Executive Summary

Economic and political unity have been the driving force in the implementation of strategic milestones in the history of the EU including also the harmonisation and significant development of financial services' legislation.

Among these milestones is the Copenhagen Council which determined the eligibility criteria for member states. The application process is an onerous one that ensures political and economic harmonisation. This process, and the various institutions within the EU that support and safeguard harmonisation, differentiate the EU from any other economic and/or political bloc.

The Arab world, in contrast, is unified more through cultural and social characteristics than it is politically or economically. The Arab League, for example, although older than even the predecessors of the European Union, is more of a 'regional' United Nations than an economic or political union. The Council of Arab Economic Unity (CAEU) was established in 1964 with very similar policies to those of the, then, European Economic Community (EEC). However, it has not evolved at the same pace or in the same form as the EEC, which is now the European Union (EU).

These differing characteristics pose challenges to the application or adaptability of financial services' reforms in Europe to the Arab world. Nevertheless, there are many lessons to be learnt and various initiatives that can be successfully applied to the Arab region, particularly in:

- Cross-border trading and the recognition of insurance policies from other Arab states in the case of Arab multi-national companies;
- Liberalisation (and the recognition by other Arab states) of marine, transportation, aviation and energy insurance policies;
- Foreign ownership of insurance companies and a common policy on the licensing and supervision of foreign insurance companies;
- The participation of foreign insurance companies in government and/or parastatal insurance tenders
- The removal of compulsory reinsurance cessions
- A unified structure of compensation, unified legal interpretation and harmonisation of motor insurance in Arab states
- A common policy on license-driven qualifications and continued professional development in the insurance industry
- Systematic implementation of Enterprise Risk Management and Economic Capital Modelling supported by regulation
- A structured dismantling of barriers to competition within and, subsequently between, Arab states.

Table of Contents

Sources:

- CEA: Insurance Solutions for a Changing Society (June 2005)
- CEA: The Contribution of the Insurance Sector to Economic Growth & Employment in the EU (June 2006)
- CEA: Financial Awareness Initiatives Promoted by the European Insurance Industry (July 2007 – Position Paper)
- CEA: Solvency II Glossary (March 2007)
- CEA: Main Results of CEA's Impact Assessment (June 2007)
- CEA: Solvency II Frequently Asked Questions (February 2007)
- CEA: Guidance on Quantitative Impact Study 3 (May 2007) *On the CEIOPS MCR and MSR Specifications*
- CEA: Prospects for Simplifying European Insurance Legislation (2004)
- CEA: Consumer Protection in the European Single Market (2004)
- EU Directive 2002/65/EC (September 2002)
- EU on Solvency II: http://ec.europa.eu/internal_market/insurance/solvency
- First Initiative www.firstinitiative.org
- First Initiative Project Ref 359 Documentation)
- FSA: Financial Services' Authority (UK) Board: 'Prudential Requirements for Insurers' (December 2006)
- GIAU Meeting Minutes (November 2005)
- International Insurance Foundation: www.iifdc.org
- International Underwriting Association on Solvency: http://www.solvencyii.co.uk/
- IAIS Structure for the Assessment of Insurer Solvency (Dubai, February 2007)
- IUA/ABI: 'Individual Capital Assessment' Guidelines (February 2007)
- International Association of Insurance Supervisors: www.iaisweb.org
- Swiss Re SIGMA (World Insurance in 2005) & Swiss Re SIGMA (World Insurance in 2006)
- Swiss Re SIGMA (Innovating to Insure the Uninsurable)
- UAE Federal law 6 of 2007
- UN Economic & Social Council: Harmonisation of Requirements Concerning International Road Transport and Facilitation of Its Operation (Working Party on Road Transport *Economic Commission for Europe* -August 2004)

1. Introduction

Visiting a small, family-run Lebanese restaurant in a popular southern European tourist destination, I expected to be greeted with the usual array of hot and cold mezze, preceded by an inviting fresh salad entrée or almond platter. Unfortunately, no salad was served and the mezze tasted rather differently … the moutabal lacked that extra touch of garlic … To cut a long story short, I asked the Lebanese owner why Lebanese food here tasted so differently to that in the Middle East or the Arabian Gulf. "Simple," he replied, "I cater for a different clientele. One that regards the salad dish and nut entrées as pet food and that extra hint of garlic as giving bad breathe! One man's medicine is another man's poison!"

One's conduct evolves and adapts according to the environment he or she lives in. Similarly, evolving conduct shapes rules and regulations that would govern conduct for years to come.

Rules and regulations are created by organisations (be they social, political, economic or personal) to govern the conduct and behaviour of persons within that specific organisation.

Therefore, before delving into insurance rules and regulations, one must first examine the structure, the mechanisms and the external environment to which such regulations apply. Only then can we evaluate their applicability or adaptation to another market.

The European Union is *sui generis*. It is not only the single largest market but also a unified, global political institution. The objectives of the European Union are to promote and reinforce peace and democracy and to harmonise, protect and increase economic prosperity for its members. It is a cohesive political and economic force with a unified voice.

12 years prior to the establishment of the European Economic Community (the predecessor of the European Union, in 1957), Arab countries created the League of Arab Nations. The Arab League was founded in 1945 with the objective of co-ordinating economic, cultural and social activity between Member states. The Charter of the Arab League safeguards individual statehood and preserves the autonomy in decision-making within individual states. The European Union, on the other hand, is one bloc.

The Arab League is different to the European Union in that it is more of a regional version of the United Nations. Its membership is mainly based on cultural affinity. Economic blocs, in contrast, are generally more based on geographical location. Furthermore, The Arab League has no direct relations with the citizens of its member states. The European Union, on the other hand, has a direct influence on the legislation of member states. Citizens of member countries are also citizens of the European Union, even electing their representatives in the European Parliament.

Economic and political unity have been a *sine qua non* in the implementation of strategic milestones in the history of the EU. These milestones include the establishment of the Customs Union, the development of the European Currency Unit (ECU) into an active single European Currency (Euro), the founding of the European Central Bank, the evolution of the European Union (EU) from the European Economic Community (EEC) sealed by the Treaty of Maastricht, the creation of the European Parliament and the Council of Ministers (Council of European Union). Among these milestones is also the Copenhagen Council which determined the eligibility criteria for member states. Before joining the EU, applicant countries have to prove that they would have already undertaken significant political, social and economic changes and that, in many respects they are already compliant with EU legislation. The application process is an onerous one that has taken certain countries many years to fulfil. But these criteria ensure harmonisation. Political and economic harmonisation is the foundation on which effective common policy (whether in social, economic, political, administrative or financial services’ harmonisation) can be universally applied within the single largest international economic union.

Notwithstanding the differences between the European and Arab blocs, this document seeks to identify the strategic success stories in insurance regulation and practice and explore the extent to which these can be adapted and/or applied to the Arab insurance markets.

2. *Background*

a) Market Economics and Insurance in the Arab (MENA) and EU Markets

The objective of the Copenhagen Council was to etch eligibility criteria for **European Union** applicant states resulting in the harmonisation of the social, political and economic standard of each member state. The consequence, although an ongoing economic process in itself, is the growth of wealth in new EU member states, as standards of living in each EU member states draw closer together.

For example the average GDP per capita in Western Europe in 2006 was just over US$ 20,000[1] whereas that of the MENA region for the same period was around US$ 6,000 (i.e. less than ⅓ that of the European Union).

Insurance activity in a market is generally representative of economic prosperity. The average insurance spending as a proportion of GDP in the European Union was US$ 2,830 as at the end of 2006. If we had to group the EU into three blocs, i.e. the older or more industrialised group of 15 nations, the latter group of 10 that joined and the latest 2 entrants – i.e. Bulgaria and Romania - the distribution may be grouped as follows:

European Union by Region	Insurance	
	Per Capita	% GPD
15 industrialised Countries	US$ 3,509	9.90%
10 post Yr-2000 Entrants	US$ 762	6.43%
Bulgaria & Romania	US$ 96	1.90%

Although there is significant disparity in statistics between the lower echelon and the top fifteen industrialised EU countries, it is worth noting that these have only just joined the union and, other countries who joined in the last 2 or 3 years have already witnessed significant improvement noted by insurance being more than 6% of the average GDP in those countries. As part of the entry criteria, EU member states are also obliged to remove protectionist barriers to trade, promote competition and, as a result, limit monopolistic practice. Therefore, governments within EU member states move away from direct or indirect involvement as suppliers to commerce and industry in their respective markets, assuming the role of promoters, legislators and regulators. This has a major positive impact on competition and consumer knowledge and protection.

The **Arab (MENA) region** represents more a collection of individual states, bonded by religious, social and cultural ties than an economic union as is the European Union. Maybe the closest economic association to the EEC (the EU's precursor) is the Council for Arab Economic Unity (CAEU) created in 1964 to implement the Arab League's Arab Economic Unity Agreement (ratified

[1] Oxford Economic Forecasting

in 1957 by 12 Arab countries). The objectives of the Arab Economic Unity Agreement were not too different – in principle – from those of the EEC at the time, i.e.

- Freedom of movement of individuals and capital
- Freedom of exchange of domestic and foreign goods
- Freedom of residence, work employment and the practicing of economic activity
- Freedom of transport, transit and civil airport facilities
- Freedom of ownership and inheritance.

The CAEU was also very much structured like the EEC at the time with a Council (i.e. the organisation's legislative arm not unlike the Council of Europe), Permanent Committees and a General Secretariat. It also has some landmark achievements such as the establishment of the Arab Monetary Fund, the Arab Organisation for Investment, Double Taxation Agreement, Social Insurance Agreement and Mobility of Labour within the CAEU states. It also created several unions and federations, among them the General Arab Insurance Federation (GAIF).

However, for various historical political and economic reasons, CAEU did not progress in the same direction and at the same pace as the EEC, which pushed ahead with political union and enlargement.

<u>The Arab region can be loosely grouped into four groups, namely</u>

- North Africa (Maghreb),
- The Middle East belt spanning south from Syria, through Lebanon and Palestine and to the East to Jordan and Iraq
- The Gulf Cooperation Council Countries
- Others, including Yemen, Sudan, Mauritania, Somalia. etc.

The average insurance spending per capita in the Arab (MENA) region was US$ 53 as at the end of 2006. The Arab region with the highest insurance spending per capita was the GCC (being an average of US$ 165). This is less than 6% of the average insurance spending per capita in the European Union. Furthermore, the GCC region, having the highest insurance spending per capita also has the lowest insurance spending as a percentage of GDP.

Arab Region	Insurance	
	Per Capita	% GPD
GCC	US$ 165	0.83%
Syria, Lebanon, Jordan, Palestine ..	US$ 107	4.46%
Maghreb	US$ 25	1.19%

Therefore, notwithstanding that real GDP growth in 2006 (and the annual average for the last decade) in the Middle East and Central Asia exceeded not only the global average but also that of North America, industrialised countries, Europe and Japan, insurance remains relatively underdeveloped in the whole of the MENA region.[2] Furthermore, within the Middle East, Jordan and Lebanon have a higher Insurance/GDP ratio than that of the Gulf or of other oil-producing Arab countries (such as Algeria or Iraq). A segmental analysis would perhaps illustrate that insurance is therefore less widespread among personal clients and small to medium-sized enterprises, which, in industrialised countries are the '*bread and butter*' business of the insurance industry.

There is also significant disparity between the respective geographical MENA segments mentioned above. It is also indicative of markets that are more biased towards protectionism or an imbalance of power favouring suppliers. This can be easily tested against objective benchmarks laid down by the International Association of Insurance Supervisors (IAIS). According to IAIS the following factors determine the level of development or sophistication of (and competitive environment in) an insurance market[3]:

- Insurance companies' capitalisation
- Technical reserves
- Investment opportunities in the market environment and financial market volatility
- The extent of reliance on and availability of the reinsurance coverage
- Aggressive underwriting/claims
- Corporate strategies and tacit practices
- Availability of sound statistical information

Relating these criteria to the experience of various MENA countries (in comparison to the experience of various EU countries), one can elicit the following:

1. **Protectionism and Government Involvement**: Throughout the whole of the MENA region, there are several examples of direct or indirect government involvement in the ownership of insurance companies. In contrast, within the EU, from the first generation directives in the 1970s until the implementation of the 'open border' insurance policy in the 1990s, European governments started to systematically divest from ownership and or control of companies as well as abrogating compulsory legal cessions. Whereas, for example, Malta and Italy removed the compulsory reinsurance cession in general and life assurance business respectively by 1995, the Kingdom of Saudi Arabia introduced it in its insurance legislation in 2005, whereby 51% of each risk (i.e. 30% of each direct risk and at least 30% of its reinsured portion) has to effectively be insured and/or reinsured within the Kingdom. Also, from a protectionism perspective, whereas the emphasis of EU governments has been on '*prescriptive*' regulations, including solvency, to safeguard consumers, there are instances in the Arab region of government involvement favouring economic protection over consumer welfare. In 1995, for

[2] Insurance Day 20th August 2007
[3] www.iaisweb.org

example, Morocco, took control of the major insurance companies at the time in an attempt to prevent economic collapse. In contrast, EU applicant countries, such as Cyprus, Malta, Bulgaria, Romania, the Czech Republic, Poland, Slovenia, Slovakia, Lithuania and Latvia (most of which having just exited 40 years of communist totalitarian regimes) where already liberalising their insurance sectors in anticipation of EU membership even though, for some of the countries, EU membership took another 9 – 12 years to happen in view of ongoing economic restructuring in other sectors.

2. **Market Collusion and Tacit Practices**: This is prevalent in many MENA markets. For example, within the UAE itself, Dubai companies struggle to participate in certain risks in, say, Abu Dhabi. In Kuwait, to cite another example, more than 80% of the business is in the hands of the national companies; notwithstanding that foreign companies have a license to practice insurance in the country. This is legally and ethically unacceptable in Europe.

3. **Aggressive Underwriting Practice**: Although most Arab markets are renowned for underwriting aggression, this is not to be mistaken with market competition. In a competitive environment, one assumes not only that the products being sold are quasi-homogeneous (which other than for packaging and delivery facets is generally the case with insurance) but also that:

    a. *There is a wide choice of suppliers from which a consumer may choose*. Although this is the case in some Arab markets, such as Dubai, Bahrain, Jordan etc. there are markets where certain companies enjoy too dominant a position;
    b. *Significant Consumer knowledge sufficient to make learned decisions*. Tacit agreements or government involvement in some Arab markets prevents this. Furthermore, even in some of the more progressive of markets, such as UAE (with an insurance penetration of 1.7% of GDP, i.e. one of the highest in the Arab world), consumer knowledge is very weak. This is evident, for example, in bancassurance practice where the risk premium on some products is less than 50% of what is charged to the clients. In contrast, In Europe, intermediaries are obliged by law to declare their remuneration.
    c. *Competition limits the extent of economic rent that a company can earn in the long run*. It is not unusual for companies in certain Arab Markets to register super-normal profits. Various factors contribute to this, namely the effect of markets that are still rapidly developing, protectionist or tacit practices, low consumer knowledge or government intervention.

The above project a substantial difference in the profile of the Arab (MENA) markets when compared to the European Union. That is no to say that one market is inferior to the other but it is certainly to be noted that whereas the EU market as a whole is more mature in every respect, the Arab (MENA) markets are still undergoing significant changes as they emerge economically.

4. **Statistical Information**: The availability of timely insurance statistics on a MENA basis is, of course, another challenge indicating that the region is still emerging. The European Union, by virtue of the strong regulatory requirements in each of the member states as well as the cohesion of the respective national insurance associations within Comité Européen des Assurances (CEA) provide regular and up-to-date market statistics on a EU-wide basis

b) *Some Pertinent Questions*

In conclusion, whilst both regions have their respective, distinct strengths and weaknesses, it is not possible to draw a proper comparison within the two regions because of the inherent difference between the two blocs. This will adversely impact the ability to assess whether EU harmonization laws can be applied to the MENA region and, if, yes, to what extent.

As stated earlier, the European Union is a single political and economic bloc with an elected European Parliament (representing all countries) and directives that are applied universally throughout the European Union. More importantly, based on a '*common welfare*' philosophy, the European Union actively seeks to harmonize entire economies (and not just individual sectors, such as the insurance sector) of all the Member States. Therefore, harmonization strengthens the region as a whole and is not perceived by individual members as a threat to the stability or prosperity of their individual economy. The MENA region, whilst having regional affiliations, is not a single political and economic bloc. The implementation of common (or regional) economic measures may be perceived by individual Arab states as an intrusion on sovereignty depending on whether they are considered to be economically beneficial or detrimental to the respective individual Arab state.

Therefore, a few pertinent questions come to mind. In attempting to create harmonization in the whole of the MENA insurance industry

1. Which regional institution would be the driving force behind the implementation of harmonization laws in each of the MENA states?
2. Is such a regional institution sufficiently empowered to ensure that individual MENA states comply?
3. At a political level, what interest do individual countries within MENA have towards implementing harmonization? It is understandable that the regional insurance industry feels that harmonization is beneficial to the whole region. But will all the governments of individual MENA states share this view? Also, going one step back, is this view shared by all individual national insurance associations of each of the MENA states? Or would some feel threatened

by the financial strength or competitively of others and, therefore, feel compelled to remain protectionist in the interest of their individual economy.

These are burning issues that would need to be addressed if one has to progress from what is otherwise an academic representation of facts to concrete action towards the harmonization and development of the insurance market in the Arab world.

3. The European Union: Integration of Insurance Legislation

Concerted effort towards the harmonisation of insurance legislation within the, then, European Economic Community (EEC) commenced in the 1970s with what were known as the 'first generation' directives. These directives focused on the freedom of establishment of operations in life and non-life companies. The process was a laborious one since it involved the consent of a large, and growing, community of countries. Certain areas of significant effect on insurance, such as contract law, continue to fall under the independent domain of each member state and are, therefore, subject to minimal harmonization efforts.

The main advantage of harmonization of insurance law is the "*creation of a broad, joint legislative platform for all Member States which, whilst not totally wiping out the identity of their respective markets, has managed to weld them together into a continent-wide single market with much more marked consistency than that of the North American Market*."[4]

But, to achieve this, volumes of directives and regulations have been drafted that now create the need for a simpler, single, codified regulatory framework that offers consistency and transparency throughout the whole of the European Union. Directives to date (spanning back to 1972) include some 15 life and non-life directives, around 15 directives, decisions or recommendations specifically on Motor Insurance as well as directives on E-commerce, distance selling, intermediation, conglomerates, accounting, reinsurance, liquidation and supervision.

In addition to the above, as a pre-requisite to directives or recommendations, there are also extensive enquires (or research on an EU-wide basis), which give rise to recommendations by national insurance associations as well as by the central European committee (Comité Européen des Assurances or CEA) on behalf of member countries. In the past these have included research on SME business, their contribution to insurance revenue and loss ratios, business distribution, broker conduct, insurance pools, consumer protection, claims settlement and so on.

This activity goes beyond co-operation. Harmonization requires a high level of integration between the Member States. Harmonization, or integration, has to be at a level that is much wider than just insurance or financial services; i.e. the degree of integration outlined in the Introduction to this paper.

Even with such a high level of coordination between individual EU Member states, it is still felt by the EU member states themselves that there is still a long way to go for full integration of the EU insurance market.

[4] CEA Policy Report 2004: Prospects for Simplifying European Insurance Legislation

4. Significant EU Insurance Regulations – Can they apply to the MENA Region?

a. Single Market: Cross Border Activity

More than 25 years have passed since the publishing of the ‘first generation’ directives aimed at the harmonisation of insurance regulation and practice. Although significant progress is evidenced in this respect, the 2004 CEA Report entitled ‘*Prospects for Simplifying European Insurance Legislation*’ states that there is still a long way to go to achieve full integration.

Bearing in mind the EU’s experience in this respect and the inherent differences between the EU and MENA regions (particularly in the paramount role that individual state sovereignty plays in Arab countries), full market integration or comprehensive regulatory harmonisation would not be achievable in insurance.

However, this does not mean that there aren’t specific areas of insurance practice that cannot be successfully harmonised on a pan-Arab basis. The following are some examples:

i) **Liberalisation of certain insurance classes**: Certain classes of insurance, such as Marine, Aviation, Transportation/Road Haulage etc. are international in nature. Most of these classes of business in industrialised countries, including the EU, would generally be exempt from the legal requirement to purchase them on an ‘admitted’ (i.e. local basis). Hence, for example in transportation insurance, importers can freely purchase goods on a CIF basis (insurance being arranged by exporters overseas). This is not the case in all Arab countries. Furthermore, notwithstanding that most companies do not, individually possess the capacity or expertise to underwrite, for example, Aviation, Energy or Marine Hull business, legislation in individual Arab states would still require such business to be insured (or more often the case fronted) within their respective local market. This limits the consumers’ ability (most of whom can be considered to be international or major regional companies) to seek insurance directly from other markets. This also deprives strongly rated Arab insurance companies, who otherwise write these classes of business in other markets, from successfully competing for such business on a direct basis.

Arab countries can either opt for full liberalisation or, alternatively for recognising insurance for such classes as ‘*admitted*’ if purchased from other Arab states. Both scenarios require minor amendments to the insurance laws in the respective countries. In the case of the latter recommendation, one can also contemplate a phased approach, i.e. starting first with simultaneous reciprocal recognition within smaller blocs of the MENA region (i.e. the GCC, or the Maghreb) with the intention of ultimately consolidating the practice on an Arab (MENA) basis.

ii) **Liberalisation of Insurance for Conglomerates**: The growth of certain commercial and/or industrial concerns, particularly from the GCC region, has resulted in business acquisition or development in other regions. 'Admitted' insurance regulation in each of the Arab states prohibits, for example, a UAE company from purchasing insurance to cover the assets of one company in, say, UAE, Lebanon, Jordan and Egypt under one policy in the UAE without the need of fronting in each of the other countries. This is further complicated if differing conditions or market practices exist in the respective regions. Currently, this problem is overcome by means of a system of fronting, coupled with '*Difference in Conditions'* or '*Difference in Limits'* policies. If insurance laws in the respective Arab countries exempt conglomerates from the requirement of buying insurance on an 'admitted' basis, the process of insurance purchasing would be greatly simplified for the conglomerate buyers. They would also have a wider choice of markets to purchase from if the exemption does not limit companies to purchase insurance from the country where their Head Office is situated. Initial EU regulations were aimed at facilitating the purchase of insurance for pan-European companies and this was, arguably, the first step towards greater market liberalization. Again, this is a practice that can be initiated first by agreement within smaller blocs of the MENA region (i.e. pan-GCC, or Maghreb) and later consolidated on a wider geographical area.

iii) **Harmonisation of Claims Sharing Agreements Cross Boarder Motor Insurance**:
Earlier this year, the Bahrain Insurance Association announced the signing of a market agreement to facilitate motor claims recovery procedures in the Kingdom[5]. This is a positive move forward and there are lessons to be learnt by other Arab countries.

In this respect, there are also various lessons to be learnt even from Europe (for example the CICOS system adopted in Spain) which have bound motor insurers to direct settlement agreements irrespective of blame. Within 5 years of implementation, this has cut the average time required to settle motor claims by more than 75%.

The harmonisation of claims settlement (particularly in Motor) over a specified geographical region helps the further development of cross-border insurance since companies would have the comfort of a level playing field in claims settlement. Through CEA, Europe applies an International Claims Sharing Agreement. The advantage of the agreement is that it enables insurers to recover 50% of claims (in the case of collision involving two vehicles and up to the limit of a pre-agreed maximum limit) thereby significantly reducing the costs inherent in the management of an international claim.

[5] Bahrain Tribune 11th July 2007

However, for these processes to be successfully implemented there also needs to be agreement on the underlying laws and practice governing motor insurance and liability arising out of motor in the various Arab countries. There is, for example, disparity in practice on what constitutes 3rd parties (particularly in relation to family members as passengers), compensation levels as well as the acceptance of 'loss of use' as a valid component of private motor claims.

iv) **Border Motor Insurance/International Motor Insurance System**:

In Europe, it is not even necessary to purchase the 'Green Card' when travelling to all EU member states plus Andorra, Croatia, Iceland and Switzerland, whereas in the Arab region the General Arab Insurance Union (GAIU) is still debating how to overcome the challenges of fully implementing the Orange Card system.

GAIU discussions also focus on the closer cooperation of Arab insurance companies through the unification of laws and legislation within the member Arab states[6] aimed at greater mobility between Arab countries. However these actions beg such questions as:

- *Why did the UN Council of Bureaux decide to limit the scope of the Motor Insurance Card system (Green Card) in 1996 effectively excluding, among others, the participation of Arab States?* Report of the President of Council of Bureaux[7], states that discussions with the General Arab Insurance Federation re-commenced in 2004 for the inclusion of the Orange Card system.
- *Why isn't the Orange Card system widely used in Arab states?* There is disparity in practice, whereby private motor policy holders often buy 'border insurance' to ensure that they have adequate insurance protection when visiting neighbouring countries, oblivious to the fact that the insurers in their home country can provide them with an orange card.

The harmonisation of insurance laws, claims practices and compensation with Arab States can be achieved with the effective coordination of a regional institution or union such as GAIU or GAIF. Their subsequent ratification by each Arab member state would ensure better mobility for Arabs as well as providing the platform for harmonisation with the Green Card Bureaux.

[6] Minutes of the GAIU Meeting November 2005
[7] UN Economic and Social Council Working Party on Road Transport 27-29th October 2004 (Agenda Item 6(d)(i))

b. Licensing, Regulation & Supervision

Wide-scale consensus on the harmonisation of insurance laws is probably not possible. This opportunity has, for example, presented itself within the GCC region over the past 5 years where Bahrain, Qatar, UAE, Saudi Arabia and Oman have independently implemented major changes or enacted fresh legislation. All laws are significantly different from each other, whether because of compulsory reinsurance cessions, or majority local ownership or in capital and/or solvency requirements etc. If such an opportunity has been bypassed in one of the larger MENA blocs, how much more difficult would it be to achieve consensus on a whole MENA region?

Because of this a better objective would probably be to seek to harmonise specific licensing and supervision issues rather than harmonising insurance law as a whole. In this context, one can learn more from the relationship that, for example, the European Union has with the European Economic Area (EEA) countries, such as Iceland, Liechtenstein and Norway. Such countries, although not members of the European Union, enjoy 'passporting' benefits when transacting business with EU member states.

Whilst a company in, say, Iceland (a country outside the EU but in an EEA member state) cannot have its UK activities supervised by the Iceland regulator (these have to be regulated by the UK Financial Services Authority) it provides the opportunity for an EEA company to transact business within the EU provided that it is regulated by an EU insurance regulator. This process of mutual recognition and cross-border supervision and regulation can easily be implemented by reciprocal agreements between individual Arab countries. This would promote harmonisation of supervision laws between participating Arab countries to ensure a fair and level playing field, subsequently enabling agreements to cover wider Arab regions supervision processes in the respective countries to become more similar.

c. Foreign Insurers' Involvement and Host Country Supervision

As a single market, there are no restrictions on cross border ownership within the European Union. For examples British companies, such as Cornhill, Minster and GRE have long been owned by Allianz (German), GAN and AXA (French) companies respectively.

Furthermore, there are no legal restrictions to foreign insurers either applying for a license to operate in the EU or purchasing shares in EU countries provided that they are subject to the scrutiny of the insurance regulators (and in case of ownership in public listed companies, stock exchange regulations) in the respective EU member state. A foreign insurer licensed and regulated by one EU member state has full '*passporting*' rights throughout the EU.

Market liberalisation, both in terms of majority share ownership as well as licensing of foreign companies, provided that foreign insurance companies are suitably regulated and supervised by the insurance authorities of the host country, would constitute a significant breakthrough in market liberalisation and harmonisation within the Arab world.

In the Arab (MENA) region, this can be implemented in phases, among member countries of smaller blocs (such as GCC or Maghreb) first, with the objective of achieving liberalisation within a larger Arab (MENA) region.

d. Consumer Protection

Some argue that, for example in the United Kingdom, institutional regulation will succeed where self-regulation of professional insurance bodies has failed in protecting consumers. This, of course, is not entirely the case, bearing in mind that various European countries have, historically, taken great care in protecting consumers particularly in the micro-environment, i.e. in individual disputes. Legislation has traditionally concentrated more on protecting the customer from, for example, company insolvency. Scandinavian states have had an Ombudsman service (the word Ombudsman is, in fact, a Scandinavian word) for over a century. In the United Kingdom, before the creation of the Financial Ombudsman as a government institution, insurance companies bound themselves to provide this service through their professional associations. In personal insurances, a UK insurance company, for example, bound itself by a decision of an Ombudsman (up to a pre-determined financial amount) but allowing the client to seek recourse in the courts if dissatisfied with an Ombudsman decision.

Whereas more recent insurance legislation in the Arab world has addressed the macro-consumer protection issues by improving capitalisation and solvency measures, they have not adequately addressed the micro-environment; the protection of an individual policy holder in the event of a dispute with an insurance company.

Regulation towards institutionalising an ombudsman service as well as insurance arbitration on a wide scale is another area which can be addressed on a regional (Arab) basis.

This will also significantly increase consumer confidence in the industry.

e. License-driven Qualifications

Recent insurance legislation in various Arab countries contains provisions to ensure that qualified insurance practitioners are engaged, at least in senior positions, within insurance companies. The new UAE Insurance Law (2007) goes as far as to state that one of its objectives is to set up an 'insurance institute'[8]. There are training institutions of repute in the region who, through the years have contributed to insurance training in the Arab world. Unfortunately the devil (and substance) is in the detail and this topic begs a number of questions, namely:

- To what extent do individual Arab markets rely on qualified or experienced expatriate staff in the insurance sector? The whole of the GCC, for example, (the largest of the main Arab blocs) is almost entirely dependent on expatriate employees.
- In the markets where locals represent a higher percentage of the insurance labour force, how qualified or experienced is the local component of the work-force? Although qualifications have been developed for foundation and intermediate insurance education, there is still a major gap in the market in terms of graduate or post-graduate level insurance education of real value.
- What is the true investment in insurance training and development if one had to discount training levies imposed in some Arab states?
- To what extent are insurance licenses driven by qualifications? Whilst this may be the case – in some Arab markets for, as an example, an insurance broker – it is not the case for agents, sales persons, financial advisors etc.
- How many qualified Arabs are providing ancillary professional support, such as loss adjustors, actuaries, insurance arbitrators etc. to the industry?

In one particular sector, i.e. insurance regulation and supervision there has been a regional initiative between 2002 and 2006 (under the auspices of the First Initiative Organisation and funded by the World Bank)[9] to train regulators from the MENA and Maghreb regions in Capital Adequacy and Solvency, Preventive and Corrective Measures and Life Insurance Company Analysis. But this seems to be an isolated initiative.

More needs to be done in training and development both in the regulation and supervision aspect as well as in the other areas outlined above. This is an area where an insurance federation such as GAIF (enjoying support from the whole region), with the assistance of regional or international funding, can make a big difference. Specifically, plans can be drawn up for a framework of

- Insurance qualifications that are relevant to the Arab insurance markets. This would also take into account existing qualifications and how they measure up to market requirements;
- License-driven qualifications to serve as a guide to individual Arab regulators in drafting qualification requirements;
- Funding and sponsorship for approved programmes of studies.

[8] UAE Federal Law 6 of 2007 – Chapter 2, Article 7.3
[9] First Initiative Project Ref No 359

Under the auspices of CEA, in Europe, European training institutions meet regularly and take concrete action to develop the whole industry across Europe. For example, the Federation of European Training Institutions was discussing the impact of the Intermediation Directive before it was actually implemented. One also has to mention that CEA is made up of 33 member-countries, i.e. including representatives from European countries that are not part of the EU.

Similarly an association such as GAIF can create the correct platform for a Federation of Arab Insurance/Financial Services' training institutions as well as a unified force for harmonising legislation in this respect.

f. Enterprise Risk Management and Solvency II Requirements

The practice of Enterprise Risk Management in Europe when compared to the Arab world can be summed up as follows:

- ERM is a '*must have*' regulatory requirement in Europe evermore so under Pillar III of the proposed 'Solvency II' requirements;
- In the Arab world ERM is a '*nice to have*' requirement if a company is aspiring for a higher rating by the credit rating agencies such as S&P or A.M. Best.

'Solvency II', the first draft of which was presented to the European Parliament in October 2006 (following a lengthy quantitative impact exercise in Europe) is expected to be incorporated in EU law in 2008. This will be followed by the individual adoption into their laws by each EU member state also within 2008.[10] However, prudential and/or solvency regulation in Europe has existed for some 30 years.

Whereas prudential regulations (known as 'Solvency I'), fundamental to Enterprise Risk Management, have been enforced in Europe since the 1970s, solvency issues and their regulation have only started to take centre stage in many emerging insurance markets (including Arab countries) after the establishment of the International Association of Insurance Supervisors in 1994. It is fair to state that 'Solvency I', currently in force, focuses more on underwriting risk and not on market risk. Individual regulators in Europe proposed and/or adopted their own additional rules to analyse the wider risk management or market risk implications. These included:

- Denmark and Sweden: 'Traffic Light' System
- Germany: GDV Model
- Holland: FTK Model
- Switzerland: Swiss Solvency Test
- 'United Kingdom: ICAS Model

[10] 'Individual Capital Assessment' Guidelines (International Underwriting Association/Association of British Insurers/Lloyds Market Association/ Investment & Life Assurance Group, February 2007) and 'Prudential Requirements for Insurers', (FSA Board, 15th December 2006)

In all cases, regulators assess 'economic models' based on market prices of assets and liabilities and capital requirements. What Solvency II brings to the table[11] is an early assessment of the true risk (and realistic risk profile of the supervised entities) with the corresponding economic capital requirements and a timely supervisory intervention before a crisis situation occurs. It is a risk management regime with a strong pre-emptive bias.

The Solvency II framework is a holistic approach to Enterprise Risk Management based on three pillars, i.e.

- Pillar I: Defines the financial resources required for a company to be solvent and introduces quantitative requirements in the form of the '*Solvency Capital Requirements*' (SCR) and the '*Minimum Capital Requirements* (MCR)'
- Pillar II: Defines more qualitative regulation requirements
- Pillar III: Focuses on '*Risk Disclosure Requirements*'.

The focus on operational and market risk management, in addition to underwriting risk management, though largely new within the regulatory framework, is not new to the industry risk management practice. Enterprise Risk Management as a discipline and, more so, as a culture, has been constantly evolving in the Western world over the past 3 decades. In certain parts of Europe this was even more the case because of a traditionally higher element of self-regulation in the industry. The implementation of Solvency II will arguably be the result of the converging forces of:

- Harmonized regulatory regimes on a model that favours 'regulator-driven' systems as opposed to self-regulation;
- Benchmarking of 'industry best practice' in Enterprise Risk Management from leading insurance markets such as the United Kingdom, Nordic countries, Germany, Switzerland etc;
- Development and universal adoption of IFRS practice;
- Legal cases and subsequent industry response that helped shape a culture of Enterprise Risk Management.

The above indicates that Risk Management practice is very much a culture (and not merely a regulatory or credit rating requirement) in Europe. This is a marked difference from the Arab region.

The successful implementation of Enterprise Risk Management in the Arab world, encompassing the management of underwriting, operational, investment, credit and market risks would have to be 'regulator' driven. Arab countries that have recently overhauled their insurance regulatory framework such as Jordan and Bahrain as well as new insurance jurisdictions such as DIFC (Dubai) and QFC (Qatar) have in-built elements of Solvency Margin and Minimum Capital requirements regulation. Furthermore, there is a history of consultative and impact assessment papers from Europe on which

[11] Solvency II – FAQs (CEA Consultation Paper – February 2007) and Introductory Guide to Solvency II (CEA / Tillinghast Towers Perrin – June 2006)

regulators in the region can benchmark the implementation of a more dynamic economic capital regulation.

For a change in this area to become a culture it would need to be driven by regulators in the same way (and maybe to a greater extent) that regulators played a great role in shaping prudential rules in Europe. A major project to build common structures for the assessment of insurer solvency has been initiated by the International Association of Insurance Supervisors (IAIS)[12]. A number of Arab countries, such as Bahrain, Oman, Qatar and Jordan are already members of IAIS.

g. Competition

True competition (and not fierce underwriting) is probably the largest challenge to the Arab region as a whole as it needs greater market transparency, higher intermediary involvement, greater market sophistication and, above all, higher consumer awareness.

The above process, namely

- Greater market liberalisation,
- Foreign insurer involvement,
- Some regulatory harmonisation,
- Institutionalised consumer protection measures,
- License-driven qualifications and
- Enterprise risk management practice/economic capital modelling

will, undoubtedly, provide impetus to create a true environment for greater competition in the market. This will involve the active participation of all concerned, be they insurance companies, intermediaries, consumer associations and regulators and is a step best achieved after all of the above processes are in motion.

[12] The IAIS Common Structure for the Assessment of Insurer Solvency – signed in Dubai in February 2007

5. *Significant EU Insurance Market Practice – Can They Apply to the MENA Region?*

a. Lesson from CEA: EU-wide Insurance Institution

One of the greatest catalysts of change in the European insurance industry is the Comité Européen des Assurances (CEA).

CEA is the Federation or European Association of all insurance associations within the European market. It also has members from other European countries that are not EU member-states.

The Mission Statement of CEA is simple; '*to further private initiative and free competition'*. This it achieves by representing and defending the interests of its member associations as well as by advancing the views of its members at a national, regional or international level.

Over the years CEA has presented over 70 studies/position papers to the European Industry and/or respective European Commissions on:

1. Retail Financial Services
2. Green Paper on Retail Financial Services (CEA's Position)
3. Limitation Periods in Cross-Border Disputes
4. Draft recommendations on Limitation Periods in Cross-Border disputes involving Injuries and Fatal Accidents
5. Legal Expenses
6. Feasibility Study on a Patent Litigation Insurance
7. Damages for Consumers & Producer Liability in Sales
8. Common Frame of Reference
9. European Contract Law (various)
10. Public Consultation on the Future of the Internal Market
11. Law applicable to Non-Contractual Obligations (various)
12. Discussion Unfair Terms Papers
13. Insurance Guarantee Schemes (various)
14. Solvency II
15. Financial Services Action Plan
16. Agricultural Risks
17. Communication on Risk and Crisis Management in Agriculture
18. European Parliament Legislative Resolution of 6 July 2005 (Rome II)
19. Financial Services Policy (various)
20. Financial Services Regulation
21. Commission Communication on Better Regulation for Growth and Jobs in the EU

22. European Financial Integration (various)
23. Money Laundering and terrorist financing (various)
24. Terrorism Coverage (various)
25. OECD Insurance Committee Task Force Terrorism
26. CEIOPS Draft Public Statement of Consultation Practices
27. Insurance and Pensions
28. IAIS Consultation Paper on Combating Money Laundering and Terrorism Financing
29. Industry Practices (various)
30. Alternative Dispute Resolution (various)
31. Improving regulation and supervision of banking, insurance and investment funds
32. Gender Equality in Insurance (various)
33. The Process for Regulating Securities Markets in Europe (various)
34. Investment Services
35. Natural Events
36. EU Solidarity Fund
37. Insurance Intermediation (various)
38. European Governance: European Commission White Paper
39. Internal Market Strategy for Services
40. Modernisation of the Motor Insurance Directives
41. Winding up of Insurance Undertakings
42. Single Passport for European Professional Reinsurers
43. Consumer Information
44. Jurisdiction and Enforcement of Judgements in Civil and Commercial Matters
45. 'Fit and Proper' Criteria for Managers, Directors and Shareholders of Insurance Companies
46. Freedom to provide services and the general good in the insurance sector
47. Simplifying Insurance Legislation
48. Impact and Effectiveness of a Single Market
49. Participation of Foreign Insurance Companies in the Activities and Governing Bodies of National Associations
50. Public Procurement in the European Union

Drawing a parallel with the Arab world, GAIF is the federation to which Arab insurance companies subscribe to. Several initiatives have been initiated under the auspices of GAIF over the years but, as an organisation, it is less visible as a unified voice for the whole of the Arab insurance industry when compared to CEA. CEA's presence is evident from the above studies and technical papers, most of which have had significant impact at European Parliament or Council of Europe level in shaping the European Market as a single market.

GAIF can also be a catalyst in implementing greater harmonisation in the insurance laws of the various Arab states. Drawing on the above examples where harmonisation can be effectively implemented, GAIF can create the necessary framework for respective countries to ratify in:

- Cross-border trading particularly for the recognition of insurance policies from other Arab states in the case of Arab multi-national companies;
- Liberalisation (and the recognition of other states) of marine, transportation, aviation and energy insurance;
- Foreign ownership of insurance companies
- The participation of foreign insurance companies in government and/or parastatal insurance tenders
- The removal of compulsory reinsurance cessions
- A common policy on the licensing and supervision of foreign insurance companies
- A unified structure of compensation, unified legal interpretation and harmonisation of motor insurance in Arab states
- A common policy on license-driven qualifications and continued professional development in the insurance industry
- Systematic implementation of Enterprise Risk Management and Economic Capital Modelling supported by regulation
- A structured dismantling of barriers to competition within and, subsequently between, Arab states.
- A common policy on consumer protection and mediation systems that offer a faster and more economical alternative to the courts

b. Market Agreements

Examples of successful market agreements emanating from Europe have been described earlier in 4a(iii)[13] in relation to international claims sharing agreement for Motor Insurance.

Agreements can also be achieved in other areas, particularly in relation to licensing and supervision and GAIF can play an important role in this respect.

c. The Human Capital: Resource Development

The area of human capital has also been expanded upon earlier under 4(e). Again, GAIF can play an important role in creating the necessary framework to promote pan-Arab insurance education, to identify funding and to undertake projects that promote insurance education and continued professional development in the Arab insurance markets.

[13] Pages 13 and 14 in this document

d. Public & Private Sector Partnerships

The insurance industry does not operate in a vacuum. It exists to serve customers and to pay claims. Relevant authorities regulate its operations. A successful environment is one where the three parties in any economic system, i.e. buyers, sellers and regulators, work in tandem for the long-term development of their market.

<u>Examples of public-private sector partnerships in the European insurance sectors include</u>:

- In Denmark, Belgium, Finland and Portugal workmen's compensation schemes for accidents at work have been successfully assigned to the insurance companies. Insurers developed the products beyond public service expectations particularly in risk prevention and rehabilitation;
- Social Insurance (known as GOSI in some of the Arab countries) has been privatised in Holland. Financial incentives were introduced for employers to focus on loss / illness prevention and on the re-integration of disabled employees into the work-stream.
- The MUFACE system in Spain provides civil servants with the possibility of opting out of state health care and over 80% do so.
- In Denmark, Sweden, Belgium, Germany and Holland private health care has either substituted or provides additional coverage to what the general public health service offers.
- One area where state-private partnership does not seem to have gained ground is in pension provision. For example, in the United Kingdom, the 'Stakeholder' pension scheme introduced in 2001 with an objective of increasing savings in simple, low-cost private pensions seems to have fallen short of expectations.

In some Arab states, the state – insurance market relationship has been more 'prescriptive'. For example, in order to counter the rising public heath sector costs in the GCC, various governments have either implemented or are in the process of implementing Private Healthcare legislations whereby all expatriate residents need to be supported by a private healthcare plan. This is creating significant concerns particularly among the low-income workers (of whom there is a significant percentage) in the region. Abu Dhabi has gone the extra mile towards partnership with the creation of DAMAN, a quasi-government insurance company, with private insurance/reinsurance participation, that offers a spectrum of insurance products including products specifically designed to meet the needs of low-income consumers.

There are other areas, especially in the Employer's Liability, Workmen's Compensation, Medical Insurance and Social Insurance where greater public-private sector cooperation can further develop the Arab insurance markets.

e. Insurance Awareness Initiatives

Although not a regulation matter, this is another area where European insurance industry excels and where there are potential learning points for Arab insurance markets to embrace. The direct objective of awareness initiatives is to 'educate' consumers in insurance by proving neutral information on risks, their management and the role of insurance.[14] Sadly, association-driven awareness campaigns are largely absent in the Arab insurance world. Some of the more notable examples from Europe are:

- The Association of British Insurers (ABI) helped set up an educational organisation – Personal Finance Education Group – to educate young people on how to make independent and informed decisions on personal finance and investment choices. ABI also sponsored the development of a 'Workplace Education Programme' aimed at teaching adults more about insurance, finance and credit/debt.
- Assuralia (the Belgian Insurance Association) provides educational material to secondary schools on insurance topics
- The Austrian Insurance Association (VVO) provided teacher training material in the form of a 'Guide of Insurance Business Lines'
- The Danish Insurance Association[15] provide an online pension enquiry service called "Pension ABC" (meaning pensions made simple). The Danish insurance sector has over 70 years experience in providing answers to insurance consumers
- The German Insurance Association (GDV) established an information centre 'Klipp & Klar'[16] providing updated information on insurance products

Although not directly linked to the selling of insurance, these initiatives propagate knowledge that, in turn, helps consumers make informed buying decisions about insurance. Consumer knowledge is one of the key determinants of competition in insurance.

How can this be implemented in the Arab markets? There is a wide spectrum of media through which to develop consumer education. These include media (TV/radio) spots, sponsoring of internet spots on official/popular local/regional websites, brochures and publications, Call Centre (Hotline) services, specialised websites, education supplements with popular newspapers or journals, regular columns in magazines on varied insurance topics (or question and answer service in a magazine with a wide readership), sponsoring of educational materials for teachers/schools or

[14] CEA: Awareness Initiatives Promoted by the European Insurance Industry
[15] http://www.forsikringenshus.dk/pensionsABC.aspx
[16] http://www.klipp-und-klar.de

'Insurance Association Road Shows' to senior schools, colleges or universities with a specific and neutral educational insurance agenda.

The effectiveness of such campaigns would need two-pronged support, i.e. the campaigns would need to be under the auspices of a national insurance association (i.e. representing the insurance industry as a whole) but may need to be financially supported by specific market 'champions', i.e. leading insurance companies in each respective market.

6. Conclusion: Learning Points

It is fair to say that whereas the European Union presents us with a relatively mature and integrated insurance market, driven in practice and regulation mainly by the older and more established individual jurisdictions or markets, the Arab region consists of a collection of relatively young and autonomous insurance markets lacking any form of organic cohesion.

This, however, does not mean that in comparing the two we are comparing apples to oranges. We are comparing stages in a life cycle that all markets have to go through *albeit* not necessarily in the same manner or at the same pace.

All insurance markets aspire for greater:

- Market competition
- Technical sophistication/expertise
- Product diversity (i.e. finite products and alternative risk transfer solutions in addition to traditional insurance)
- Emphasis on technical results
- Greater regional co-operation
- Fair, transparent, effective and consistent regulatory enforcement
- Greater consumer awareness

These are the characteristics of and driving forces behind a developed insurance market. It is fair to say that the European Union (or a significant number of member countries within it) have achieved these. Of course, each of these characteristics is, in itself, in a state of continuous evolvement. These are also characteristics that the Arab insurance markets (and not individual companies or countries working in isolation) need to aspire for.

<u>The main learning points are that</u>:

1. The European Union has achieved what it has achieved in insurance over a period of more than 30 years;
2. As a precursor to a single insurance market in the 1990s, effective integration measures started being implemented as early as the 1970s over a period of 20 years. These included cross-border acquisitions and cross border supervision, liberalisation of certain classes of insurance and harmonisation of solvency rules;
3. Efforts were largely successful because of the active participation and investment of insurance companies within their respective national associations consolidating, at EU and EEA level, in the Comité Européen des Assurances (CEA).

Therefore, although not an integrated region, the Arab market can also implement regulations and practice that will help the region's insurance industry develop.

From a regulatory perspective a lot can certainly be achieved within the Arab region in cross-border trading and the recognition of insurance policies from other Arab states in the case of Arab multi-national companies liberalisation (and the recognition by other Arab states) of marine, transportation, aviation and energy insurance policies and foreign ownership of insurance companies as well as a common policy on the licensing and supervision of foreign insurance companies. Of course, a major development area, very much ripe for implementation, relates to common standards in the implementation of solvency requirements.

From a wider legislative perspective other measures can be implemented, such as removal of anti-competitive barriers or tacit agreements, removal of compulsory reinsurance cessions and unified policies in Motor and/or Workmen's Compensation levels.

From a market perspective greater harmonisation in policy interpretation (particularly in Motor Insurance), cross-border recognition and a similar approach to professional development and license-driven qualifications in the respective Arab markets is needed.

Although the process requires concerted efforts at company, country, association and regional basis, the ultimate beneficiaries are the insurance companies operating in the respective markets. It is therefore not imprudent to assume that the industry, each individual company in each of the markets needs to contribute towards the investment required for the project to be a success.