MARKET SPOTLIGHT – SAUDI ARABIA

# Fund raising and consolidation driven by capital requirements

**Saudi insurers are raising funds following requirements to increase their minimum capital. A few have signed M&A deals leading to further consolidation of the market. Middle East Insurance Review spoke to Badri Management Consultancy's Mr Hasham Piperdy about the implications for the market.**

By Nadhir Mokhtar

A challenging period for profitability in Saudi Arabia has slowed insurers' plans to merge, according to Badri Management Consultancy (Badri).

The kingdom's insurance market recorded three M&A deals in 2020 (Walaa-MetLife, SSTC-AlJazira, GUCIC-AlAhlia) which have been completed. According to Badri, a further three mergers will be completed this year, including the completed merger between Arabian Shield and Alahli Takaful and an ongoing merger between Walaa and SABB Takaful.

These deals come as the Saudi Central Bank (SAMA) increases minimum capital requirements to SAR300m ($79.8m).

"They're taking a bit more time with these M&A deals and I think the market backdrop is part of the reason for that. Profits are being challenged and companies are trying hard to return to profitability - which they will eventually. We had a very soft market last year and that is hardening up. And currently, we're seeing more insurers going directly to the markets to raise capital," said Badri actuarial services director Hasham Piperdy.

Insurers like Amana have resorted to raising capital through rights issues after plans to merge with Saudi Enaya were rejected by the latter's shareholders in January this year. Amana's proposed capital increase of SAR300m was approved by the Capital Market Authority (CMA) in May, bringing its capital from SAR130m to SAR430m.

Similarly, Wataniya's request to increase its capital by SAR200m was approved by the CMA in March 2022. This doubled its capital from SAR200m to SAR400m. Arabia Insurance's proposed capital increase of SAR265m was also approved by the CMA in May 2022, doubling its capital from SAR265m to SAR530m after the rights issue.

## Recovering from the pandemic

The Saudi insurance market recorded one of the worst years for profitability in 2021. According to Badri, overall GWP increased by 9.7% from SAR38bn to SAR42bn but profitability after zakat and tax plummeted by 103% from SAR1.4bn the previous year to a loss of SAR45m in 2021 (2019: SAR900m). The insurance industry in the kingdom witnessed a dramatic decline in profitability in 1Q2022 compared to

the same period last year.

"Claims for medical insurance and activity levels on the motor lines of business picked up to pre-COVID levels but the premiums have not caught up. It's a combination of things that have led to sharp drops in profits. A lot of insurers have built up sizable accumulated losses on their balance sheets, burning through their capital. That's made things challenging, but in general insurance if you have one or two bad quarters, it sometimes takes five quarters to run off that bad business," said Mr Piperdy.

He said insurers will require scale to compete with the larger players because of the fragmented nature of the market. Expense ratios, particularly for smaller insurers, are higher. In the first quarter of 2022, the weighted average expense ratio excluding the top five companies was 32% compared to 10% for the top five companies.

"A lot of insurers have had very high loss ratios. But high expense ratios exacerbate it and made it worse, pushing the combined ratio to 104% for the industry last year," he said.

## Boosting growth in the sector

Ten insurers have a total shareholder's equity of less than SAR300m as of the first quarter of 2022, according to Badri. These companies will have to raise capital or merge to meet capital requirements. Despite challenges in profitability, insurers have shown significant growth in GWP. Badri expects SAMA's requirements to raise minimum capital to boost that growth.

"The market has developed rapidly in Saudi Arabia with SAR42bn in gross written premiums recorded for the industry. And I think now is the right time to increase the capital level because it's going drive more capital behind you. The biggest advantage is being able to weather losses to write more business, more risks with greater capacity and less reliance on reinsurance," he said.

"When you're a small insurer and you only have SAR200m of capital behind you, it's very difficult to take on all of that risk. Because if an event happened, it would jeopardise the solvency of the company. A lot of insurers rely heavily on reinsurance. Even though they're making healthy profits, they're passing a lot of the profits to reinsurance. With the additional capital requirements, I see an exciting opportunity for the industry to reduce the reliance on reinsurance and increase the capacity to take on much larger risks. And that will really bolster the profitability for the sector for the industry," he said.

## Saudi Vision 2030

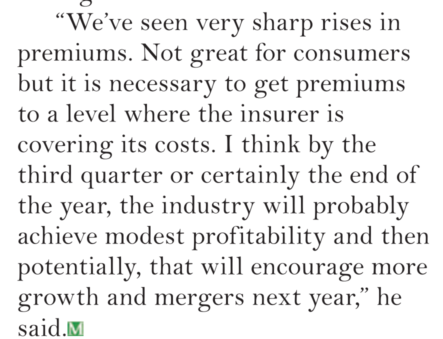
Saudi Arabia's insurance industry is forecast to grow at a CAGR of 1.6% led by massive infrastructure development as part of its Vision 2030 economic plan, health and motor insurance lines and expected recovery in business activity, according to a report by UAE-based investment banking advisory firm Alpen Capital. Mr Piperdy believes raising the capital requirements will give the industry the flexibility it needs to support the coverage of these developments.

"The capital requirements from SAMA give more flexibility and freedom. For example, instead of reinsuring 70% of a shopping mall, maybe I'll just reinsure 40% or 50%, which is possibly millions in terms of premiums, which is huge. Overall, it could be a few billion for the industry. This is something that I think will evolve naturally over the next two to three years as the new capital requirements come in," he said.

## Slowing down on mergers

Mr Piperdy believes there are some main distractions faced by insurers that are slowing down plans to merge. This includes addressing challenges to profitability especially on the motor and medical lines of business. He said insurers are also concerned with meeting IFRS17 requirements and it will be hard to consider mergers at the same time.

"There are a lot of advantages from economies of scale but I'm seeing more companies going directly to the market rather than looking at merger opportunities. Although discussions are ongoing, they're taking many months and it's unclear whether they are going through or not.



"We've seen very sharp rises in premiums. Not great for consumers but it is necessary to get premiums to a level where the insurer is covering its costs. I think by the third quarter or certainly the end of the year, the industry will probably achieve modest profitability and then potentially, that will encourage more growth and mergers next year," he said.

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