The New Insurance Regulations in Saudi Arabia – Churning Order Out of Chaos

By V. A. Tommy

Introduction

If the mission of a conscientious insurance regulator is to protect the interests of the policyholders, to regulate, promote and ensure orderly growth of the insurance industry, then SAMA, the entity entrusted with supervising the insurance industry in the Kingdom of Saudi Arabia is taking the right steps and taking measures to execute the mission successfully. The first of a series of steps in the right direction was the promulgation of Royal Decree on the cooperative insurance companies control law.

History was being created in Saudi Arabia and a giant step towards revolutionizing the middle east insurance market was being taken when the new royal decree was released in the year 2004 which mandated that "Insurance in the Kingdom shall be undertaken through registered insurance companies operating in a cooperative manner as it is provided within the article of establishment of the National Company for Cooperative Insurance promulgated by Royal Decree M/5 dated 17/5/1405 H, and in accordance with the principles of Islamic Shari'a."

Enactment of the new insurance law gave a notice to more than 100 insurance companies operating in the Kingdom through their 'Managing Agencies' to either get themselves in to proper shape by adequate capitalization and be subject to regular monitoring from the insurance regulator SAMA and capital market regulator CMA or make appropriate exit plans. The deadline given for these agencies to convert themselves into licensed insurance companies was 11th March, 2008 which of course was extended number of times in order to give the new born inexperienced companies more time to get their acts together.

New Regulations are to ensure that the insurance companies operate maintaining risk based capital adequacy and sufficient solvency margin as stipulated under the law at all times and pay their liabilities giving maximum importance to customer care and satisfaction. In order to fully appreciate the significance of the new regulations in the Saudi Insurance Market, it is important to know as to what was the prevailing situation until the regulations were announced and started being implemented.

Saudi Insurance Scene Prior to Regulations

Until 2004 when the insurance regulations were announced through a Royal Decree, there was only one insurance company – National Company for Cooperative Insurance (NCCI) – established by a Royal Decree back in 1986. NCCI (later rebranded as Taawunia) was fully owned by the Government of Saudi Arabia until 2004 when 30% of the total equity was off loaded to the Saudi Public through an IPO.

Even though NCCI was the only insurance company incorporated by the Ministry of Commerce, there were more than 100 companies transacting insurance in the Kingdom in the form of Agencies of insurance companies registered with jurisdictions outside Saudi Arabia.

As could be expected when the agencies operate free of any semblance of regulations, many of these companies had a 'free run' with the premium income entrusted with them by the uninitiated insured clients. Instances of premium income being used for purposes other than claim payment and/ or management overheads were rampant and 'fly by night' operators were also not uncommon. During this time, there was no need for any compulsory insurance on any assets or liabilities including Automobile Liability insurance which is normally statutorily mandated in the other countries of the GCC region and Middle East.

Insurance including motor insurance was however purchased by the residents on a voluntary basis – provided by NCCI and the 'Foreign Insurance Companies' operating through their agencies. It followed, quite naturally, that many drivers/ owners of the vehicles were caught off guard when there was a road accident and as per the Sharia'h Law, the drivers of the vehicles were liable to pay the 'Diya' or 'Blood Money' as compensation for accidental deaths/ injuries. Inability to pay the 'Diya' resulted in imprisonment and other criminal punishment, unless the victims or their legal heirs came forward and pardoned the defaulters. As a result many drivers who were faulted with causing accidents and who could not afford the payment of compensation, were put behind the bars; some of these unfortunate victims are still reportedly not yet released as the legal heirs of the victims have not so far pardoned them.

It was in 2002, the authorities decided to implement the compulsoty 'Ruksa Insurance' scheme, whereby any one with a driving license had to have a third party liability insurance which protected him against liabilities incurred for accidents caused by him. Ruksa protected the drivers rather than the owners of the vehicles and to that extent it was an 'insurance on driving license'.

A flurry of activities took place amongst the existing players in the insurance industry consisting of the single registered insurance company – NCCI, and the large number of Agencies. Without any adequate scientific experience on the frequency and severity of the motor accidents in the Kingdom, the Agencies priced their Ruksa Insurance on their whims and fancies. Some companies even exploited the situation by collecting premium with no intention to pay the claims later. The Kingdom witnessed the 'uncontrolled expansion' of the insurance companies especially in the Ruksa Insurance Portfolio. And when the claims started flooding in, some companies had to close shops, very often, leaving massive liabilities unpaid!

The chaos created by the uncontrolled and unregulated expansion of insurance caused primarily through the Ruksa Insurance was put to a stop when the Royal Decree announcing compulsory registration of insurance companies was released in 2004.

Introduction of the New Insurance Law in KSA

Broadly, the objectives of the insurance law and it's implementing regulations are:

1. Protection of policyholders and shareholders;
2. Encouraging fair and effective competition;
3. Enhancing the stability of the insurance market;
4. Enhancing the insurance sector in the Kingdom, and
5. provide training and employment opportunities to Saudi nationals.

As per the insurance law, the regulator SAMA was entrusted with the following responsibilities:

1. Licensing of Insurance Companies and other players in the insurance industry like Brokers, Agencies, Consultants, TPAs, Actuaries and Loss Adjusters;
2. Supervision of the Technical Operations of Insurers and Reinsurers licensed by SAMA;
3. Regulating the investment operations of the insurers and reinsurers;
4. Determining the funds needed to undertake each class of insurance activity;
5. Approving insurance and re-insurance standard policy forms and the pricing policy of insurers and reinsurers;
6. Approval of the Reinsurance Strategy;
7. Monitoring the capital adequacy and solvency margin of insurers and reinsurers;
8. Approval of Senior Management of insurance and reinsurance companies;

The insurance law and it's implementing provisions are framed in line with the best international financial services regulations and encompass diverse aspects ensuring overall protection to the general shareholders and policy holders and to that extent can be considered as a landmark legislation.

In general, the statute provides full powers to the regulators to ensure that the insurance and reinsurance companies manage their operations in compliance with the internationally recognized accounting and actuarial practices.

Insurance provisions adopted by SAMA, if implemented in right earnest, are to ensure that the insurers and reinsurers under their regulation are at all times kept adequately capitalized and their margin of solvency are consistently maintained above the stipulated minimum. The law therefore aims to provide a 'guarantee' to the insuring public that the companies that they deal with would have the financial and technical capabilities to fulfill their contractual obligations or in other words pay the claims which are admitted under the insurance policies purchased by them.

The law finally provides for severe penalties including winding up of the Company in case of non compliance with it's provisions.

Directives issued by SAMA

Unlike some of the other regions where the insurance laws are issued though not implemented in both letter and spirit, SAMA is particularly strong in ensuring strict compliance and monitoring. As part of their continuous supervision and regular monitoring, the regulator also comes up, periodically and in tune with the changing global financial circumstances, with directives aimed at curbing potential malpractices in the insurance industry. As part of this initiative, SAMA has already issued it's detailed directives as mentioned below:

1. Anti money laundering and combating terrorism financing rules;
2. Risk Management Regulations;
3. Anti fraud regulations for insurance companies;
4. Reinsurance Regulations; and
5. Insurance Market code of conduct regulations.

Whereas the purpose of anti money laundering regulations, inter alia, is to Protect licensed c ompanies and their customers from illegal transactions or exploitation as canals for money laundering or terrorist finance activities or any other criminal activity., the risk management directives are aimed at maintaining minimum standards that should be met by insurers, reinsurers and insurance service providers.

Risk Management Directives

As per the SAMA directives, insurance and reinsurance companies should have a comprehensive risk management strategy to understand and manage the types of risk arising from their core business operations. The strategy should consider the impact of market conditions and available expertise on inherent risks to which the company is exposed. Consideration should not be limited to the risks associated with one class of business but should extend to risks from all other classes.

While it is not uncommon for some large global insurance and reinsurance companies to opt for a Risk Management Department, voluntarily, especially in line with the Basle II risk based capital measures, it is for the first time that specific risk management directives have been issued by any regulator in the emerging economies.

SAMA can also claim pride in directing the insurance companies to assign at least 2 risk management officers, one for general and health insurance and one for protection and savings insurance with the added condition that they should be independent of the underwriting officers.

Reinsurance Directives:

When it comes to reinsurance directives, SAMA is more precise in it's proclaimed objectives. Clearly, the regulators do not appreciate the behaviour of a large number of insurance companies (reportedly there are about 400 insurance companies in the region) who operate more as 'whole sale brokers' rather than risk carriers. The regulations mandate that a licensed insurance company should retain at least 30% of it's overall portfolio and a minimum of 30% of it's reinsurance is to be offered within the Kingdom of Saudi Arabia, albeit amongst insurance companies permitted to accept facultative reinsurance business and not necessarily with licensed reinsruers operating from the Kingdom.

With a view to eliminate malpractices relating to reinsurance transferred to companies which are financially and technically not competent, the regulators have spelled out the following additional directives with regard to reinsurance regulations:

1. Reinsurance cannot be placed with a security whose rating is below BBB by S&P or equivalent;
2. All the reinsurance treaties have to be submitted to SAMA for it's validations;
3. Reinsurance Department is to be headed by a qualified reinsurance officer duly notified to the BOD and SAMA and his functions shall not conflict or overlap with any other role within the Company's organisation. Clearly, the regulators do not want the Company's balance sheet to be exposed for the sake of commercial considerations; and
4. An analysis on the financial implications of the reinsurance strategy including the per risk retention philosophy of the insurance company is to be provided to SAMA.

In addition the reinsurance directives also mandate that the reinsurance intermediaries placing the business have to, necessarily, be registered with SAMA.

Capital Adequacy and Solvency Margin

Whereas the minimum capital stipulated for an insurance company is SR 100 M, the same for a reinsurance company is SR 200 M. Notwithstanding the minimum capital as per law, the risk based capital needed is to be measured constantly based on the actual premium written by each company.

An insurance company, in respect of its general and health insurance business, shall maintain a margin of solvency equivalent to the highest of the following three amounts:
a) Minimum Capital Requirement.
b) Premium Solvency Margin.
c) Claims Solvency Margin
(As an exception, Premium Solvency Margin, method shall be used to calculate the solvency margin for the first three years of the company's registration)

The solvency margin for the Protection and Saving Insurance business on the other hand is the aggregate of the following amounts:
1. Four percent (4%) of the technical provisions for the protection and saving direct insurance.
2. Three per thousand (3/1000) of the Capital at Risk for individual policies after the deduction of reinsurance cessions, provided that the reinsurance amount do not exceed 50% of the total Capital at Risk.
3. One per thousand (1/1000) of the Capital at Risk For group policies after

the deduction of reinsurance cessions, provided that the reinsurance amount do not exceed 50% of the total Capital at Risk.

Solvency margin requirements stipulated will ensure that the management of the insurance companies are not tempted to show top line growth without taking into considerations price adequacy and bottom line concerns. This is especially true for motor and health insurance business where proportional reinsurance support is rarely available and insurers tend to undercut each other for the sake of winning business deals. In such situations, uncontrolled and reckless growth in motor and medical business where the burn ratio is relatively high, solvency margin monitoring may warrant fresh infusion of capital from the shareholders. Ultimately, maintaining solvency margin is to make sure that the companies do not default in claim payments.

Miscellaneous Provisions to protect policy holders

There are other important features mandated by the insurance law aimed at offering protection to gullible investors and innocent policy holders. These are listed below:

Investment Restrictions

The year 2008 has been a eventful one for many insurers and reinsurers who burnt their balance sheets due to unbalanced investment strategy and overexposure to toxic assets. The SAMA's investment guidelines, though issued in year 2005 (much before the global financial debacle) seem to have foreseen the outcome of reckless investments and hence have dictated an extremely balanced investment philosophy to be practiced by each insurance company. It is also mandated that the investment strategy of the insurance company be submitted to SAMA in advance.

Actuarial Verification

One of the famous methods of the management to 'window dress' the financials of the insurance company is to under provide or over provide the outstanding losses (including IBNR) and unearned premium reserves. By dictating that each insurance company should have an independent Actuary duly approved by SAMA to verify the technical reserves of the company and submit a report along with the financials, the regulators are trying to ensure that the Management is not in a position to 'doctor' the balance sheet of the Company.

Licensing of an insurance Company

Having highlighted the salient features of the new legislation, we shall now dwell a while on the general methodology of licensing an insurance company. The very first requirement obviously, is submission of application to SAMA. While submitting the application, it is to be ensured that the founder share holders of the insurance companies are to be approved by SAMA, noting that no individual founder share holder can have more than 2% of the total share capital and no entity can hold more than 5% share capital. In general SAMA encourages formation of new insurance companies promoted by existing foreign insurance companies and/ or local banks and expect that at least 30% of the total shares are floated to Saudi Public through an IPO.

Once the application is vetted and accepted by SAMA, the same is forwarded to Ministry of Commerce for their processing. In case any foreign shareholders are there amongst the founders, then approval from SAGIA (Saudi Arabian General Investment Authority) is also required. On completion of processing by Ministry of Commerce, the application is sent to the Ministerial Council (Saudi Royal Cabinet) from where it is accorded with a Royal Decree. The applicant will then have to get the needed approval from Capital Market Authority (CMA) for their approval to float the IPO. On successful listing of the Company's shares, the Ministry of Commerce issues the Company a Certificate of Commercial Registration (CR).

Issuance of CR however is not a trigger for the insurance company to commence operations; the company will then have to obtain the insurance license from SAMA which will be given only after the regulator is fully satisfied that the insurance company is capable of operating from all technical aspects. SAMA would, inter alia, like to be sure that the Company is adequately equipped with:

1. Appropriate technically qualified underwriters and claim officers;
2. Sufficient reinsurance protections;
3. A robust organisational structure to manage the operations;
4. Approved products and processes; and
5. Appropriate investment and risk management measures.

Saudi Insurance Scene post regulations

As on date (20th June 2009) there are 20 insurers licensed by SAMA and one Reinsurance Company (Saudi Re) having valid license. There are 9 insurance companies who have received the Royal Decree but are awaiting SAMA license. In addition there are more than 10 insurance companies who are waiting in line for their applications to be approved. It is expected that by the end of 2010, there would be at least 40 licensed insurance companies in the Kingdom.

There are also 36 licensed insurance brokers and 10 insurance agencies.

In addition to the licensing of insurance companies and service providers, Saudi insurance market have also witnessed some major developments post regulations, the major one being the introduction of compulsory medical insurance in different phases. In the first three phases, the medical insurance have been made compulsory for all the expatriate residents in the country and Saudi Nationals who are employed in the Private Sector. The medical insurance in the country is supervised by a Government authority – Council for Cooperative Health Insurance (CCHI). In due course, CCHI expects the entire population of Saudi Arabia (nearly 26 million) to be brought under the insurance umbrella.

There was also a significant change in the Ruksa Insurance scheme which was cancelled and in it's place the authorities introduced the standard Third Party Liability insurance on motor vehicles, which is compulsory. From 'Driving License Insurance' it is now changed to 'vehicle liability insurance'.

The Gross Written Premium of the country has more than doubled post regulations; from SR 5.1 billion in 2005, the GWP has risen to SR 10.9 billion as the end of 2008, although 67% of this is generated from the compulsory lines – motor and medical. Whereas motor insurance account for 23% of the overall premium, medical insurance accounts for 44% of the total.

Notwithstanding the above, there is still tremendous potential for growth of insurance business in KSA. Insurance penetration (Gross Written Premium as a percentage of Gross Domestic Product (GDP)) in Saudi Arabia was 0.44% in 2005 and it has increased to 0.62% in 2008. Compared to international standards, it is still a miniscule proportion. Same applies to insurance density which has increased from SR 223 in 2005 to SR 440 in 2008, which is substantially below that of the developed countries.

Another significant feature of post regulatory regime is the growth of takaful business in the country, especially since some of the Islamic banks have promoted insurance companies and embarked up on banca takaful as a major channel of distributing insurance.

Conclusion

Saudi insurance market has changed dramatically since the introduction of the new SAMA regulations. The regulators by their orderly intervention in the market are ensuring that the market grows systematically and with appropriate checks and balances so that neither the shareholders nor the policy holders have to suffer unpleasant surprises.

The introduction of compulsory insurance in motor and medical have helped the market to grow by leaps and bounds, however the strict monitoring of the solvency margins of the insurance companies will ensure that the managements do not resort to reckless methods purely to increase their top lines.

The regulators, by their strict licensing procedures, are ensuring that the Companies manage their operations duly supported by appropriate technical and actuarial controls. All in all the new insurance regulations seem to have brought a semblance of order to the other wise chaotic market place and for this SAMA needs to be complemented. In case the market marches in the right direction at which it is set, then both policy holders and the share holders are likely to reap immense benefits arising from the professionalism developing in the market.

Profile of the Author

V.A. Tommy

- V. A. Tommy is the Director for Sun Reinsurance Brokers LLC, a reinsurance broking company registered in Dubai and catering to the middle eastern, African and Indian Sub Continent Markets;

- Mr Tommy was deeply involved in setting up a new Takaful Company - Al Rajhi Company for Cooperative Insurance under the SAMA regulations and served the Company as it's Deputy General Manager from the June 2005 to May 2009. The Takaful Company, promoted by the World's leading Al Rajhi Bank is currently awaiting the formal Insurance license from SAMA;

- Previously, as the Executive Manager, Business Development Unit, Oman Insurance Company, Mr Tommy was instrumental in introducing many new products to the UAE market, some of which have been roaring success and continue to generate revenue for the Company.

- Mr Tommy, with 24 years of experience spread around New Delhi, Dubai and Riyadh, is an MBA from University of Delhi and a Fellow of Chartered Insurance Institute, London

- Mr Tommy has published many articles in various insurance journals and news papers and have spoken on Bancassurance, BancTakaful and Middle East Insurance Developments in various forums.