

THE FUTURE FOR THE GCC INSURANCE MARKET
LORD LEVENE, CHAIRMAN OF LLOYD'S
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Introduction

Good morning, I am delighted to be back in Qatar and to see you all. Although it is only 12 months since my last visit, I wondered if I was on the right flight as the plane began its descent yesterday. With over 50 towers currently under construction, I hardly recognised the Doha skyline, but it is great to see that Qatar is still booming, something which is also good news for insurers. Indeed, the Gulf is a region where many businesses in our market enjoy strong relationships as reinsurers. In the oil and gas sector, Lloyd's is a market leader; while we lead reinsurance coverage on many other risks, from Palm Island, shopping malls and ski slopes, to terrorism cover for new construction projects.

Today I have therefore been asked to give you a view from London on the future for the GCC insurance industry and I plan to cover three key themes this morning:

- First, I will share the thoughts from some of our underwriters on the risk environment in the region;
- Second, I will discuss the GCC's place in the global insurance market; and
- Third, I will talk about Lloyd's strategy for the region.

The changing risk environment

Let me start, then, with the changing risk environment and ask a question: Is the world actually becoming a riskier place?

I think that the jury is still out on that one. So far this century, after events like Enron, 9/11 and the worst ever US hurricanes, the challenges we face seem to be getting bigger. Balancing this, there is some evidence to suggest that we are getting better at risk management. In our 2008 survey of Lloyd's underwriters, over three quarters said that business leaders are spending more time on risk management than they were just a few years ago. But one thing is clear: we are certainly more aware of the risks we face than ever before, and I would like to highlight four issues of particular relevance to the Middle East right now.

First, climate change. Last summer, Cyclone Gonu became the strongest to hit the Arabian Peninsula since records started in 1945, reaching the equivalent of a category five hurricane – the highest possible – as it crossed the Indian Ocean¹. At the same time, deaths and crop damage have resulted from temperatures falling to exceptional lows and ten people died in Saudi Arabia after snowfalls this winter².

Meteorologists in the Middle East don't yet agree whether these are the result of climate change. But we do know is that what you have been experiencing here this is similar to the pattern we are seeing elsewhere in the world. Moreover, it is typical of what we would expect to see under most future climate change scenarios – unpredictable and intense impacts at a local level. One particular issue which

cyclones and unpredictable rainfall brings is flood risk. Typically, businesses here do not have flood insurance in place but flood is something they may need to begin building into their risk management planning.

Terrorism and political risk is another subject giving cause for concern on a worldwide scale. In our research with global business leaders, the majority expressed the view that the world would become a less stable place over the next five years. Events around the world so far this year have done nothing to ease concerns and while – as in the UK – GCC countries are well equipped to respond to the current threat, nobody is immune. Terrorists have been very clear about their desire to strike economic targets and iconic buildings in their quest to cause as many casualties and as much disruption as possible. With tensions in the wider Middle East region also running high, there is also the risk of violence impacting more stable neighbouring economies in unpredictable ways. One Lloyd's business recently highlighted the apparent disconnect between the fact that nearly a quarter of terrorist attacks occur in the Middle East and North Africa, but the region accounts for under five per cent of their premium spend. Looking forward, we believe this will change due to the massive scale of investment taking place and because of lenders' requirements, which usually stipulate terrorism cover³.

The third risk area I want to discuss is liability. Two thirds of Lloyd's underwriters are concerned that compensation culture is spiraling out of control. In particular, as business globalises, the influence of US practices and regulation is spreading. Here in the Gulf, an influx of foreign-owned professional services means that the demand for

¹ BBC, 'Cyclone hits Gulf state of Oman', 6 June 2007

liability coverage is growing amongst financial services, legal services, architects and other professions. Insurers are reporting increased demand for products such as directors and officers, and also errors and omissions and professional indemnity products. We expect this trend to grow as your infrastructure expands.

Finally, the sheer pace and scale of development taking place in the region presents its own risk management challenges. There are few places undergoing more transformation right now than the Gulf states, and projects are getting larger at the same time as their number is soaring. Ranging from petroleum processing facilities to power plants, some of them are worth hundreds of billions of dollars.

One issue for insurers is that these huge projects tend to be concentrated in very limited areas, posing challenges around aggregation and accumulation of risk. Moreover, the pressure on resources is huge. Time pressures and a stretched labour pool mean that there are concerns about maintaining quality of construction – and there have already been cases where projects have had to be partially rebuilt because of major flaws. Not only does this demand an increased focus on risk management standards and processes; it also adds to the growing liability exposures.

In this complex environment, insurers want to see strong risk management planning and robust processes. But the good news is that the best companies are now leading the way.

³ David James, Ascot Underwriting, speaking at Arab Insurance Federation (GAIF) conference in Bahrain, 26 February 2008

Preparedness is key – and while our research shows that almost 40 per cent of business leaders do not have adequate disaster plans in place to respond to respond to terrorism, around a quarter now even build in the risk of chemical, biological and nuclear attack into their planning ⁴.

Understanding and managing supply chain risk – in its widest sense – is something else companies must get to grips with better in an era when energy security is a growing concern and industry is increasingly dependent on outsourced and off-shored services. For those involved in construction projects, where there are worries about the availability of skilled workers and contractors, plant space and raw materials, this is especially important. Again, the good news is that a quarter of the world’s most forward-looking companies have reviewed their risk management strategy and processes in line with supply chain risk.

Insurers have the expertise and the risk appetite to take these growing exposures on, but they want to work with companies who are willing to adopt a strong risk management culture and implement strong processes at every level of the organisation.

⁴ Lloyd’s and EIU, ‘Under Attack?’, May 2007

The GCC's place in the global insurance market

Moving on to our second theme, what role can Gulf States play within the global insurance market?

Right now, although they are growing fast, the Gulf States insurance markets still account for less than one per cent of global premium⁵.

Our own view is that there is currently significant competition and capacity locally, and we do not expect this to change over the next few years. However, given the huge scale of development taking place, the market will continue to undergo rapid expansion.

To prepare for the next wave of growth, a high level of professionalism and strong management will be critical. Lloyd's underwriters already see excellent management locally – which is constantly improving – and they have a real sense of a very vibrant local insurance community. There has also been great expansion within the broker community in recent years with some highly skilled intermediaries now operating in the region.

It will be important for the local market to build its technical expertise further in order to retain business locally. And we also believe that you will require greater support for niche and specialist risks. Take terrorism which I mentioned earlier: many local insurers avoid writing this as it does not form part of their traditional expertise and they do not have reinsurance treaty protection in place. However, the London

market has significant expertise to partner with local insurers on tailored solutions for Middle Eastern companies.

This brings me on to a second point. As the economy here diversifies and expands, the local market needs to build strong relationships so it has access to the full range of global markets. Larger, more complex risks will generate greater demand for intermediaries with established international relationships, and insurers and reinsurers with specialist expertise. And, as the local market develops, policyholders and their we expect insurers to begin to look more closely at issues such as security and long-term relationships, rather than just price, as a factor in their buying decision.

Third, it will be increasingly important for the region's emerging financial centres to interface effectively with each other – and with other supervisory structures around the world.

Our own experience in London tells us that the most successful financial centres act as gateways into a regional market larger than just the domestic market. Within the EU, we might protest from time to time about another level of regulation from Brussels, but we recognise the benefits of this regional infrastructure in practice. There are no major barriers to transacting commercial lines insurance and reinsurance across the EU. And it as well as providing a solid basis for dialogue with other trading regions as we try to establish ways of working together and achieve mutual recognition.

⁵ Sigma non-life data, 2006

It is therefore clear to us in London that there is a huge opportunity for GCC states to work together on regulatory issues. Not only will it lead to greater cross-border business flows. It will also encourage the development of 'best practice' across the region. And, importantly, it will also bolster the region's position within the global markets.

Today, London is a global insurance hub second to none, and within one square mile, the concentration of insurance skills is unrivalled, resulting in a huge cluster effect. We are pleased that the QFC is using London as one of its models for development, and as the Gulf States seek to grow their insurance and reinsurance capabilities we would certainly be delighted to share our own experience with you further.

What is Lloyd's strategy for the region?

Finally, I will speak briefly about Lloyd's strategy for the region.

In our fourth annual survey at the start of the year, we asked Lloyd's underwriters what would prove to be Lloyd's key sources of competitive advantage as they do business around the world in 2008. Along with the market's strong financial position and ratings, Lloyd's international licence structure was ranked in joint first place.

Right across the world, globalisation is bringing more freedom for businesses to work cross-nationally; economic integration; deregulation of markets; and an internationalisation of products and services. These developments present major opportunities for us in the insurance industry.

We recognise that there are considerable challenges in this age of global economic interdependence – not least as we face another downturn in the insurance cycle. But an urgent need to manage performance and step up underwriting discipline must be balanced by work to develop new markets – in anticipation of eventual upturn in market conditions and the opportunities provided by new income streams. Lloyd's is therefore working to ensure that it is well placed to take full advantage of new business opportunities which emerge.

Together with China and India, the Middle East is high on the list for Lloyd's underwriters as an area of opportunity this year. We are therefore now in discussion

with the businesses in our market about their expectations and their appetite for business in the region.

We have already concluded that Lloyd's needs some sort of local presence in order to get a stronger sense of what business is available and to build relationships over time. The question we are now trying to answer is what structure that should take.

I made my first visit to the Middle East as Chairman of Lloyd's a year ago and was warmly welcomed by the leadership both here and in Dubai to discuss these issues. We are meeting with them once again during this visit to become better informed about our strategy for the region. We are especially interested in understanding where Lloyd's might access direct insurance business across the Gulf region – working in co-operation rather than competition with local companies in specialist and niche lines where demand is expected to grow. We are also interested to hear more about what is happening in the Takaful market, as we think Lloyd's may be well placed to provide Retakaful support in the future.

Despite our concerns about high levels of competition in the Gulf right now, in the medium to long term, as the economy grows, it seems likely that Lloyd's and the Gulf economy will do more business together.

Lloyd's is well placed to respond to the changing needs of insurance buyers, however, I have mentioned market conditions already and so you will not be surprised if end with a note of caution. The fact that we are heading in the direction of another soft cycle is already well documented. All the recent signs are that global rates are falling by their fastest rate for a decade – and insurers are reporting

rate reductions in almost every line of business. Lloyd's latest three-year-plan therefore spells out very clearly that the number one priority for Lloyd's right now is to work with managing agents to maintain prudent underwriting discipline during this period of softening market conditions.

Additionally, the huge scale of the risks we are now working with means the insurance markets have no choice but to price insurance more carefully and more accurately, according to the underlying exposure.

Conclusion

In conclusion ladies and gentlemen, risk management must be at the heart of economic strategy, especially in the Middle East where risk exposures are soaring.

The Gulf States now have a growing need – and an unprecedented opportunity – to build an insurance sector which supports this growth, and interfaces efficiently with the wider global market.

If we in London can help with that process in any way, we would only be delighted to do so. For our part, Lloyd's is now looking closely at how we can best work with the region in future, and I hope that our relationship will continue to flourish and grow.

Thank you for listening and I hope you enjoy the rest of the conference.