CLYDE&CO

Going Global 2010
Developments in the insurance markets around the world

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Foreword

Developments in the global re/insurance markets

The global nature of the (re)insurance markets means flows of investment and business development between the countries and markets. If the last two decades were defined by investments in Lloyd's and Bermuda, there is no doubt that the next will be about the emerging markets.

The economic cycle is driving insurers and intermediaries in more mature economies to look for growth in new territories, to provide capital and underwriting skills to meet the re/insurance needs in those markets – as well as looking for risk diversification and cost reduction. Since the beginning of the 1990s, international insurers have been expanding their activities into the emerging markets. The market share of insurers who are either partly or fully foreign-owned now stands at around 47% and 41% in Latin America, Central Europe and Eastern Europe respectively, while in Asia the average is much lower at 2%.

For players in established markets, the low insurance penetration in developing countries is a key driver – the emerging markets account for just 9% of global premium. The development of insurance markets in China, India and Russia is being driven by the growing consumer class, increased foreign direct investment, infrastructure development and an increased awareness of catastrophe exposure. However, there is traffic in both directions – for example, the strong interest from Indian and Chinese companies in setting up operations in Lloyd's.

The challenge of the unknown

The opening up of these markets presents a number of challenges to the (re)insurance industry. The market will need to assess the impact on the amount of capital it holds, or can access, when writing significant volumes of business in economies where there may be little historic data available. This may accelerate development in capital market risk transfer products, such as catastrophe bonds, insurance linked securities and contingent capital.

The further convergence between the (re)insurers and the capital markets over the underwriting of catastrophic risk will continue as the (re)insurance markets march along their path of globalisation. These capital challenges may also be exacerbated by the technical implications of Solvency II (although delayed now until 2012) and IFRS II, both of which require the movement of capital around the balance sheet.

A guiding hand

Understanding this industry inside out is what makes the Clyde & Co insurance and reinsurance practice a world leader. More than 70 partners work solely on insurance related matters and our depth of understanding covers all types of claims, corporate and regulatory advice. With clients all over the world, involved in every sector of the industry, we have both a local and global view of development and trends.

Our knowledge and expertise has been brought together here to provide an overview of some of the key emerging markets. This publication gives key facts about countries in which we are active and views on current and future trends.

Michael Payton
Senior Partner

China

Market overview

According to data published by the China Insurance Regulatory Commission (CIRC), the total annual premium income for 2009 reached the equivalent of RMB1.1 trillion (approx €134 billion). Of this amount, roughly RMB826.1 billion (approx €100 billion) was for life insurance and RMB287.6 billion (approx €35 billion) was for non-life insurance respectively.

China's insurance market continues to grow at rates that are unprecedented in other regions of the world. According to CIRC, the total assets of the insurance sector reached RMB4.3 trillion (approx €524billion) by the end of March 2010, up 7.5% from the beginning of the year. In the first quarter of 2010, insurance premium rose 38.6% from a year earlier, reaching RMB454.1 billion (approx €55 billion). Property insurance premiums rose 38.4% and life insurance premiums rose by 38.7%.

Key facts

Following China's accession to the World Trade Organisation, these limitations / restrictions on foreign-invested insurers in the form of corporate entry vehicles, geographical coverage and business scope, have been gradually lifted. There has been a continuous growth in foreign participation in the Chinese insurance market in 2010, which is probably supported by the China's macro-economic policies in an effort to enhance the role of commercial insurance in supplementing social insurance schemes.

In the property and casualty insurance market, international insurer XL received approval from the CIRC to commence preparatory work to set up a full-fledged property and casualty insurance company in Shanghai in November 2009. In May 2010, Lloyd's Reinsurance Company (China) Ltd based in Shanghai was granted a licence by the CIRC to write direct insurance business in China. This may potentially allow other insurers to use the Lloyd's China platform to gain entry into the Chinese insurance market.

There has also been a marked increase in foreign participation in the healthcare insurance industry during the period from late 2009 to early 2010 after the Chinese government has confirmed that commercial health insurance would be an integral part of the overall healthcare system in China. Both Wellpoint and Humana Inc have received approvals from CIRC to establish their respective representative offices in Beijing early 2010. In addition, many other companies have opted to enter the Chinese market as Third Party Administrator in the form of service or consulting companies. An example of this is Beijing Prestige Health Consulting Services Ltd established by Swiss Re in 2008.

On 12 April 2010, the CIRC approved the Administrative Measures for Equity Interests of Insurance Companies which came into effect on 10 June 2010. These Measures seek to regulate equity investments in domestic insurance companies with less than 25% foreign shareholding. These Measures have primarily provided for the qualification for eligible shareholders investing in domestic insurance companies, shareholding limit for each single shareholder and non-compete restrictions for domestic insurance companies under common control.

On the contentious front, China adopts a civil law system and the common law doctrine of binding case precedent does not apply. A judge presiding over a case will decide based on what the Chinese laws and regulations say. Chinese law does not impose any restriction on the choice of dispute resolution mechanism. Parties to an insurance contract are free to decide whether to submit their disputes to either an arbitral tribunal or a Chinese court. Specialised maritime courts are located in 10 coastal cities in China for handling marine insurance cases.

Clyde & Co in China

Clyde & Co's Shanghai and Hong Kong offices operate as an integrated unit and there is much involvement and interaction between the two offices. We have the critical mass, resources and depth of experience to handle the largest and most complex transactions. We have extensive experience in dealing with corporate and regulatory insurance as well as claims issues in the region. We service our local and international clients in a wide range of legal issues including their investment in the Chinese reinsurance / insurance market, liaising with regulatory authorities, policy wording compliance review and dispute resolution.

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India

Market overview

Despite the presence of many international insurance companies, the Indian insurance market remains significantly under-exploited and thus offers opportunities to both, the existing players and potential entrants.

The insurance sector exhibits immense potential for growth. According to the Investment Commission of India, the Indian insurance market is expected to grow at a compounded annual growth rate of over 30% per annum.

Even with the life insurance sector clocking a growth of over 18% in total premium received in the fiscal year 2010, the penetration level of life insurance remains at about 4% of the GDP as against the global average of over 7%. Higher disposable income, aging population, no universal life cover and tax benefits to life insurance products make life insurance market an attractive proposition for insurance companies seeking expansion.

On the other hand, despite an average annual growth of about 16%, the penetration level of general insurance business in India is less than 0.60% of the GDP as against the global average of 2.14%. Untapped rural markets, lower consumer preference and constrained distribution channels are understood to be the reasons for the lower levels of penetration.

These, combined with ongoing reforms, will certainly make this growing sector appear more attractive for existing and newer participants.

Key facts

- Insurance industry is regulated under the provisions of the Insurance Act, 1938, the Insurance Regulatory and Development Authority (IRDA) Act, 1999 and the rules and regulations notified by the IRDA
- The IRDA has been conferred with powers and function relating to the regulation of insurance companies and insurance intermediaries like insurance brokers, surveyors and loss assessors and agents. It stipulates the guidelines and code of conduct with the objective of protecting policy holders
- In addition, it regulates investments of funds by insurance companies, maintenance of solvency margins, social sector obligations of insurers and adjudicates disputes between insurers and intermediaries
- Licenses are necessary for insurance brokers, insurance agents, loss assessors and surveyors, third party administrators and other such insurance intermediaries
- Further the principal officers or designated persons of such intermediaries must also possess the prescribed qualifications including practical training in some cases

Currently 23 life insurance companies and 23 in general insurance companies are licensed to carry out their respective insurance businesses in India. All insurance products are subject to File and Use guidelines, whereby insurers are required to submit the proposed insurance products to IRDA for approval before selling such insurance products to consumers. The general insurance market has for the most part been de-tariffed since 2007.

Future development

Notwithstanding the reforms introduced in the insurance sector, insurance companies have been asking for further de-regulation. Since the sector was first opened up to private companies, successive governments have acknowledged the need for further reforms. However, most proposals for reform have been trapped in legislative quagmire, with governments not having the political power to push them through due to opposition from coalition partners.

The Bill provides for appeals against decisions by IRDA to lie with the Securities Appellate Tribunal set up under the Securities Exchange Board of India Act, 1992. Among other proposals, the Bill also provides for Lloyd's of London to be included within the definition of a foreign company and is thus likely to open doors for Lloyd's entry into India.

The Insurance Laws (Amendment) Bill 2008 ("the Bill") is still pending in the Parliament. The Bill proposes to allow foreign investors to hold up to 49% of the capital in an Indian insurance company. It also paves way nationalised general insurance companies to raise funds from the capital markets.

The mandatory requirement for Indian promoters of an insurance company to reduce their stake to 26% over a period of ten years is also proposed to be dropped. The Bill proposes to permit a policyholder to completely assign all rights under the policy to a third party subject to conditions and prescribes stricter penalties for insurers that fail to meet social sector obligations.

Clyde & Co in India

In June, 2009, Clyde & Co announced the formation of an association with ALMT Legal, a dynamic and progressive Indian law firm, with offices in Mumbai, Bangalore and London. By joining up with ALMT, Clyde & Co's can now extend it capabilities from the Middle East to the Far East, enabling both firms to capitalise on the significant opportunities presented by the Indian market and assist in establishing a joint platform for the further development of Indian business both within and outside India.

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Japan

Market overview

The Japanese insurance market presents various challenges for both domestic carriers and foreign insurers considering entry. Despite boasting the second largest life insurance and fourth largest non-life insurance sectors globally, scope for long-term growth is hampered by both the maturity of the market and the basic issue of Japan's demographic contraction. With its low birth rate and an increasingly "greying" workforce, Japan's current population of 126 million is predicted to fall to less than 50 million by 2100. Against this background, the challenges for insurers in a sector where over 70% of non-life insurance business is personal lines are obvious.

The gradual decline in non-life premium income, and inevitable search for ways to reduce expense ratios, has led to increasing consolidation within the Japanese non-life industry, as evidenced most recently by the April 2010 integration of Mitsui Sumitomo, Aioi and Nissay Dowa into a single holding company structure (MSA&D Insurance Group). Sompo Japan and NipponKoa adopted a similar structure in April 2010 to form NKSJ Holdings which, in conjunction with MSA&D and Tokio Marine Holdings, now control some 83% of the total Japanese non-life company market. MSA&D is now the largest non-life insurer in Japan.

Similar concentration has occurred at the bottom end of the non-life market. Following amendments to the Insurance Business Law in 2006 some 430 unregulated insurance co-operatives (*kyosai*) were compelled to either register as regulated "small-amount, short-term insurers" (SSIs), secure licences as formal insurers or else cease business. The increased capital and regulatory requirements of this shift led many *kyosai* to merge, transfer their business to already licensed insurers, or cease trading altogether, such that just over 60 SSIs existed when the transition period ended in April 2008.

This high level of concentration in a declining market has led to predictably high levels of competition, and attendant consumer scandals. Investigations by the Japanese Financial Services Agency (FSA) in 2005 – 2007 into non-payment of medical, motor and life claims, together with overcharging of household premiums, has led to a recent stiffening of FSA regulatory control to ensure greater consumer protection. Various FSA supervisory guidelines have since been issued requiring full disclosure to consumers of policy features at point of sale, ensuring suitability of insurance advice given and the development of robust claims management systems.

Most recently, the Insurance Law 2010 has required a complete re-drafting of, and re-submission for approval by the FSA of, personal lines forms to ensure consumer clarity, while also curtailing insurers' right to rely on non-disclosures in a consumer context.

The path into the Japanese market for foreign insurers has also proved difficult. The 20 foreign subsidiaries and/or branches in Japan hold less than 6% of the non-life market (mainly in niche lines), a position partially attributable to lack of access to agency networks in a country where more than 2.15m insurance agents work on a full or part time basis.

Key facts

- The Japanese non-life insurance market consisted of 30 domestic insurers and 20 foreign branches/subsidiaries at the end of March 2009, with some 59 co-operative insurance associations and 64 SSIs also active in the sector
- Regulation of insurer, broker, SSI and agent activities in the Japanese insurance market is overseen by the Financial Services Agency. The FSA's main responsibility is for insurer solvency and consumer protection
- Tariffs only apply to compulsory automobile liability insurance (CALI) and household earthquake lines. Proposed rates on other lines must be filed with the FSA and specifically approved before use, though rates filed and approved for commercial lines can be adjusted
- Policy wordings must be approved by the FSA before use. If no objection is raised within 90 days of filing commercial forms, they are deemed approved and can be freely endorsed. Consumer policies must be specifically approved prior to use
- Non-admitted insurance – including global policies and DIC/DIL cover for multinational assets located in Japan - is not allowed, with the exception of international marine cargo, hull/liability cover for Japanese ships and aircraft engaged in international trade, and overseas travel insurance. There are no legal or supervisory restrictions on fronting in the Japanese market

Future development

The position is, however, not all gloomy. The increasingly aged Japanese population presents sizeable opportunities for 'third sector' market entrants providing PA, medical and nursing cover. With over 37% of the Japanese population predicted to be over 65 by 2050, this sector is considered to be worth in excess of $20bn - $30bn in annual premium income once fully developed.

Potential opportunities also exist in the direct and internet sales sectors, particularly for motor and travel cover, while affinity alliances and joint ventures between insurers and non-insurance providers such as mobile phone companies offer new sales channels for insurance products e.g. E.Design (Tokio Marine/NTT) and SBI (Aioi/Softbank).

Ultimately, however, the emphasis in the Japanese non-life insurance sector is on international expansion. While this is presently concentrated in Asia and the BRIC states, recent acquisitions by Sompo Japan of the Turkish non-life insurer Fiba Sigorta (June 2010), the takaful offerings of Tokio Marine in the UAE, Malaysia and Egypt and high profile Tokio Marine acquisitions in 2008 of Kiln and Philadelphia Consolidated show that Japanese insurers – already present in many countries to service Japanese Interests Abroad business – are now clearly targetting local market business as well.

Further information

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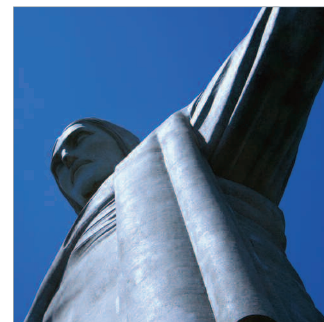
Latin America

Market overview



Latin America in general has stood firm under the current volatility of the global economy with insurance markets continuing to expand. Unsurprisingly, some markets were more affected than others due to their dependence on world trade. The growth of insurance markets has slowed in South America as incomes have dropped. Insurance is highly related to credit in these markets because banks lend less and people have fewer assets to insure. However, prospects for growth are increasing. If the economies start to improve again, the insurance industry will grow.

Insurance penetration in Latin America, despite its recent growth, lags the trends of more developed markets of Europe or the US. It is a relatively small market taking into consideration its geographical size as compared to other markets, but demonstrates strong growth potential.

Brazil and Mexico dominate the region, accounting for two-thirds of all premiums. Brazil is the largest insurance market in the region. With around 46% premium market share it is almost double the second largest market in the region, Mexico, which accounts for 25%. Some countries are just leaving behind years of state-owned monopolies, as in the case of Brazil in reinsurance or Costa Rica in primary insurance.

There have been various developments in investment in the insurance industry including more risks underwritten by subsidiaries of North American and European insurers. There has also been development in new distribution channels for insurance products such as banks and utility companies generating new interest in insurance products. The growth of the banking industry has led to large scale bancassurance in Argentina, Mexico, Chile and Brazil. Speciality lines such as liability, surety, agriculture and engineering account for a significant percentage of new growth in the region, in particular in Brazil.

It is also important to remember that regulation differs from market to market and most Latin American countries are still trying to develop stronger regulatory frameworks and regulators. So far, insurance regulators have not evolved as much as banking regulators but some countries have further to go than others.

Brazil

- In 2007 the Brazilian authorities liberalised the reinsurance market
- Complementary Law 126 issued in January 2007 brought to an end the almost 70-year monopoly of the state owned reinsurers IRB Brazil Re
- It created three categories of reinsurers - local, admitted and occasional
- Local reinsurers (including the IRB) were given the right of first refusal or "preferential offer" of at least 60% of the cedant's total reinsurance cessions in the first 3 years up to 2010, to be reduced to 40% thereafter
- In December 2007 the CNSP, the Brazilian National Council of Private Insurance, issued implementing Reinsurance Resolutions 168 to 173
- Resolution 168 which came into effect on 17 April 2008 is the main resolution and sets out the criteria for registration entry and operation of reinsurers in the new open market

The reinsurance market in Brazil has now been open for competition for more than a year. At present there are in excess of 70 foreign reinsurers registered in Brazil, including Lloyd's of London as an "admitted reinsurer". In general, indications are for the establishment of a more mature and transparent (re)insurance market with great potential for future growth. The reinsurance liberalisation and the country's continued economic development is driving demand for new reinsurance products.

Other countries

Mexico has also amended its insurance laws to provide more strength and structure for the legal framework relating to inter alia distribution regulation and capitalisation in respect of insurance products and companies.

Other countries are encouraging the set-up of more foreign owned insurance companies.

Clyde & Co in Latin America

Clyde & Co has a strong local presence as well as a dedicated Latin American team in London. Our lawyers advise on changing regulatory regimes in all countries in Latin America as well as assisting in setting up branches and representative offices in various countries for leading international insurers and reinsurers.

Clyde & Co has been involved in negotiating terms of covers and claims handling and loss adjusting procedures for reinsurers as well as structuring fronting arrangements enabling greater protection and participation in local risks.

Clyde & Co's lawyers have been active in promoting internationally accepted terms, wordings and dispute resolution models. We are involved in some of the major insurance and reinsurance claims concerning the region, ranging from construction, engineering, aviation and operational risks, offshore energy and marine and financial guarantees in Brazil, credit risk disputes in Argentina, mining disasters in Chile, energy and public utilities in Venezuela, Ecuador and Mexico and financial institutions and/or BBBs in Colombia.

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Russia

Market overview

The Russian insurance market continues to reel from the impact of the global economic crisis, which began to seriously affect Russia in the second half of 2008.

Until then the Russian economy had averaged 7% growth since 1998 resulting in the doubling of real disposable incomes and the emergence of a middle class. Russia became Europe's largest new car market in 2008, overtaking Germany. It became IKEA's largest market in 2008.

The Russian insurance market had seen several years of consistent and rapid growth. Car and motor purchases were increasingly made with the assistance of bank finance and hence also insurance – very often at the same point of sale. Motor and property insurance have been the main drivers behind recent market growth.

By spring 2008 over 50% of adults had at least one insurance policy. Annual premium per person was estimated to be between US$100 to US$125, although the life sector remained very small, reflecting Russians' continued reluctance to make long term savings and investments. This itself reflects the short pedigree of post-Soviet economic institutions and continuously high levels of inflation amongst other factors. In commercial lines, insurance was increasingly seen as a necessity rather than a luxury and there had been encouraging signs of growth in the SME sector.

In fact, until 2008, the Russian market had been the fastest growing amongst the BRIC countries. The Russian economy was hit hard by the economic crisis, oil prices collapsed and the supply of foreign credit to Russian banks dried up. GDP fell to -7.9% for 2009. Many large construction projects were abandoned and property prices suffered. 2009 car sales were a mere 51% of those in 2008. The economic decline appeared to bottom out towards the end of 2009. Although undoubtedly very serious, Russia has shown very considerable resilience in the face of such a serious recession. There has been no real sign of the repeat of the economic / social / political collapse that accompanied the 1998 crisis for example.

The 2009 insurance premium levels were about two thirds of those of 2008. Serious as they are, these setbacks will almost certainly be of a short term nature. Insurance has become embedded into the post-Soviet Russian economy and there remains real room for growth in the sector over the medium term.

There are still millions of uninsured Russians and properties. It is also worth remembering that before the 1917 revolution, the Russian Empire was the second largest insurance market in the world. When Russia emerges from the current economic situation, the insurance market will also recover, although probably in a much more consolidated form.

Key facts

Foreign Entrants by Acquisition (2005–10)

Allianz (Rosno)
Zurich (Nasta)
Axa (Reso)

There are many other foreign insurers directly or indirectly active in the Russian market.

Regulatory

- Only Russian insurers can insure Russian risks. There is a limited exception for ships registered on the Russian International Shipping Register
- Foreign insurers must therefore participate in the market by way of reinsurance and/or by acquiring shares in a Russian insurer
- There is no prohibition on Russian insurers being reinsured by overseas reinsurers
- Legislation requires capital reserves, brokers to be licensed, prescribes how assets are to be allocated and requires the separation of business lines, amongst other things
- Minimum capital requirements remain very low indeed in absolute terms, with the consequence that the market still has a grossly disproportionate number of licensed insurers
- Regulatory and legislative discussion continues about expanding the role of compulsory insurances

Lloyd's of London in Russia

Lloyd's, in common with all foreign insurers, has no licence to write direct insurance in Russia, but its members reinsure Russian business. Various Lloyd's brokers have well-established presences in Moscow. A delegation consisting of Lloyd's management, underwriters and brokers visited Moscow in May 2010 on a fact finding mission. Lloyd's Chairman Lord Levene said:

> *"Our entire delegation was impressed by what they saw. We understand that there are enough good reasons to work here in the future. The Russian market is huge, but the penetration of insurance and reinsurance in the Russian economy is quite low. I have no doubt that in the next few years, the market here will grow. We are ready to provide Lloyd's resources to the Russian economy."*

In 2009 the volume of business to Lloyd's from Russia increased by 14% to US$168 million, making Russia the 23rd largest market to Lloyd's. This number likely significantly understates the true volume of Russian – related premium into Lloyd's since it does not necessarily account for premium paid by overseas holding companies of Russian businesses (the use of such vehicles for holding Russian assets is very common).

Market developments

The number of insurers continues steadily to decrease as businesses merge and poorly capitalised players fall by the wayside. By the end of the first half of 2009 there were 743 insurers in Russia (90 less than in 2008), but in reality the market is highly concentrated with the top 10 insurers taking 53% of premium income.

There are very real doubts about the sufficiency of the capital base of many insurers, particularly regarding the mid to smaller companies. There are grave concerns that those with weaker balance sheets are cutting rates to uneconomic levels to generate cashflow and to buy time.

On 22 April 2010 a new law increased minimum authorised capital for non-life insurers to RUB120m (US4m), RUB 240mn (US8m) for life and RUB480m (US16m) for reinsurance.

The same law increased the regulators' powers to vet appointees to senior management and to approve the acquisition of shares in Russian insurers.

Major losses 2009

All eyes were on the major accident of 17 August 2009 at RusHydro's Sayano-Shushenskaya dam, the 6th largest in the world. An explosion was followed by massive water ingress destroying the turbine hall and several of its 10 turbines. 74 people were confirmed dead and power was cut to nearby towns and industry, including four of Rusal's aluminium smelting plants. This incident may be the largest insured loss in Russian history. Local insurers came under significant political pressure to pay very promptly. Total insured loss on the dam has been said to amount to USD200M, but actual reconstruction costs are far higher.

Clyde & Co in Russia

As with all emerging markets, a number of special issues need to be confronted by anyone conducting business in Russia. Clyde & Co has the local and international expertise to assist. Clyde & Co has been active in Russia since 1992 when it established a St Petersburg office in association with Musin & Partners.

In 2005, Clyde & Co opened an office in Moscow and which supports all our offices, in our core areas of insurance, shipping, international trade, corporate and securities law.

The London and international offices are extensively involved in multiple major Russian related transactions and litigation around the globe.

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The Middle East

Market overview

The Middle East region has not been immune to the global credit crunch. Insurers have been impacted by falling investment returns and calls for the industry to focus on its technical underwriting returns are commonplace. However, competition is fierce – there are around 180 licensed insurance companies in the GCC writing an estimated US$10.5bn of premiums – and, as a result, premium rates have remained soft across most sectors.

The attraction of the Middle East remains significant potential for future growth. Insurance penetration remains low, even when compared to other emerging markets (the average across the region is less than 1.5%). Premium growth across the region prior to 2009 was in the region of 20% - 30% per year. Even in 2009, after the financial crisis, growth of 6% in life and 9% in non-life premiums was achieved. The development of compulsory motor and health insurance schemes means that these markets have been at the forefront of current growth. Future projects and the growth in expatriate property ownership, together with significant ongoing legislative and regulatory reforms are likely to ensure that the insurance market continues to grow.

Whilst concerns remain over the future of Dubai's economy, the broader region continues to see continued investment in the infrastructure and property sectors. As far as insurers and brokers are concerned, the Middle East continues to be perceived as a growth region.

United Arab Emirates

- The UAE has 56 registered insurers, of whom 27 are foreign insurers, and around 200 licensed brokers or agents
- In December 2008, a moratorium was imposed by the Insurance Authority on licensing of insurance companies (it was later extended to new insurance intermediaries)
- Locally incorporated insurance companies are required to be publicly listed and 75% owned by UAE nationals
- A code of conduct and business ethics introduced by the Insurance Authority (which regulates all non-DIFC insurance businesses) setting out a code of conduct for all insurers will be in force in the UAE from 29 July 2010
- New strata laws have resulted in an additional line of compulsory insurance being introduced in the property sector
- Compulsory health insurance for expatriates (currently only applicable in Abu Dhabi) is expected to be rolled out at a federal level.

The Insurance Authority is also in the process of issuing implementing regulations to flesh out the overhaul of the federal insurance law that took place in 2007 (the Implementing Regulations). New regulations have already been issued relating to anti-money laundering, the licensing of insurers and the code of conduct to be followed by insurers. The remaining, much anticipated, regulations are currently being finalized, include:

- Regulations concerning insurance agents
- Regulations concerning registration of insurance and reinsurance brokers
- Directives concerning the accounting policies of insurance companies
- Takaful insurance regulations

In the meantime, the 2007 insurance law is currently read in conjunction with the old regulations issued under the previous framework of laws.

The moratorium on licensing of new insurance companies and brokers remains in effect. However, Resolution No. 2 of 2009 sets out a revised set of licensing requirements, presumably indicating that the moratorium may be lifted at some point in the future. Precisely when the moratorium may be lifted, remains to be seen and in the interim it is likely that acquisitions in the insurance sector will increase as international players continue to seek to enter the market.

Much progress on regulation of the insurance market has been made in recent years but there are still areas in urgent need of attention to protect consumer interests. For example, bancassurance is widely available in the UAE but, is currently lacking a detailed framework to regulate its provision (and arguably is illegal as the law currently stands). Sale of insurance products over the internet and via telephone sales is increasingly common. Yet, while there are e-commerce laws in the UAE, the insurance laws do not take into account this contemporary method of sales and still envisage face to face transactions.

Dubai (DIFC)

- The Dubai International Financial Centre in Dubai (DIFC) was established as a financial free zone in 2004
- It is exempt from onshore commercial and civil laws (although onshore penal and anti-money laundering legislation applies)
- It has its own independent regulator, the Dubai Financial Service Authority (DFSA) and its laws have been drafted specifically for the DIFC, cherry picking from jurisdictions such as England and Singapore
- It operates as a reinsurance hub for the region and there are approximately 35 insurance market players, including reinsurers, underwriting agents and brokers in the Centre

Recent developments in the DIFC include the development of a retail regime, although this presents difficulties to the insurance market in light of existing federal restrictions on direct insurance in the UAE, and changes to the DFSA rulebook to allow insurers operating in the DIFC to be able to insure risks situated in the DIFC directly, as opposed to through reinsurance. The application process has also been simplified, fees reduced, and amendments made to the rulebook to allow more flexible arrangements for compliance and anti-money laundering reporting officers. The DIFC's Collect Investment Fund regime has also recently been overhauled.

The DIFC is continuing to encourage and establish a captive insurance market in the DIFC and appears to have achieved some success of late. The first fully fledged captive insurer and protected cell companies were recently established, and at least two further authorisations are being processed. There are currently two captive managers registered (Marsh and Kane) with the DFSA.

Kingdom of Saudi Arabia

- Insurance in Saudi Arabia is governed by the Law on Supervision of Cooperative Insurance Companies
- It is regulated by the Saudi Arabian Monetary Agency (SAMA)
- There are currently 32 insurance and reinsurance companies licensed or in the process of being licensed to operate in the KSA
- Saudi insurers (but not reinsurers) must operate on a co-operative basis and incorporate as public joint stock companies
- Restrictions on foreign involvement in insurance companies exist with a maximum participation of 60% but which in practice SAMA only usually stretches to 49%. These restrictions also apply to insurance intermediaries.
- Depending on the participants in the company, a range of between 25% - 40% of shares will need to be floated

Since 2004, SAMA has undertaken a major overhaul of the Saudi market, and initiated a process where existing participants were invited to restructure or to exit the market. The process of registering 32 insurance companies in the Kingdom is now complete. We understand that whilst no moratorium has technically been established, SAMA is understood to be actively encouraging acquisitions of existing licensed entities as a way to consolidate the market.

Foreign insurers can still access the marketplace through reinsurance. SAMA has recently released for consultation draft reinsurance regulations and approved a code of corporate governance regulation, investment guidelines and broker regulation as well as regulations for risk management, anti-money laundering and anti-fraud measures. For reinsurers, the regulations presently require that a Saudi-registered insurer retain 30% of total insurance premiums and that a further 30% should be reinsured with a licensed Saudi reinsurer. The new reinsurance regulations are not proposing to change that rule.

A range of further regulations are expected and the consultation period for a comprehensive set of outsourcing regulations which will apply to insurance companies and service providers closes in September 2010.

Qatar Financial Centre

- The Qatar Financial Centre (QFC) was created in 2005 along similar lines to the DIFC, and based on a familiar FSA-model
- It is exempt from the majority of local Qatari commercial legislation, and equipped with its own financial services regulator, courts and tribunal staffed by appointees of the highest calibre
- In contrast to the DIFC, insurers setting up in the QFC are able to write direct, retail insurance business in the local Qatar Market

There are currently around 20 authorised insurance authorities operating from the QFC. The first captive manager (Kane) was authorised in August 2010.

Since January 2010 the Qatar Financial Centre Regulatory Authority (QFCRA) has issued a number of consultation papers with a view to reforming its landscape in relation to composite insurance, licensing of intermediaries, captive managers and client money obligations for insurance entities, in addition to around a dozen Qatar based companies (which include four foreign insurers).

A social health insurance scheme for Qatar is currently being considered which is likely to impact the growth of health insurance in Qatar.

Bahrain

- The Central Bank of Bahrain (CBB) is the integrated regulator of financial services in Bahrain, including insurances
- Volume 3 of the CBB's detailed rulebook governs insurance regulation
- According to the CBB, at the time of writing, there are 15 locally incorporated firms, 11 foreign branches and six representative offices of foreign insurance companies operating in the conventional segment of the industry. There are also nine companies, including two retakaful firms active in the sharia-compliant sector. In addition to these, there are a further 38 conventional firms and nine takaful companies based in Bahrain that are licensed to write solely offshore business.

The Bahrain insurance market is relatively well established in the region, having for many years been the defacto centre for Saudi Arabian insurance. A number of international insurers, including ACE, Hannover Re, AXA and Allianz have chosen to establish Bahrain as their regional hub. The first licensed GCC captive insurer (for Tabreed, a UAE utilities company) was established in Bahrain in 2007. Bahrain is also understood to be in the process of promulgating a compulsory health insurance scheme for expatriates.

Other GCC developments

Kuwait has announced its intention to revamp its existing insurance legislation, which is anticipated to be widely welcomed as its current insurance law was passed in 1961.

Oman’s Capital Market Authority (CMA) has continued its program of reform of insurance legislation, including issuing a code of governance for insurance companies in 2008 and detailed regulations for insurance interests. There was also a change in respect of capital requirements for branches of insurance companies, introducing the requirement that capital must be held locally and an important change introduced by the CMA was the removal of the obligation on the lead local insurer to allow other national insurers to participate in certain risks. However, there remains a requirement for national insurers to demonstrate that national reinsurers cannot offer adequate reinsurance cover before placing risks with foreign reinsurers.

In 2008 Oman also saw the much-anticipated establishment of Oman Re, which will increase the opportunity for reinsurance premiums to be retained within Oman and, more recently in 2010, Oman saw the acquisition of Al Ahlia by RSA which, in many insurance circles, is hailed as the start of a much called for consolidation of the region's fragmented and highly competitive markets.

With over 350 insurance companies operating across the Middle East and North Africa that collectively generated little more than USD 20bn in gross written premiums in 2008 (equating to half the total premium volume of Belgium) the general consensus seems to be that the high number of smaller companies is stretching the limited regional skills pool and thus a consolidation is required for the good of the industry.

With the average market penetration of the Middle East standing at 1.5% compared to a global average of 7.1% per Swiss Re's Economic Research & Consulting, Sigma No. 3/2008, RSA's consolidation of its market position in Oman by way of acquisition may also not just indicate the start of a period of consolidation but also the start of a developing wave of M&A activity as global insurance and reinsurance players seek to capitalize on the potential growth of such an untapped market as well as that created by the already expanding markets for more sophisticated insurance services in both the retail and the commercial sectors. The conditions are ripe but only time will tell.

Takaful business

- Islamic insurance (takaful) contributions (premiums) were US $1.4 billion per year in 2004 rising to an estimated US $5.3 billion in 2008. Saudi Arabia is the largest takaful market in the GCC with contributions of US$2.9 billion
- The compound annual growth rate of takaful in the GCC in 2008 was 45% (the UAE CAGR is 135%)
- They are predicted to reach US $8.9 billion per year by 2010 and US$15 billion by 2015

It is helpful to remember that global takaful contributions are less than 1% of the total insurance premium spend annually, despite the fact that Muslims make up around 24.79% of the total global population. Inevitably there are questions as to what proportion of this population is accessible to insurers. In the Middle East as a whole, the current level of GDP per capita is not currently reflected in the insurance penetration rates.

Life insurance remains particularly undeveloped and the opportunity for family takaful to step into this role is extremely viable. For example, it is estimated that the UAE is massively under-penetrated with insurance premiums in 2007 being reported as 56% below GDP-adjusted levels in the non-life sector and 88% in the life sector. Despite the challenges facing the takaful industry, there seems no reason why it should not be the future means by which many more Muslims and non-Muslims around the world seek to protect their lives, health, possessions and businesses.

Clyde & Co in the Middle East

We are recognised as the leading international law firm in the region. Whether it is setting up in the Dubai International Financial Centre or guiding new entrants to the region, our 25 years of experience is key.

Clyde & Co has been named Middle East Law Firm of the Year by legal market intelligence and transactional analysis provider 'PLC Which Lawyer?', as part of annual awards that canvass the views of over 5,500 legal departments internationally.

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United States

Market overview

The United States has the world's largest economy and the world's largest insurance market, generating nearly one-third of global insurance business. The insurance industry is the fifth largest sector of the US economy, is highly competitive, and offers a wide variety of products.

Annual gross insurance premiums in the US exceed $1 trillion. The largest share of the market is in life, health, and annuity insurance, which accounts for roughly 70% of the US premium volume. Property and casualty insurance is the second-largest segment, with premiums estimated at $450 billion. Other major insurance lines include financial insurance and professional liability, aviation, energy, marine, surety, political risk, trade credit and others.

The economic recession beginning in 2007 had a severe impact on the industry, exemplified most dramatically by government bailouts and other financial assistance provided to high-profile insurance groups. Property and casualty rates dropped in 2008 and generally continued to decline in 2009 and into 2010, although at a slower pace. Directors and officers' liability insurance rates were not affected as greatly at the beginning of the recession, but dropped steeply at the end of 2009 and into 2010. Overall, both capacity and competition remain high in the US insurance industry, companies have begun to regain capital lost during the economic downturn, and there is renewed focus on careful underwriting in light of an uncertain investment environment.

Key facts

- Primary regulation of the US insurance industry occurs at the State, rather than Federal, level. Each of the 50 US States, the District of Columbia, and most US territories maintain a regulatory regime with which insurers and reinsurers must comply as a condition of doing business in the jurisdiction. The statutory and regulatory schemes cover the gamut of insurance operations, including policy forms, rates, financial statement requirements, solvency margins, licensing and conduct of agents and brokers, and credit allowed for reinsurance cessions.

- The States work to harmonize their regulation of the insurance industry through the National Association of Insurance Commissioners (NAIC), whose membership includes the insurance regulators from the 50 US states, the District of Columbia and five US territories, including Puerto Rico, the US Virgin Islands, and Guam. The NAIC issues Model Laws, Regulations and Guidelines, which are widely adopted by its members, though not always promptly, and often with individual variations.

Future Developments

US passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act on 22 July 2010 has been heralded as the dawn of a new age in US insurance regulation (Act). The Act calls for establishment of a new Federal Insurance Office (FIO), which is charged with assisting in administration of the Terrorism Insurance Program. The FIO also is directed to monitor and collect data from the insurance industry generally, monitor the availability of "traditionally underserved" communities and consumers, coordinate Federal efforts on international insurance matters, and consult with the States on "insurance matters of national importance." While the Act provides for Federal pre-emption of State regulation only to protect non-US insurers that are treated less favourably than US insurers, it also directs the FIO to "examine the costs and benefits of potential Federal regulation of insurance."

The US Congress has the ability to transform the current State-based regulatory system into a Federal one, and many consider establishment of the FIO as a prelude to such a step.

Clyde & Co in the United States

Clyde & Co US LLP has offices in New York, San Francisco, and New Jersey. In response to great demand for its services, the firm has expanded quickly since first establishing its US presence in 2006. Clyde & Co's US offices represent many of the world's leading insurers and reinsurers in various complex, high-value matters.

Further information

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United Kingdom

Market overview

The UK market is the world's third largest insurance market. In 2008 it employed a third of the UK financial sector workforce. General insurance companies' premium income was £38.1 billion in 2009. Long-term insurance companies' premium income was £121.7 billion.

The London market is the world's leading international insurance centre, comprising UK and international insurance and reinsurance companies and Lloyd's of London. The London market specialises in inwards reinsurance, marine and aviation business, US surplus lines and international direct risks of a large or complex nature.

There are currently approximately 1,000 authorised insurers in the UK. 75% of these carry out general insurance business, 5% both general and long-term insurance and the remainder long term insurance only

Lloyd's is the world's leading specialist insurance market and occupies fifth place in terms of global reinsurance premium income. In 2010, There are 78 syndicates at Lloyd's, covering all classes of business from more than 200 countries and territories worldwide.

Key facts

- The basic framework of regulation in the UK is driven by the various European Directives governing life and non-life insurance and reinsurance which aim to establish a single market for insurance in the European Economic Area based on the principle of home state regulation. Insurers authorised elsewhere in the EEA are entitled to passport into the UK, either by providing insurance to policyholders in the UK or by establishing a branch here, without the need to be authorised by the UK regulator

- The regulation of insurance (and insurance mediation) in the UK is governed by The Financial Services and Markets Act 2000 ("FSMA"), which established the Financial Services Authority ("FSA") as the single regulator of financial services in the UK; various statutory instruments made under powers contained in FSMA including The Financial Services and Markets Act 2000 (Regulated Activities Order) 2001; and the FSA's Handbook of Rules and Guidance

- The FSA is responsible for both prudential and conduct of business regulation. It has a number of statutory objectives: maintaining market confidence, increasing public awareness, protection of consumers and reduction in financial crime.

- Only members of Lloyd's of London and insurance companies authorised by the FSA or by another regulator elsewhere in the European Economic Area may carry on insurance business in the UK

- Insurers may not carry on any commercial business other than insurance business and activities arising directly from insurance business

- European Directives impose minimum capital requirements on insurers. The FSA operates an Individual Capital Adequacy Standards (ICAS) framework, under which firms assess their own capital needs having regard to their business risks and systems and controls. The FSA reviews that assessment may impose individual capital guidance. The ICAS regime anticipates the radical reforms currently being implemented at European level as part of the Solvency II project (see below)

- Insurers are subject to minimum threshold conditions which must be met in order to be authorised, including requirements to have adequate capital and to be fit and proper to carry out their business; fundamental principles for business with which all firms are obliged to comply in carrying out their regulated activities; annual reporting requirements; an approved persons regime under which individuals performing certain functions (including directors) must first be approved by the FSA as fit and proper; rules governing senior management arrangements, systems and controls; and conduct of business rules

- Controllers of insurers whose level of control exceeds certain thresholds must be approved by the FSA, generally before ownership increases beyond the relevant threshold

- Reinsurance is regulated in the UK on the same basis as insurance. As a result of the European Reinsurance Directive, pure reinsurers i.e. reinsurers authorised to carry out reinsurance business only, which are authorised elsewhere in the EEA may carry on reinsurance business in the UK without being authorised by the FSA

CLYDE&CO

- Mediation of insurance and reinsurance in the UK is a regulated activity, requiring authorisation from the FSA. The activities covered are entering into (re)insurance contracts as agent, arranging (re)insurance contracts, advising, and assisting in the administration and performance of a (re)insurance contract

- There are a number of exclusions and exemptions. Loss adjusters and persons managing claims on behalf on insurers do not require authorisation. It is also possible to avoid the need for authorisation by becoming the appointed representative (AR) of an authorised insurance intermediary, who takes responsibility for the AR's actions in carrying out regulated activities

- Insurance intermediaries are subject to the FSA threshold conditions and principles for business, as well as obligations relating to systems and controls, regulatory capital, client assets and approved persons and to rules relating to communication with clients, marketing materials, and advising on and selling products

Future development

The FSA's 2010 Financial Risk Outlook noted that consumer confidence and disposable income remained low and that this was likely to have an effect on demand for life products, although it noted that new business levels recovered to a limited extent at the end of 2009. The slowdown in economic activity in 2008/09 has also affected business in the general insurance sector. The FSA noted that the market and economic environment, together with regulatory developments, will make it challenging for many insurers to return to the level of profitability experienced before the financial crisis, unless they make significant changes and adjust their capital and strategic plans to take account of the new environment.

One of the major challenges facing insurance companies in the UK, as in the rest of Europe, is Solvency II, the EU project for a fundamental reform of the prudential regulation of (re)insurers. The Solvency II proposals introduce a risk based approach to the calculation of capital which takes account of a firm's individual risk profile and incentivises risk management.

Solvency II is expected to drive an increase in consolidation as insurers look for merger partners in order to develop more balanced portfolios and take the benefit of diversification of risk in calculating capital requirements. There is a concern, particularly after the last round of advice issued by CEIOPS in 2009, that capital requirements under the new regime may be excessively conservative, driving price increases for capital intensive products, reduction in investor returns and making it more difficult to attract new capital. There are also concerns that the UK tax regime, including the approach to taxation of foreign profits may discourage new insurance start ups or cause existing insurers to redomicile in more tax friendly jurisdictions, such as the Netherlands, which has an exemption regime for foreign branches. The issue of taxation of foreign branches is particularly pressing given that Solvency II is driving insurers to change to a branch structure that than operating through subsidiaries. The Treasury is currently consulting on the form of an exemption regime for foreign branch profits, to enhance the UK's competitiveness and to achieve greater consistency of tax treatment between foreign branches and subsidiaries of UK companies.

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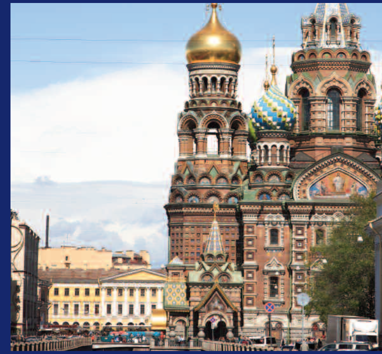

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