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CLIENT SERVICES

Insurance – Gulf Cooperation Countries

Takaful insurers' deteriorating H1 profit highlights challenges

Providers of Islamic insurance (takaful) in the Gulf Cooperation Council (GCC) countries reported a decline of over a third in their combined net income during the first half of 2021 (H1 2021) compared with the same period last year. The deterioration reflected rising claims and stiff competition in a still fragmented industry. We expect GCC takaful operators, which currently lack scale, to accelerate their technology investment and seek out merger and acquisition (M&A) deals to build the critical mass needed to improve efficiency and comply with more demanding regulation.

Premium growth flat, but prospects remain healthy. The GCC takaful sector's combined premium revenue rose by just 0.5% in H1 2021 compared with the same period of 2020, held back by intense price competition. This masks some stronger performances at national level, with H1 premiums in Saudi Arabia, the region's dominant takaful market, expanding by 3.2%. We believe growth prospects in the GCC region remain favorable, reflecting a steady widening of mandatory medical cover and growing demand for health insurance post pandemic. GCC takaful operators, which focus on retail lines, have benefited over the last five years from the introduction of compulsory retail cover and will continue to benefit.

Competition and claims weigh on profitability. Takaful operators' aggregate net income fell by 36.5% in H1 2021 compared with the year earlier period. The decline reflected a 12.4% rise in insured losses as claims returned to normal levels after falling steeply during last year's pandemic-induced lockdown, as well as slow premium growth due to price competition. We expect competition to pose continued profitability challenges for the takaful sector. Other headwinds include the adverse impact of low interest rates and volatile financial markets on investment income.

Digitalization investment and regulation will accelerate M&A. The GCC takaful industry stepped up its investment in digitalization in response to the coronavirus pandemic, which encouraged consumers to buy insurance online. We foresee that many small takaful players will seek M&A opportunities to spread the cost of this investment, and to meet increased capital and other regulatory requirements, particularly in Kuwait, Saudi Arabia and the United Arab Emirates.

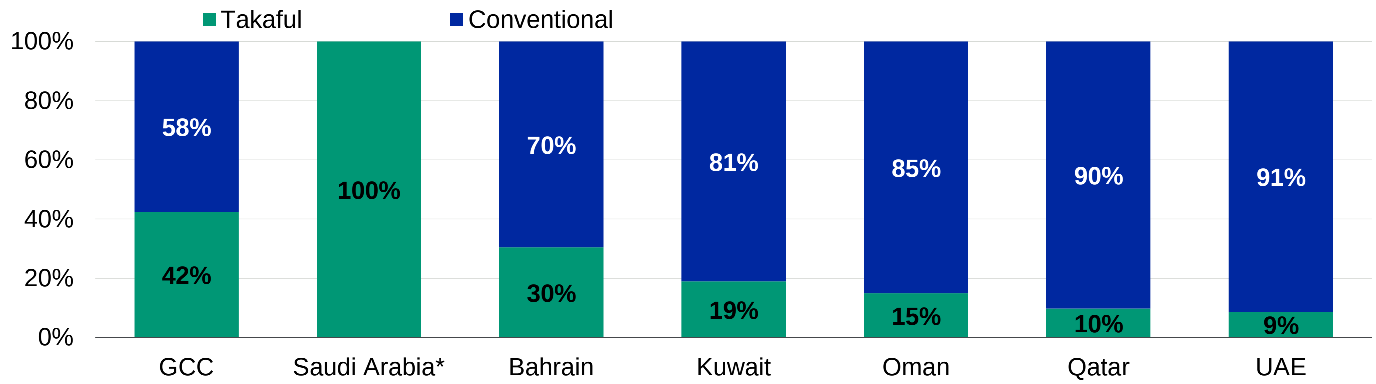
Premium growth flat, but prospects remain healthy

The GCC takaful sector's premium revenue rose by just 0.5% in H1 2021 compared with the same period last year, reflecting intense price competition in a still fragmented industry. Outside Saudi Arabia, where all insurance is takaful, GCC takaful operators are generally small in size, accounting collectively for between 9% and 30% of their respective markets. While 50% of the top ten GCC insurers' combined premiums are takaful, this proportion falls to 10% when Saudi Arabia is excluded (Exhibits 1 and 2).

Exhibit 1

Takaful insurers' share of the market is relatively small outside Saudi Arabia

GCC premium mix, takaful versus conventional



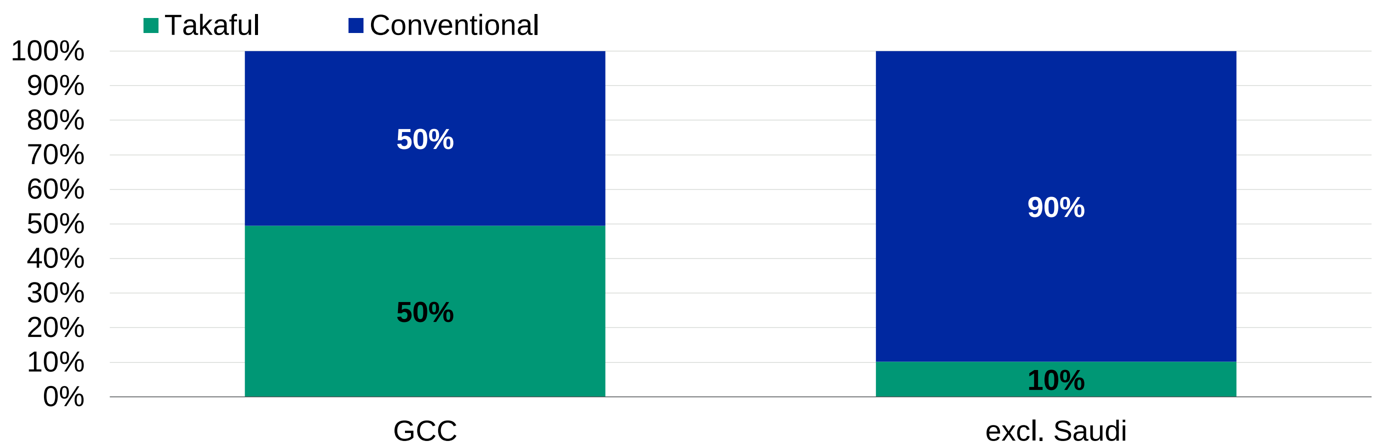
* All of Saudi Arabia's premiums are considered as takaful because it is a Shariah-compliant market

Source: Company financial reports, SAMA Insurance sector reports, Badri Management Consultancy Industry Analysis, SwissRe SIGMA and Moody's Investors Service

Exhibit 2

Takaful's share of the top ten GCC insurers' premiums falls to 10% when Saudi is excluded

Premium mix of top ten GCC insurers

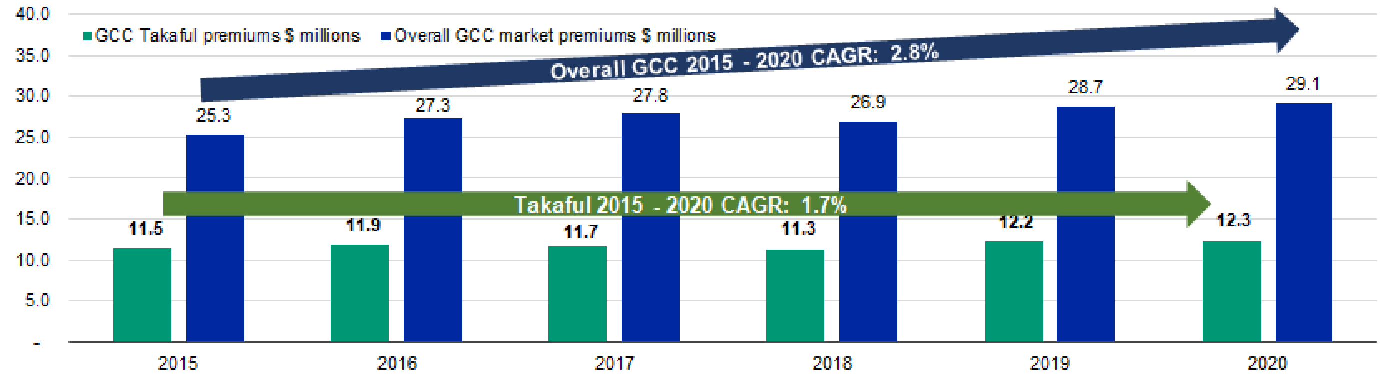


The top ten insurers in GCC command 64% of the region's premiums and 56% when excluding Saudi Arabia

Source: Company financial reports, SAMA Insurance sector reports, Badri Management Consultancy Industry Analysis, SwissRe SIGMA and Moody's Investors Service

GCC takaful insurers' small average size makes them prone to fierce price competition. This is a key reason why GCC takaful premiums have grown by just 1.7% over the past five years, lagging behind the overall market growth rate of 2.8% (Exhibit 3).

Exhibit 3
Takaful premium growth has lagged behind the overall market
GCC premium growth, takaful versus conventional

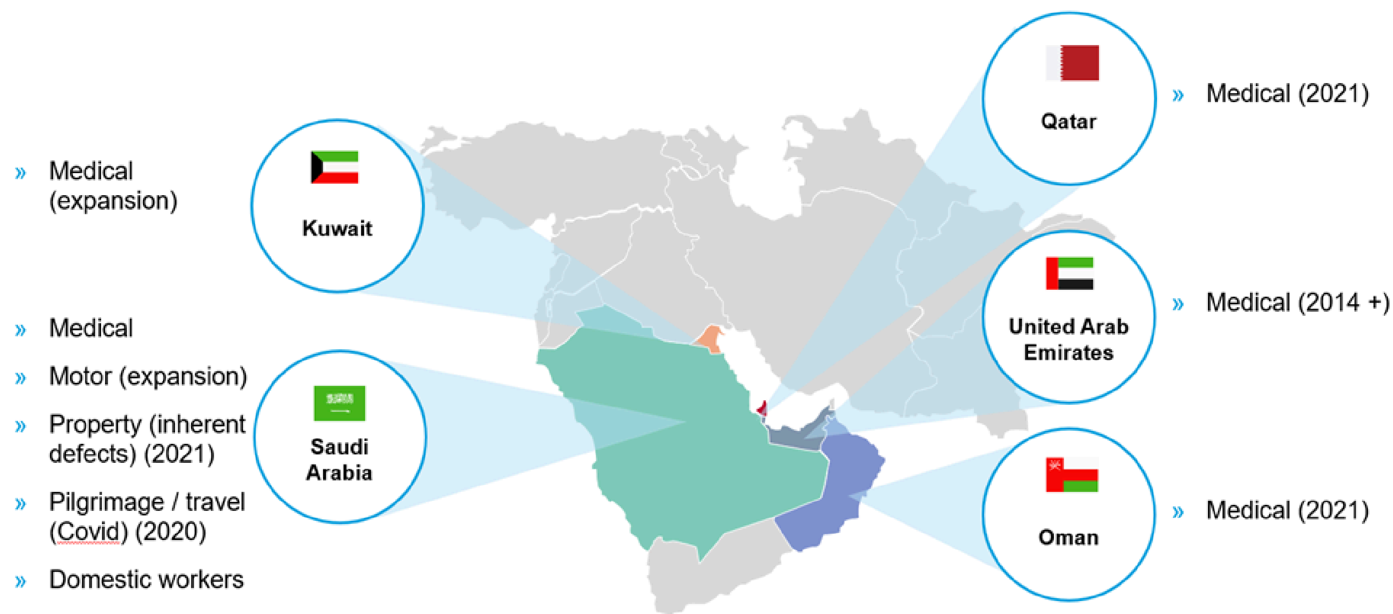


Source: Company financial reports, SAMA Insurance sector reports, Badri Management Consultancy Industry Analysis, SwissRe SIGMA and Moody's Investors Service

Takaful insurers in Saudi Arabia, the GCC region's dominant takaful market with 88% of total premiums, bucked the trend in H1 2021 with a 3.2% increase in premium revenue compared with the same period last year (Exhibit 6). This marks an increase from the year on year growth rate of 2.3% reported at year end 2020. The Saudi takaful industry's superior performance reflects a widening of mandatory motor and medical insurance cover in 2021, which drove additional premium growth.

We see the GCC takaful industry's growth prospects as favorable, despite its flat performance in H1 2021. Regulators in the United Arab Emirates, Oman, Qatar and Kuwait have also introduced various forms of mandatory retail insurance cover in the last five years, benefiting the predominantly retail-focused takaful sector (Exhibit 4).

Exhibit 4
Compulsory retail insurance has fueled takaful sector growth



Medical coverage shows date of introduction, onwards from which coverage and implementation has been widening
Source: Moody's Investors Service

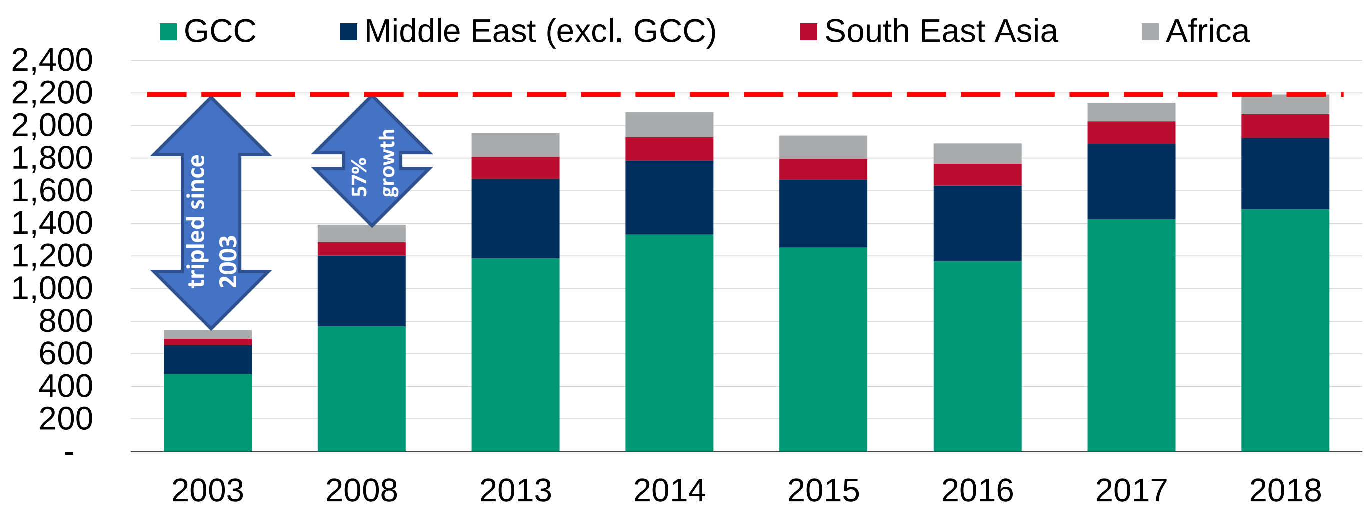
Additionally regulators in many GCC countries, like their Saudi counterparts, have gradually widened the scope of mandatory medical cover. We expect further expansion of covered risks to push up overall premiums in the years ahead, even if premium revenue for now faces growth constraints.

Spending on healthcare is also growing steadily in the GCC region (Exhibit 5). This is an indicator of increased health awareness at a time when governments are looking to improve the populations health and protection whilst transferring the onus of this to insurers. This is positive for life and health insurance demand and this trend is likely to accelerate further in the years ahead as a result of the coronavirus pandemic.

Exhibit 5

Increased health spending indicates growing awareness of health risks

Health spending per capita ($) in key takaful markets



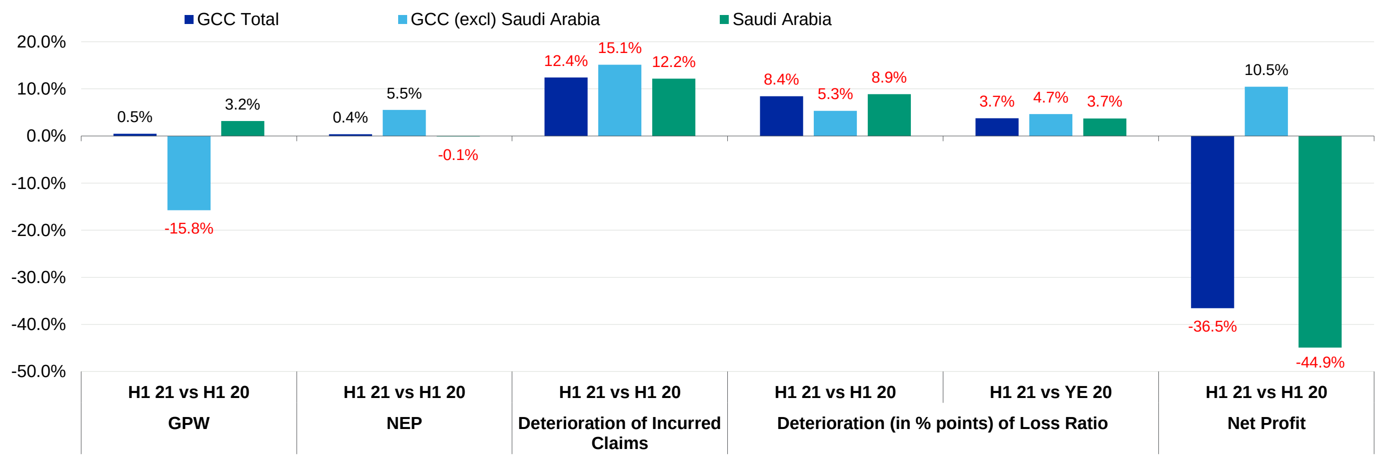
Source: World Health Organization "Global spending on health: Weathering the storm 2020"

Competition and claims weigh on profitability

GCC takaful insurers' aggregate net income for H1 2021 was 36.5% lower than in the same period last year (Exhibit 6). Although in aggregate the sector still posted a $260 million net income, the decline over H1 2020's $411 million reflects a 12.4% increase in incurred claims as normal claims activity resumed after a sharp decline during last year's pandemic-induced lockdown, as well as the adverse impact of price competition on premium growth.

The increase in claims pushed up the takaful sector's loss ratio (claims as a percentage of premiums) to 78.7% at H1 2021 from 74.9% at year end 2020, and 70.3% at H1 2020 (Exhibit 6).

Exhibit 6
Higher claims outweighed modest premium growth for GCC takaful insurers in H1 2021
GCC Takaful insurers' H1 results: Key trends



%'s in red denote those having an adverse impact
GCC excluding Saudi Arabia net profit is positive on the back of investment valuation gains
Source: Company financial reports, SAMA Insurance sector reports, Badri Management Consultancy Industry Analysis, SwissRe SIGMA and Moody's Investors Service

We expect the GCC takaful sector to face continued profitability challenges, including sustained competitive pressure on pricing and consumer resistance to price increases. In addition, the trend for regulators to broaden the scope of compulsory medical coverage may bring added difficulties, as the sector may lack the data needed to price adequately

Other profitability headwinds include low interest rates and volatile financial markets, both of which erode investment returns. The pandemic has also fueled a build up of uncollected premiums, increasing takaful insurers' receivables. This will reduce their liquidity and force them to set aside provisions, further weakening their profitability and capital. This risk is more pronounced for insurers serving small and medium sized enterprises (SMEs) and large corporate clients, as retail customers tend to pay premiums in cash upfront.

Digitalization investment and regulation will accelerate M&A

We expect takaful insurers to continue investing in digitalization to improve their efficiency. The industry stepped up its digitalization efforts in response to the coronavirus pandemic, which encouraged consumers to interact with their insurers mainly through online platforms.

Digital channels allow insurers to reach more customers at lower cost, and may allow some takaful operators to boost their premium growth. However, switching from traditional to online channels can require significant upfront investment.

As a result we foresee that many small takaful players will seek M&A opportunities to spread their digitalization costs. Smaller operators may also seek mergers to help them comply with increased capital and other regulatory requirements, particularly in Kuwait, Saudi Arabia and the United Arab Emirates.

In Saudi Arabia, for example, recent legislation gives the regulator the ability to raise the minimum capital for insurers to at least SAR300 million from SAR100 million currently, with the final regulatory implementation expected soon. Similarly, in March 2021 Kuwait's insurance regulator published new executive directives that increase insurers' minimum capital and introduce risk-based capital measures and actuarial-led reserving.

While we expect the changes in capital regulation to strengthen the industry over time, they pose some implementation and operational hurdles in the short term. It is therefore important for takaful operators to achieve the scale required to absorb these costs.

GCC governments are also encouraging consumers to build up their savings and make greater use of protection insurance. We expect this to underpin growth in family takaful products, prompting insurers to acquire relevant licenses and expand their life insurance capabilities.

Moody's related publications

Research:

» Insurance – Cross Region: Medical insurance sustains takaful growth prospects, June 2021

» Insurance – Global: Characteristics of takaful insurers, February 2021

» Insurance – Gulf Cooperation Countries: Tightening liquidity will hinder recovery of receivables, eroding profitability, November 2020

Credit opinions:

» Saudi Re For Cooperative Reinsurance Company, July 2020

» Al Rajhi Company for Cooperative Insurance, October 2020

» Walaa Cooperative Insurance Company, May 2021

» Mediterranean & Gulf Ins. & Reinsurance Co., January 2021

» Malath Cooperative Insurance Company, January 2021

» Chubb Arabia Cooperative Insurance Company, July 2020

» Buruj Cooperative Insurance Company, June 2021

» Damaan Islamic Insurance Company "Beema", March 2021

» KFH Takaful Insurance Company K.S.C., June 2020

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