56]***	[6.52]***	[3.31]***	[2.07]**	[2.03]**
LPOP	0.32	0.32	0.24	0.21	0.31	0.12	0.23
	(11.5)***	(12.6)***	(7.32)***	(6.11)***	(12.0)***	(3.30)***	(5.82)***
	[4.21]***	[4.65]***	[2.94]***	[3.02]***	[4.63]***	[1.15]	[3.23]***
LPOP_DENSITY	0.48	0.45	0.39	0.38	0.25	0.27	0.45
	(10.5)***	(10.7)***	(7.48)***	(7.27)***	(6.19)***	(8.81)***	(6.05)***
	[3.78]***	[3.98]***	[3.24]***	[3.94]***	[2.30]**	[3.15]***	[4.20]***
INFLATION	-2.90	-3.20	-6.10	-8.89	-0.79	-5.81	-8.15
	(-5.84)***	(-5.96)***	(-5.23)***	(-5.81)***	(-1.23)	(-3.24)***	(-5.71)***
	[-3.25]***	[-3.51]***	[-5.35]***	[-4.15]***	[-0.66]	[-1.64]	[-5.00]***
LLIFE_EXP	-3.00	-3.71					-0.14
	(-3.33)***	(-4.62)***					(-0.15)
	[-1.18]	[-1.64]					[-0.11]
LAGEDEP	0.17						0.072
	(0.55)						(0.13)
	[0.20]						[0.084]
LAGEDEP_OLD		0.94					
		(10.4)***					
		[3.76]***					
LAGEDEP_YNG		0.53					
		(3.11)***					
		[1.20]					
LSCHOOLING			-0.58				0.87
			(-1.48)				(1.35)
			[-0.68]				[0.81]
LINCOMETOP20			1.19				1.79
			(3.61)***				(3.69)***
			[1.56]				[2.12]**
MUSLIM			-0.66				-0.56
			(-3.66)***				(-2.97)***
			[-1.64]				[-1.82]*
LCONTRIB_RATE				-0.15			-0.20
				(-1.71)*			(-2.05)**
				[-0.87]			[-1.15]
CONCENTR.				0.23			0.29
				(1.88)*			(1.87)*

Annex Table 6: Development Drivers of the Non-Life Insurance Industry

Annex Table 6: Development Drivers of the Non-Life Insurance Industry (Source: Feyen, Lester, and Rocha (2010))

The dependent variable is the logarithm of the volume of non-life insurance premiums as a fraction of GDP. The sample consists of annual data for the period 2000-08. All regressions are estimated using pooled Ordinary Least Squares. Year-fixed effects and a constant were estimated but are not reported. LSCHOOLING, LLIFE_EXP, LINCOMETOP20, and LCONTRIB_RATE are sample period averages. In all regressions, White's heteroskedasticity-consistent (clustered) t-values are given in parentheses (brackets). ***, ** and * represent significance at 1, 5 and 10% level respectively.

VARIABLES	1	2	3	4	5	6
LGDPPC	0.14	0.26	0.30	0.20	-0.056	0.20
	(3.48)***	(18.4)***	(14.6)***	(10.1)***	(-0.46)	(7.84)***
	[1.81]*	[6.61]***	[7.26]***	[3.59]***	[-0.38]	[3.91]***
LPOP	-0.0017	-0.035	-0.073	-0.034	-0.020	-0.069
	(-0.081)	(-3.40)***	(-5.38)***	(-2.94)***	(-0.61)	(-5.17)***
	[-0.041]	[-1.22]	[-2.65]***	[-1.05]	[-0.47]	[-2.61]**
LPOP_DENSITY	0.091	0.0042	-0.022	0.0015	0.031	-0.046
	(3.81)***	(0.32)	(-1.20)	(0.11)	(1.01)	(-2.64)***
	[1.90]*	[0.13]	[-0.60]	[0.039]	[0.78]	[-1.33]
INFLATION	0.059	0.22	0.98	1.23	1.32	1.23
	(0.14)	(1.41)	(2.19)**	(5.32)***	(2.52)**	(3.11)***
	[0.098]	[0.85]	[1.22]	[4.03]***	[1.91]*	[1.71]*
MUSLIM		-0.56			-0.57	-0.28
		(-11.3)***			(-4.47)***	(-4.53)***
		[-4.02]***			[-3.57]***	[-2.23]**
CONCENTR.			-0.060		-0.23	-0.11
			(-1.15)		(-2.06)**	(-1.92)*
			[-0.58]		[-1.59]	[-0.97]
PRIVATE			0.15		-0.091	0.12
			(2.64)***		(-0.75)	(1.97)**
			[1.33]		[-0.62]	[0.99]
LEGAL_RIGHTS			0.055		0.048	0.041
			(5.53)***		(2.17)**	(4.20)***
			[2.76]***		[1.50]	[2.09]**
LPC				0.30	0.14	0.16
				(10.2)***	(1.60)	(4.80)***
				[4.02]***	[1.09]	[2.35]**
LCARS	0.19				0.24	
	(4.62)***				(2.44)**	
	[2.44]**				[2.04]**	
LTRADE	0.057					
	(1.02)					
	[0.54]					

Annex Table 7: Distribution channels

Non-life

	Motor			Non Motor		
	Agent	**Broker**	**Direct**	**Agent**	**Broker**	**Direct**
Bahrain	5	50	45	5	60	35
Jordan	79	21	0	36	64	0
Lebanon	30	40	30	20	60	20
Libya	40	0	60	10	0	90
Oman	25	30	45	5	50	45
Qatar	5	7	88	20	10	70
KSA	5	47	48	10	20	70
Tunisia*	26	61	13	37	35	25
UAE	5	50	45	20	30	50

Source: AXCO Reports and Country Visits
*Banks also distribute non life
Notes: Most personal lines distribution in Egypt has been placed through agents , and commercial and industrial business have been written directly – corporate brokers were only recently authorized. In Morocco the corporate business is largely placed through brokers – a number of banks have established broking subsidiaries to comply with the law.

Life

	Individual Life				Group Life			
	Agent	**Broker**	**Bank**	**Direct**	**Agent**	**Broker**	**Bank**	**Direct**
Kuwait	90			10	3	80		17
Lebanon	25		50	25	20	10	10	60
Libya	20	0		80	5			95
Oman	70	5		25	0	80		25
Qatar	85	5		15	20	5		75
KSA	75	5		20	75	5		20
Tunisia	23	10	40	27	23	26		51
UAE	55	10		35		50		50

Source: AXCO Reports and Country Visits
Notes: The main distributions systems for Egypt have been agency forces and, increasingly, banks. In Morocco bancassurance now accounts for more than 60% of life sales, although brokers still have a role in the group life market.

Appendix: Takaful (Cooperative) Insurance

Takaful can be considered a mutual insurance hybrid, operating in a new segment of the overall universe of insurance models. It has similarities to a Western business model involving a mutual insurance company being run by a stock insurer or management company for a fee (and possibly a profit or income share). This structure is shown in the main business structures (models) in Takaful, namely mudharaba, wakala, and wakala with mudharaba. Pure mutual or cooperative models are not common in Takaful as it does not allow profit for the operator, but would (subject to investment requirements) accord with Islamic concepts or for a government interested in helping segments of the population to deal with risk in an Islamic manner.

The hybrid consists of a shareholders’ (Takaful Operator’s or TOs) fund, a contributors mutual risk assumption fund (called the Participants’ Takaful Fund or PTF) and, for products with a savings component a contributors’ investment fund (called the Participants’ Investment Fund or PIF). The TO provides management services and capital support to the participants’ fund(s). Strictly speaking, the TO may not donate to the PTF and any funds injected to support the policy liabilities are a loan (Quard Hassan) under Shariah law. Conceptually this should be repaid without any returns from future surpluses arising in the PTF.

The acceptability of the PTF involves an interpretation of the Shariah Law (interpretations of the Q’uran and sunnah[23]) under which the concept of a gratuitous gift can be made contingent on reciprocity (hibah mashrutah bi’iwad) and to apply on a group basis. It is believed by some authorities that this overcomes the issues of uncertainty inherent in risk transfer for a price (Al-Gharar) and the related issue of gambling (Al-Maysir) which are forbidden elements of transactions under Shariah Law. The third forbidden element is the investment of funds in instruments generating returns not related to the performance of the underlying assets (Riba).

The various structures are driven by the relationship between the TO and the funds generated by participant donations (Tabarru), and in particular the method of remuneration of the TO. This can involve a straight management fee (Wakalah) and/ or a participation in any underwriting surplus or investment return generated in the policyholder funds (Mudharabah). Most Takaful systems in the Middle East follow a combined model. TO participation rights in any underwriting surplus are the most controversial and under a strict interpretation would appear to be illegal. However this has been allowed in some cases as it aligns the interests of the TO and the participants.

Corporate governance issues in Takaful arise from the use of qard hasan, or interest free loans. Such loans are used when there is a deficit in the risk fund. The structure normally used is for the qard to be considered an injection from the point of view of the risk fund but a loan from the operators fund point of view. This discrepancy potentially allows operators to show impressive results whilst selling unprofitable business. This also extends into such things as obtaining significant retakaful but with the retakaful commissions not being sufficient to cover the wakala fees of the policy being retakaful. The result is deficits for the retakaful business that would likely be made up by other profitable plans.

The significant diversity in Takaful models has also led to difficulties in regulating Takaful. Takaful is sometimes grouped together with conventional insurance for the purposes of regulations, which ignore fundamental differences. Even when Takaful is regulated separately

[23] The sayings of Muhammed.

there are issues of implied benefits and guarantees even where none formally exist. This seems to be an issue for mutual insurers as well, with mutual insurance tending to be an afterthought in regulations, as well as an issue with some other faith based organizations offering discretionary benefit or voluntary sharing in medical expenses which are not effectively regulated.

Risk based capital requirements for Takaful insurers are likely to be higher than for conventional insurers as the investment requirements of Takaful insurers push them towards equities, property and property based securities and funds (Tolefat). Ideally an active Sukuk market that provides some greater degree of security will develop however recent setbacks appear to be holding back the rate of issuance.

Reinsurance is another key emerging issue for Takaful, particularly for those that wish to compete in commercial and industrial and liability markets. Strictly speaking any reinsurer used by a Takaful insurer should also satisfy Shariah requirements (Re-takaful) as should any retrocessionaires. Taking this chain to its ultimate reaches creates an almost impossible requirement, and some Takaful insurers have opted for co-insurance, raising the scope for unmeasured accumulations within individual jurisdictions. As at the date of writing there were 8 fully established Re-takaful operators in the Middle East and a number of the major European reinsurers had opened Takaful windows so direct reinsurance capacity is not likely to be an issue.

The remaining major issue in the development of the Takaful sector is the relative powerlessness of the policyholders relative to the TO under all current hybrid structures. This has been considered by an IFSB/ IAIS joint working group, which has pointed to the need for absolute transparency as to the contractual terms and the possible need for enhanced explanation at the time of sale to achieve this. Another recommendation being considered is that a separate board be established consisting of independent directors and a representative of the Shariah Council to oversight consumers‟ interests.

The most recent survey of Takaful insurers carried out by the Middle East Insurance Review show that Malaysia and the GCC region continue to be the main areas of activity. Summary MENA data is shown in Appendix Table 1.

Appendix Table 1

Country	No. Takaful Insurers
Algeria	1
Bahrain	9
Egypt	6
KSA	26
Kuwait	13
Jordan	3
Lebanon	1
Oman	1
Qatar	6
Syria	2
Tunisia	2
Yemen	2

Source: Middle East Insurance Review