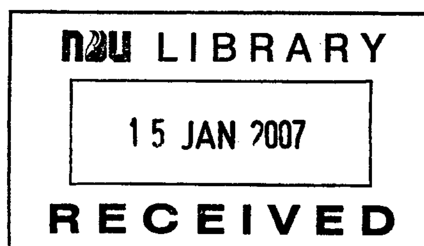
NOTRE DAME UNIVERSITY

INSURANCE, REINSURANCE & ALTERNATIVE RISK TRANSFERS
OVERVIEW, ANALYSIS & OUTLOOK

ELIE J. ABI RACHED

A THESIS SUBMITED IN PARTIAL FULFILMENT OF THE REQUIRMENTS FOR THE DEGREE OF MASTER IN BUSINESS ADMINISTRATION

LOUAZE – LEBANON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BY

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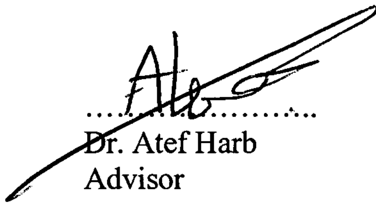
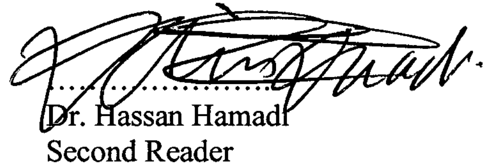
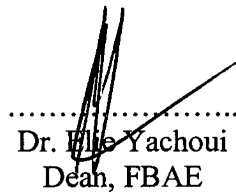


……………………
Dr. Atef Harb
Advisor



……………………
Dr. Hassan Hamadi
Second Reader



……………………
Dr. Elie Yachoui
Dean, FBAE

Notre Dame University, Louaize
Lebanon
2006

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I would like to dedicate this thesis to my parents and my family for their continuous support and concern.

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Elie Joseph Abi Rached

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PREFACE

Contribution

This thesis is about the insurance industry in Lebanon; initially it analyzes the global insurance market (*Chapter 1*) and the Arab insurance market (*Chapter 1*) by presenting key ratios and figures that will help readers comprehend the importance of insurance on a global scale and recognize comparatively the status of the Lebanese insurance industry (*Chapter 2*).

The aims of this study could be summarized to four:

1) Provide a unique, updated and easy reference of the insurance industry in Lebanon.
2) Prove that the reinsurance cover bought by insurance companies in Lebanon is not sufficient to cover the exposure to potential catastrophic events.
3) Provide a solution for this exposure.
4) Introduce a wider perspective to the solution and how it could affect the reinsurance market on the long run.

Several points will be raised in this study, each of which could be developed as a separate research, hopefully in future publications. For example:

1) Mortality table for life insurance in Lebanon.
2) Rating methodology tailored to Lebanese insurance companies.

Methodology

As the accumulated losses incurred from a catastrophic event originate from different lines of insurance, the thesis discusses each line separately, the non-life insurance market (*Chapter 2*) and the life insurance market (*Chapter 2*); which provides a better understanding of the nature of the underlying risk.

The insurance operations will be discussed in details (*Chapter 3*) as it is the backbone for a successful industry. Figures about the Lebanese industry and comparison to other insurance industries are provided.

Mergers, Acquisitions and Alliances (*Chapter 4*) that enhance the insurance company's ability to meet its liabilities and obligations are of high importance to this research.

A simple and brief explanation of Traditional Reinsurance (*Chapter 5*) providing the reader with a basic knowledge of how reinsurance covers work.

Alternative Risk Transfer (*Chapter 6*) is discussed in order to provide financial based solutions to insurance companies. Moreover, a list is provided containing the catastrophic events affecting Lebanon along with expected recurrence periods.

A thorough analysis is applied on the reinsurance structure of Libano-Arabe as well as an application to modify the existing cover.

Finally, conclusion and recommendations (*Chapter 7*) are split to three categories, being "By Line of Business", "By Business Operations", and "Alternative Risk Transfer".

Limitations

Data collected from the insurance companies in Lebanon is for the year 2004, which were released in September 2005, similarly the data of 2005 will be released in September 2006.

As is the case of many companies in Lebanon, some insurance companies try to manipulate their figures in order to avoid some taxes.

Some insurance companies refused to provide consistent figures to be used in the thesis, fearing that such data could be available to competitors.

The initial idea behind this thesis was to create a pool, which provides the extra cover needed for catastrophic exposure to all the insurance companies in Lebanon, as the underlying risk is the same.

Libano-Arabe provided the required data after some negotiations, which lead to a case concentration on the portfolio of this company.

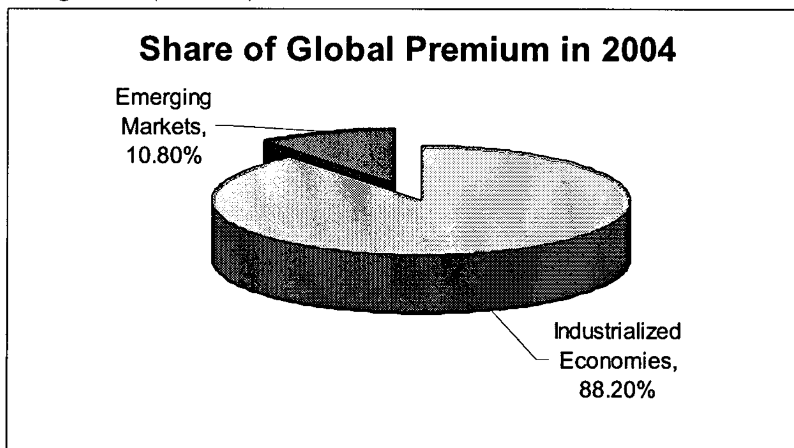
The Market Today

Market Characteristics

Global premiums totaled $3.24 trillion in 2004, of which non-life premiums amounted to $1.39 trillion that accounted for 42.9% of the total, while life premiums reached $1.85 trillion, for a 57.1% share of aggregate. *(Swiss Re)*

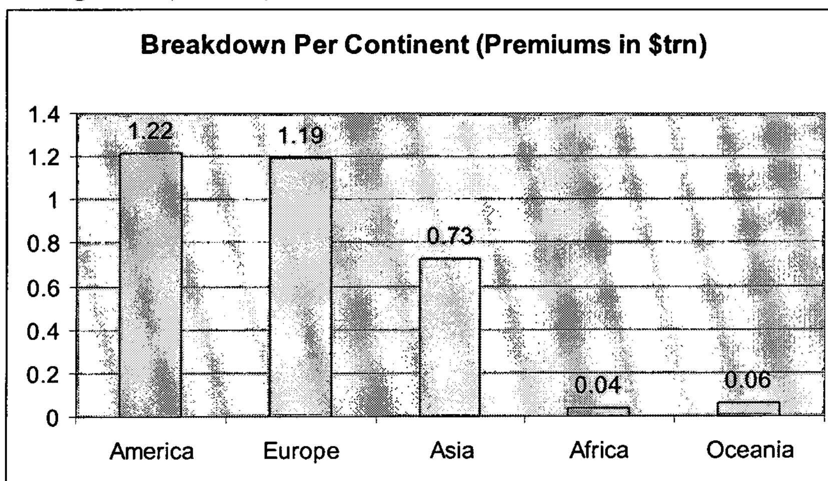
Industrialized economies (such as United States of America, Japan, United Kingdom...) have the most mature insurance markets and continue to dominate the global markets, accounting for 88.2% of total premiums generated worldwide in 2004. Consequently, they generated 90.2% of non-life premiums and 86.5% of life premiums.

Figure 1.1 (Swiss Re)



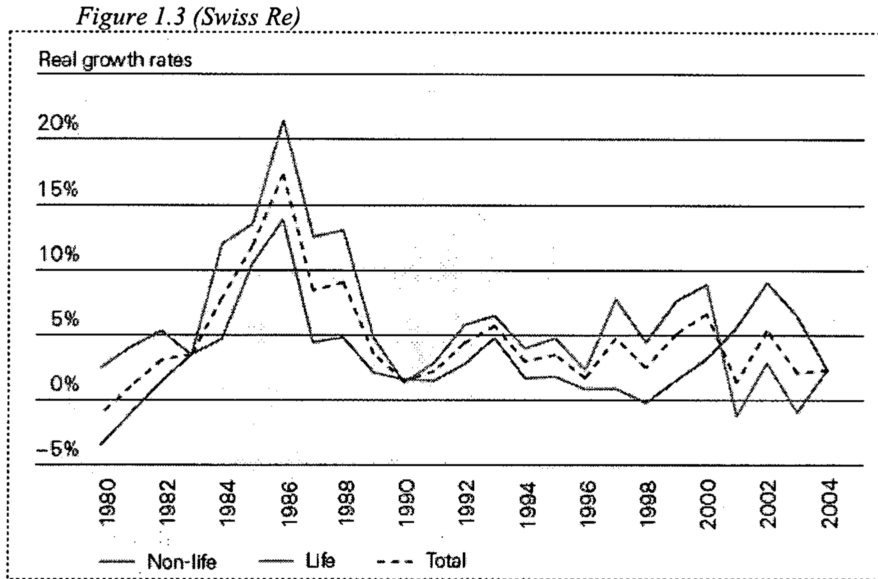
America's market, with a 37.65% share of global insurance premiums, is bigger than the combined Asia, Africa and Oceanic markets, as the latter account for 25.61% of global premiums.

Figure 1.2 (Swiss Re)



Total world premiums world premiums repeated their 2003 performance and increased by 2.3% in real terms in 2004. The Figure below reveals that Life and Non-Life business showed opposite trends: while growth gained momentum in Life it slowed down in Non-Life.

Figure 1.3 (Swiss Re)



In 2004, regional shares in the global premium volume shifted slightly. The depreciation of the dollar in the course of 2004 only partially explains this phenomenon.

Emerging markets (such as Arab Countries, African Countries...) generated $321.16 billion in insurance premiums, equivalent to 11.47% of the global market, even though they account for over 85% of the world's population.

Life insurance in emerging markets grew by 10.5% in 2004. Non-life premiums grew by 7.7% due to a rise in premium rates and the introduction of mandatory insurance in several emerging economies.

Table 1.1 (Swiss Re)

Share of World Insurance Market by Region in 2004

	Life Premiums	*Non-Life Premiums*	*Total Premiums*
America	29.65%	49.36%	38.51%
Europe	37.77%	36.85%	36.94%
Asia	30.96%	12.88%	22.69%
Africa	1.62%	0.91%	1.86%
Oceania	1.66%	2.42%	1.90%
Global	100.00%	100.00%	100.00%

Market Density

The insurance density, or insurance spending per capita, was $502 globally, of which $288.7 was spent on life insurance. Switzerland ranked in first place worldwide with premiums per capita of around $5,922, followed by the United Kingdom with $4,579, and Ireland with $4,050. *(Swiss Re)*

Insurance density is low in most emerging markets, with insurance expenditures averaging around $68.7 per capita, of which $42.1 is spent on life (i.e. 61.28%) In comparison, density in industrialized economies is at $2,966.1 per capita, of which $1,691 is spent on life.

Table 1.2

Insurance Density by Region in 2004 (Premium per Capita in US$)

	Life Premiums	*Non-Life Premiums*	*Total Premiums*
America	628.40	775.90	1,404.30
Europe	848.10	579.80	1,427.90
Asia	147.20	47.10	194.30
Africa	30.30	13.10	43.40
Oceania	851.00	885.90	1,736.90
Global	288.70	213.30	502.00

Market Penetration

The penetration rate, or ratio of premiums to GDP, reached 7.99% worldwide, of which 4.55% was for life and 3.44% for non-life insurance in 2004. Insurance is still of relative low importance in emerging markets, as demonstrated by the low penetration rate of around 3.94% compared to an average of 9.02% in industrialized countries.

Table 1.3

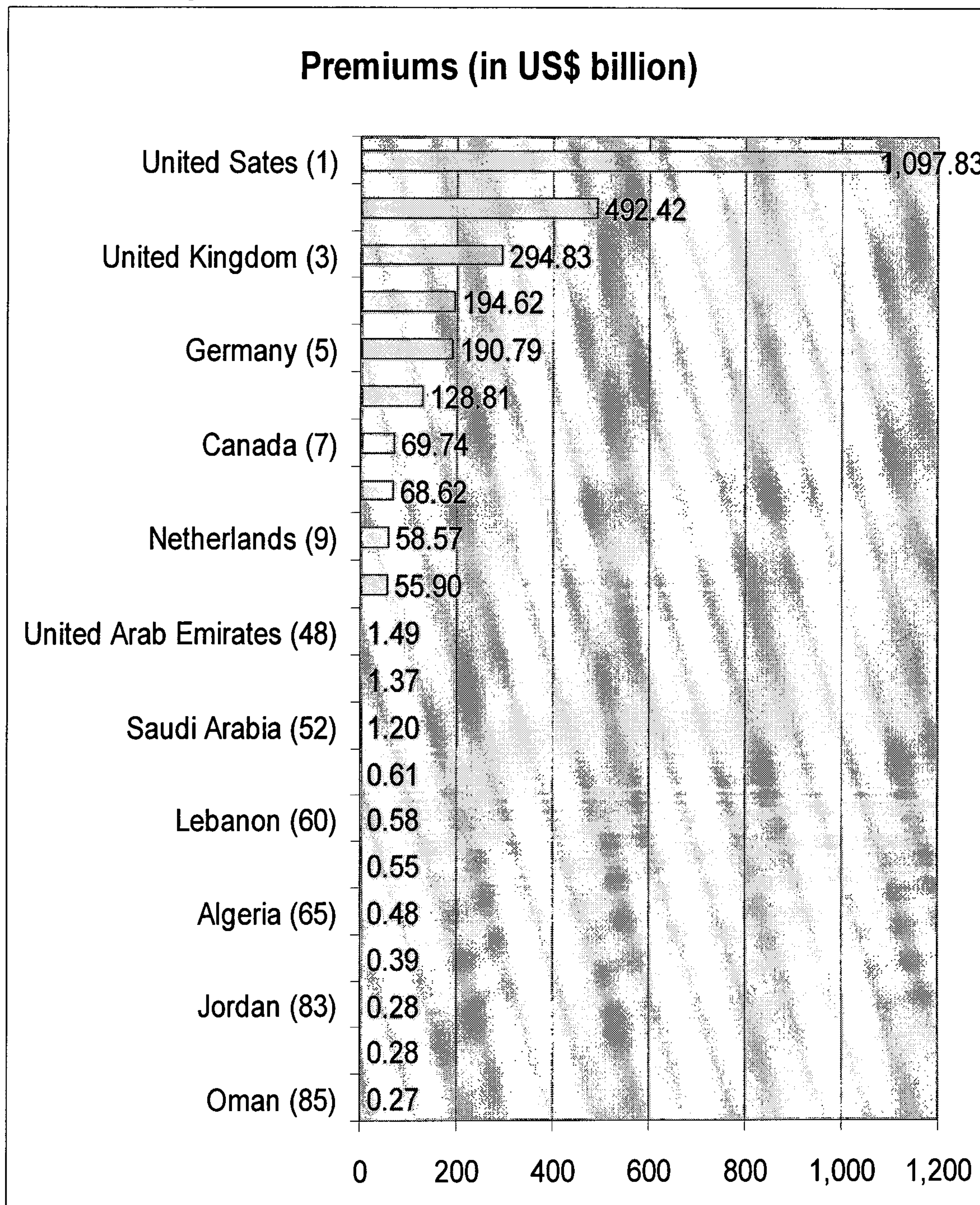
Insurance Penetration by Region in 2004 (Premium as % of GDP)

	Life Premiums	*Non-Life Premiums*	*Total Premiums*
America	3.70	4.57	8.27
Europe	4.68	3.20	7.89
Asia	5.61	1.79	7.40
Africa	3.41	1.48	4.89
Oceania	3.75	3.90	7.65
Global	4.55	3.44	7.99

Premiums

The United States continues to be the world's largest insurance market with US$ 1,097 billion in total premiums for 2004. It was followed by Japan with US$ 492 billion and the United Kingdom with US$ 294 billion. Lebanon falls in 60th place with US$ 0.58 billion.

Figure 1.4



II. THE ARAB INSURANCE MARKET

The Market Today

Aggregate insurance premiums generated in the Arab world totaled $8.5 billion in 2004, of which 80.8%, or $6.87 billion, were in non-life premiums and $1.63 billion, or 19.2%, were in life premiums.

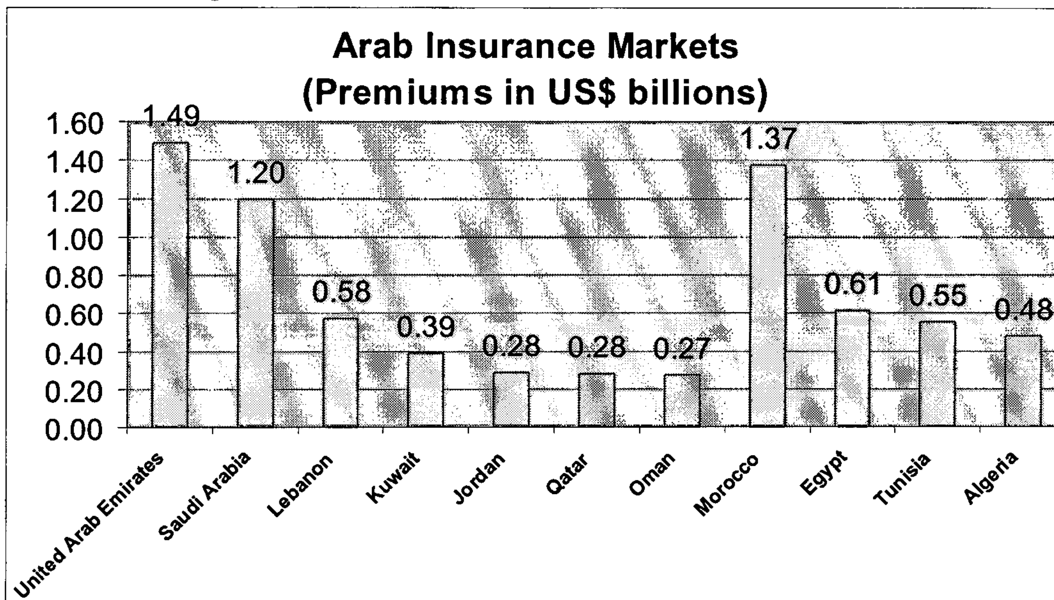
The Arab markets continue to represent a tiny share of the global insurance market, accounting for just 0.23% of overall premiums, 0.47% of non-life premiums and 0.08% of life premiums.

Total premiums generated in the Arab world account for about one-third, of the aggregate premiums in the Middle East and North Africa region (MENA).

Total premiums generated in Arab markets increased by 9.8% in 2004, with non-life premiums growing by 9% and life premiums by 15.5%. *(Al-Bayan Magazine)*

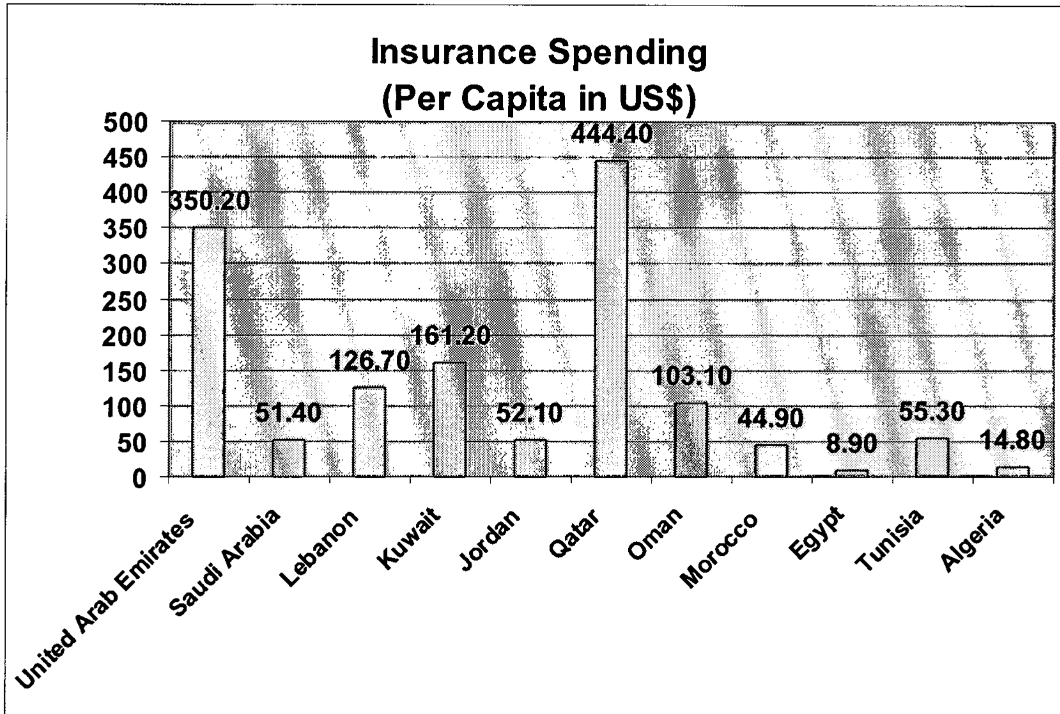
United Arab Emirates led the Arab world in terms of premiums with $1.49 billion generated in 2004.

Figure 1.5



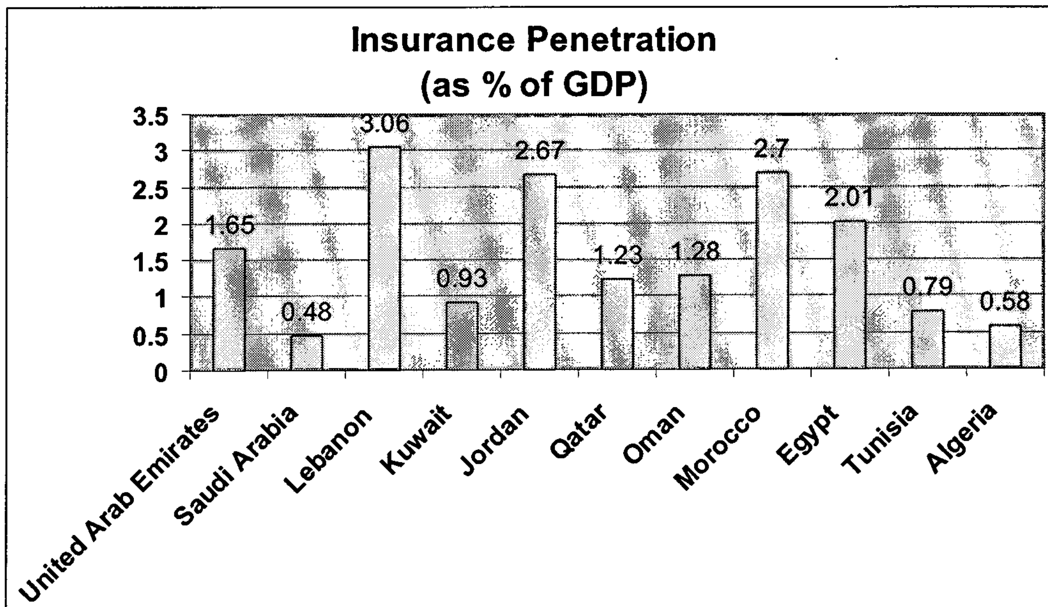
Qatar led the Arab world in terms of insurance density with $444.40 in insurance spending per capita.

Figure 1.6 (Swiss Re)



Lebanon came in first place in the Arab world in terms of insurance penetration with a ratio of 3.6% in premiums as a percentage of GDP.

Figure 1.7 (Swiss Re)



A distinguishing characteristic of the insurance market in the Arab region is the share of life insurance premiums out of total premiums.

Life insurance premiums represents less than a third of total premiums in most Arab countries such as Egypt (31%), Lebanon (27%), Kuwait (24%), UAE (23%), Tunisia (8%), Algeria (4%), Saudi Arabia (4%). In contrast, in more developed markets, life insurance is generally the dominant form of insurance representing the bulk of total premiums.

Another feature of Arab insurance markets is that the GDP in several Arab countries such as Kuwait, Saudi Arabia and UAE is high, and yet insurance penetration does not match the high GDP. This shows that the insurance industry can still be developed in these countries.

Trends favoring a rise in insurance penetration in the Arab region include the shifting of health care costs from the state to the private sector, introduction of mandatory health insurance in several countries, compulsory auto insurance, increased insurance awareness, market reforms and liberalization, and integration in the global economy.

THE LEBANESE INSURANCE MARKET

Historical Development of the Lebanese Insurance Sector

• Around 1840, when Lebanon was still a self ruled emirate within the Ottoman Empire, agents representing insurance companies from the UK, Italy and France began to offer insurance for Lebanese products, silk in particular, while being shipped to Europe.

• Insurance regulations were first introduced under the French Mandate in 1925.

• The oldest domestic companies are Arabia Insurance, which moved from Jerusalem to Beirut after the first Arab-Israeli war in 1948, and Al-Ittihad Al-Watani (L'Union) which was founded in 1947. Compagnie Libanaise d'Assurances was formed in 1951 and Libano-Suisse in 1959.

• The small size of the domestic market, combined with freedom of access to undeveloped insurance markets elsewhere in the region, encouraged overseas expansion, and by the late 1950s Beirut had become the insurance centre of the Middle East, with over 100 foreign insurers having offices in Lebanon.

• An insurance law was promulgated in 1955 to replace the regulations then in force.

• The civil war years 1975 - 1991 had a disastrous effect on the development of the insurance industry. Most of the foreign insurers closed their Beirut offices, though those which carried on throughout the fighting, such as American Life Insurance Company (Alico), UAP and Generali, were rewarded with significant market shares.

• During the war insurance supervision was effectively discontinued and capital resources fell to dangerously low levels. Many foreign reinsurers withdrew their support from the market, forcing the insurers' Assosiation des Companies d'Assurances au Liban (ACAL) to set up a domestic pool for bankers blanket bonds.

• Despite these difficulties, however, the number of insurance companies increased dramatically, presumably because insurance was one of the few types of business which could survive without a physical infrastructure.

• The insurance market which emerged from the end of the war in 1991 was over-sized, highly fragmented and largely insolvent.

• With so many other problems to contend with, the government gave a low priority to insurance reform, though it passed an emergency measure in April 1994 requiring all companies to deposit a security reserve of LEP 750mn (USD 446,000) with the Minister of Economy and Trade. Approximately 20 companies disappeared, some of them unable to raise the deposit, and others brought down by losses in medical expenses and motor business.

• Further rationalization was experienced following introduction of the new insurance legislation in 1999, leading to a significant reduction in the number of market participants.

• In 2003 a new compulsory motor third party liability law was introduced 26 years after first being promulgated. New insurance legislation to introduce modern principles of supervision was also drafted and may be brought in during 2005 at the earliest.

Market Characteristics

The Lebanese insurance sector started developing in the 1950s when several insurers were established to service the local market and later expanded to other Arab countries. Further, Beirut became a regional insurance center that serviced the Arab world up until the mid 1970s.

The Lebanese insurance market has always been open and liberal, in line with Lebanon's free market economy. Private insurers have historically been the only players in the local market and the state has never nationalized or expropriated an insurance firm. Additionally, the Lebanese State never owned insurers and therefore private companies did not have to compete with any State entities or had to worry about government monopolies, as is the case in many other Arab countries.

Insurance premiums generated in Lebanon totaled $577 million in 2004, of which non-life premiums totaled $397 million and life premiums reached $180 million. Overall premiums rose nominally by 11% in 2004 with non-life premiums growing by 4.2% and life premiums rising by 29.4% from the previous year. But on an inflation-adjusted basis, total premiums rose by 9.3%, with non-life premiums growing by 2.6% and life premiums rising by 27.4% in 2004. *(AXCO Report)*

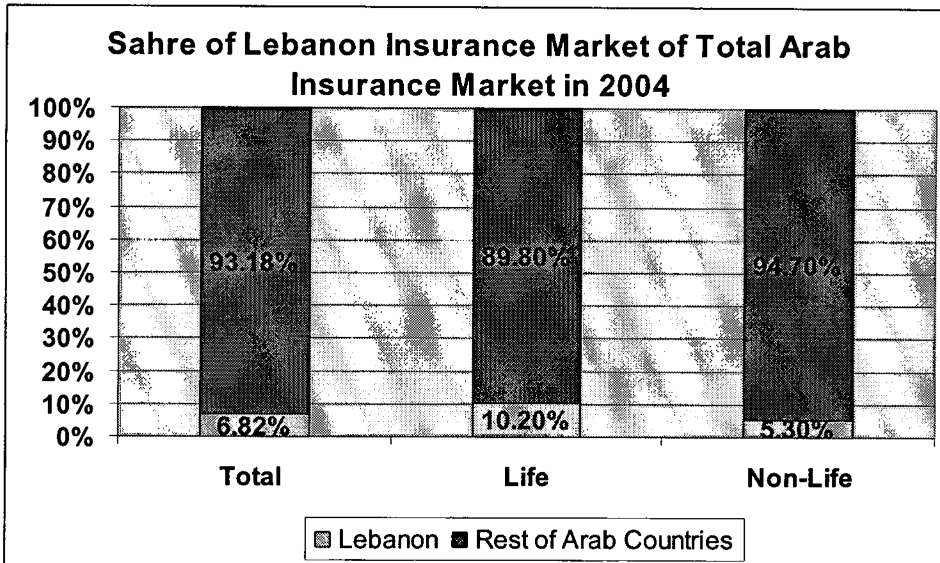
Lebanon's real growth rate of 9.3% in total premiums is higher than the 2.3% growth rate in global premiums. Its 2.6% real growth in non-life premiums is slightly higher than the corresponding global growth rate of 2.4%. But its 27.4% real growth in life business is substantially better than the 3% posted globally and the 7.4% registered by emerging economies. *(AXCO Report)*

Lebanon ranks in 60th place globally and in 5th place in the Arab world in terms of total Insurance Premiums.

Lebanon accounts for 0.02% of total insurance premiums, 0.03% of non-life premiums and 0.01% of life premiums generated worldwide.

Lebanon accounts for 6.82% of total premiums, 5.3% of aggregate non-life premiums, and 10.2% of life premiums generated in the Arab world.

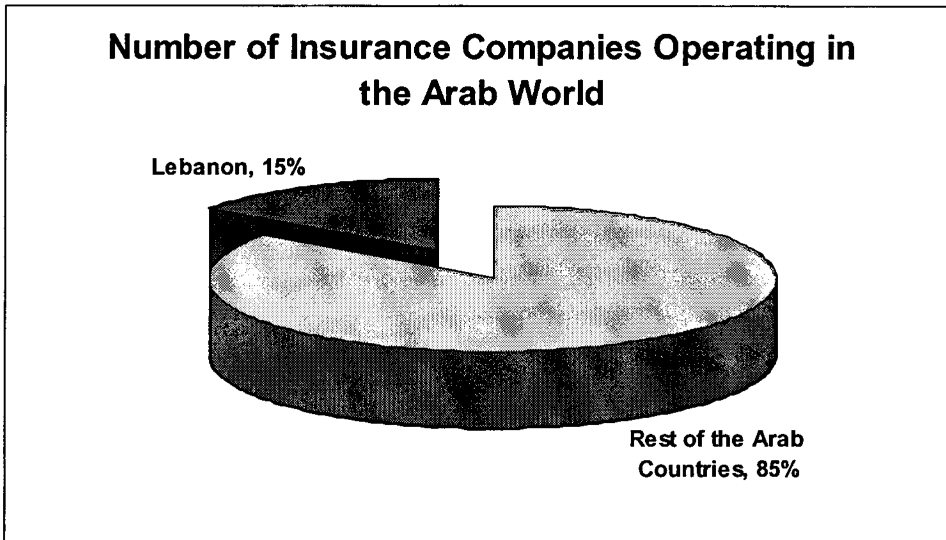
Figure 2.1



Lebanon's ratio of life to total premiums is 31.1% (i.e. 180M/577M), which is not in line with global trends where life premiums account for 56.9% of total premiums. The same ratio is not in line with emerging markets where life premiums account for 60.5% of aggregate premiums. *(Al-Bayan Magazine)*

Lebanon's 58 insurers (Appendix 1) account for 15% of total insurance firms (around 385) operating in the Arab world.

Figure 2.2



Market Density

Lebanon ranks in 50th place globally and in fourth place in the Arab world in terms of insurance density with $126.7 in premiums per capita. Lebanon's density per life and non-life categories is higher that the average density rate in the Arab world, MENA and emerging markets but it falls way behind that of industrialized countries.

Table 2.1

Insurance Density by Region in 2004 (Premium per Capita in US$)

	Life	Non-Life	Total
Lebanon	39.60	87.20	126.80
Arab Countries	7.20	26.30	33.50
MENA	13.80	34.60	48.40
Emerging Countries	42.10	26.60	68.70
Industrialized Countries	1,691.10	1,275.00	2,966.10

Market Penetration

Lebanon ranks in 47th place globally and in 1st place in the Arab world in terms of insurance penetration with a ratio of 3.06% in premiums as a percentage of GDP, which is significantly higher that the average Arab penetration rates in both the life and non-life categories.

Table 2.2

Insurance Penetration in 2004 (Premium as % of GDP)

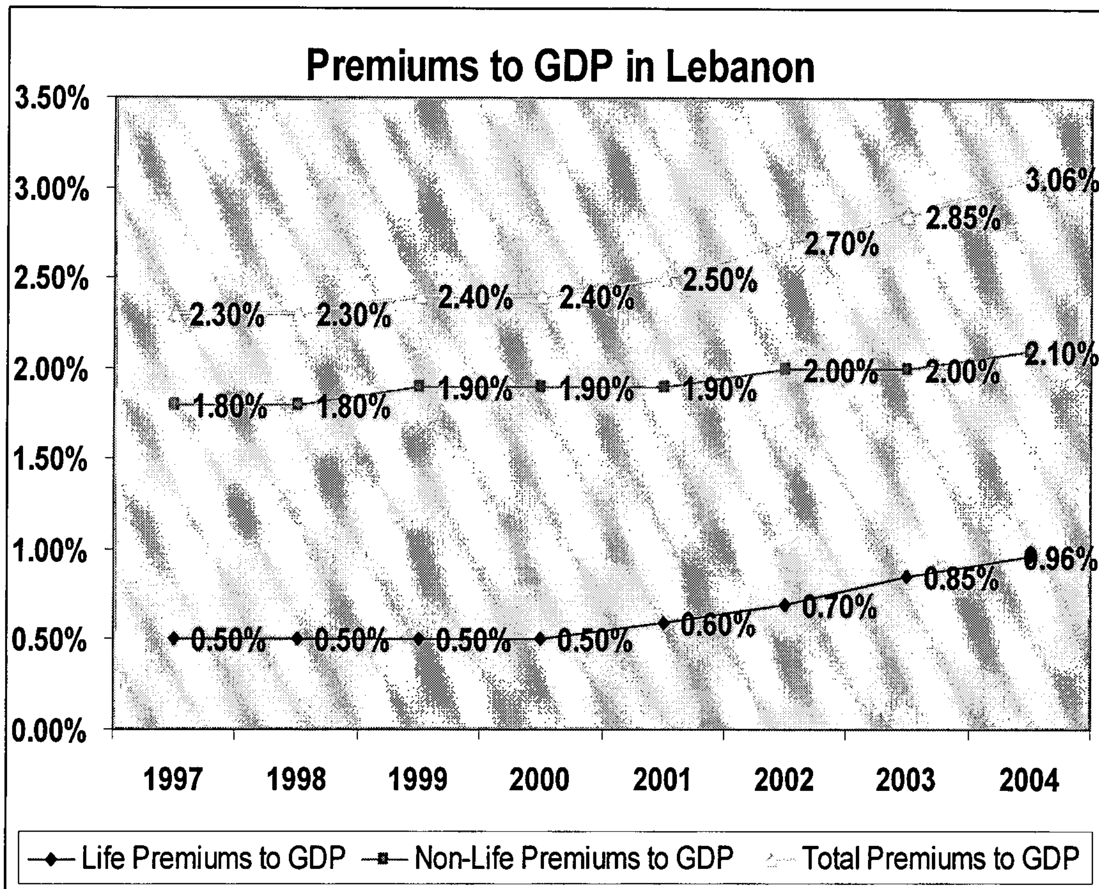
	Life	Non-Life	Total
Lebanon	0.96	2.10	3.06
Arab Countries	0.30	0.80	1.10
MENA	0.47	1.18	1.65
Emerging Countries	2.41	1.53	3.94
Industrialized Countries	5.14	3.88	9.02

Lebanon's penetration rate of 3.06% is lower than the emerging markets' average penetration rate of 3.94%. Its non-life rate of 2.1% exceeds the 1.53% posted by emerging economies while its life rate of 0.96% falls short of the 2.41% registered by emerging markets.

Further, insurance penetration in Lebanon is low compared to 9.02% in industrialized countries. The low share of premiums relative to the Lebanese economy is mainly due to the fact that insurance is still not an integral part of the Lebanese culture, as insurance awareness is relatively low. Moreover, the purchasing power of the population is a major factor affecting insurance premiums, especially in times of economic slowdown.

Overall revenues relative to GDP have been relatively stable at about 3% between 1997 and 2004, posting marginal growth from 2.2% in 1997 to 3.06% in 2004. For Lebanon to attain the penetration rate of emerging markets, premiums needed to reach about $743 million in 2004, which is $166 million higher than realized premiums during that year. The challenge is even bigger should the sector thrive to reach the penetration level of industrialized economies, as premiums would need to exceed $1.7 billion per year.

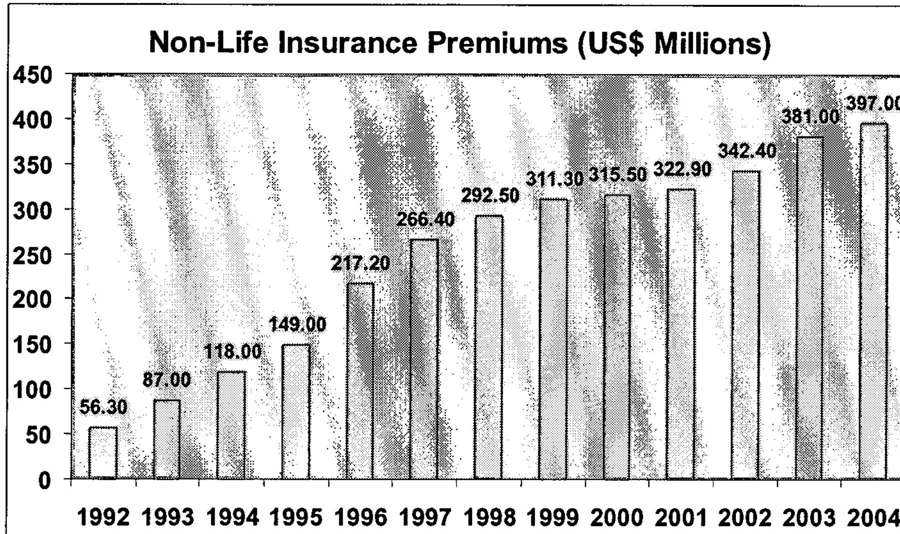
Figure 2.3



Market Size

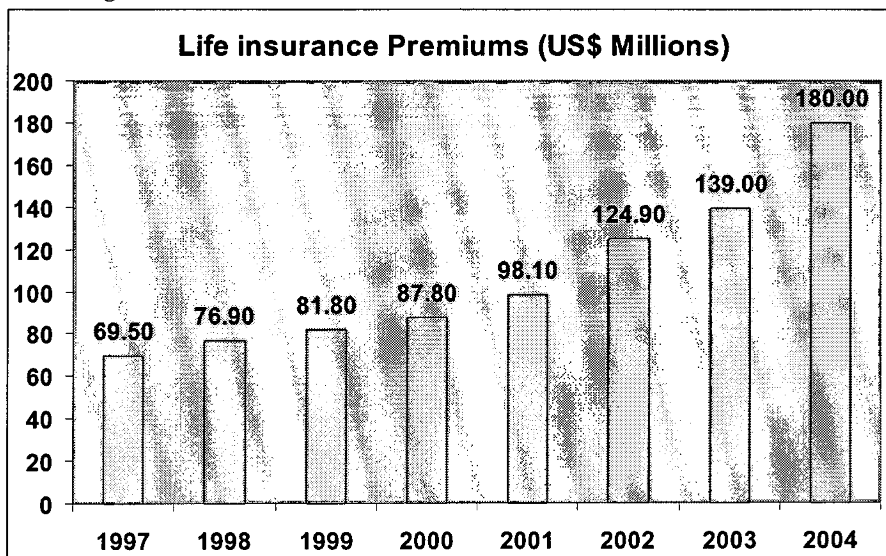
a) Non-Life Premiums:
The Lebanese insurance sector has witnessed significant growth between 1992 and 2004 with non-life gross premiums growing seven folds from $56.3 million in 1992 to $397 million in 2004. Non-life premiums rose by a compound annual growth rate (CAGR) of 16.2% between 1992 and 2004, with most of the growth coming during the 1992-1997 period.

Figure 2.4



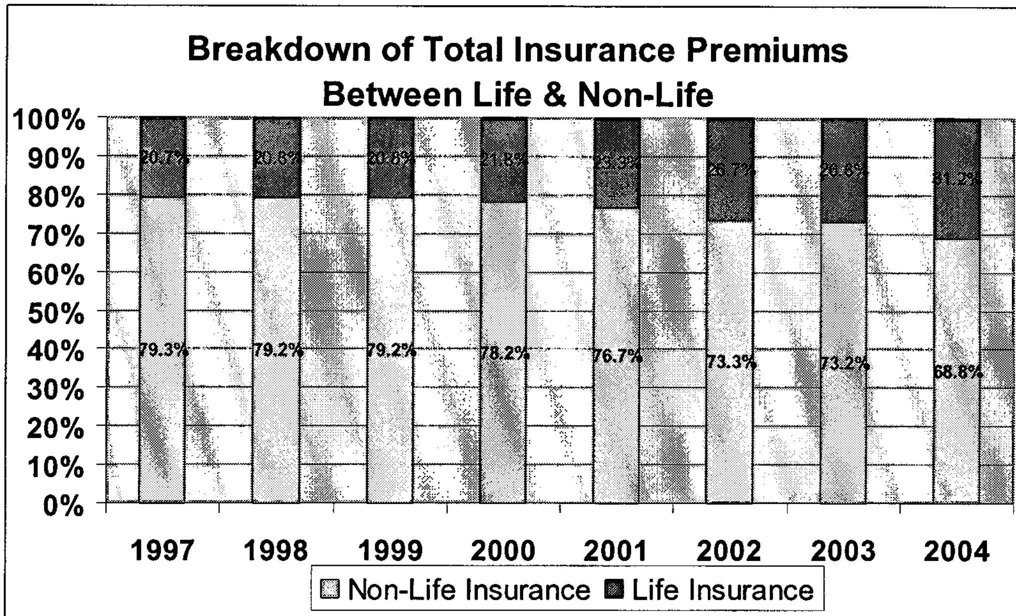
b) Life Premiums:
Life premiums posted a CAGR of 12.6% during the 1997-2004 period, nearly grew by 2.5 times from $69.5 million in 1997 to $180 million in 2004. Life premiums growth has driven overall premium growth since 1997, as they grew faster than general premiums.

Figure 2.5



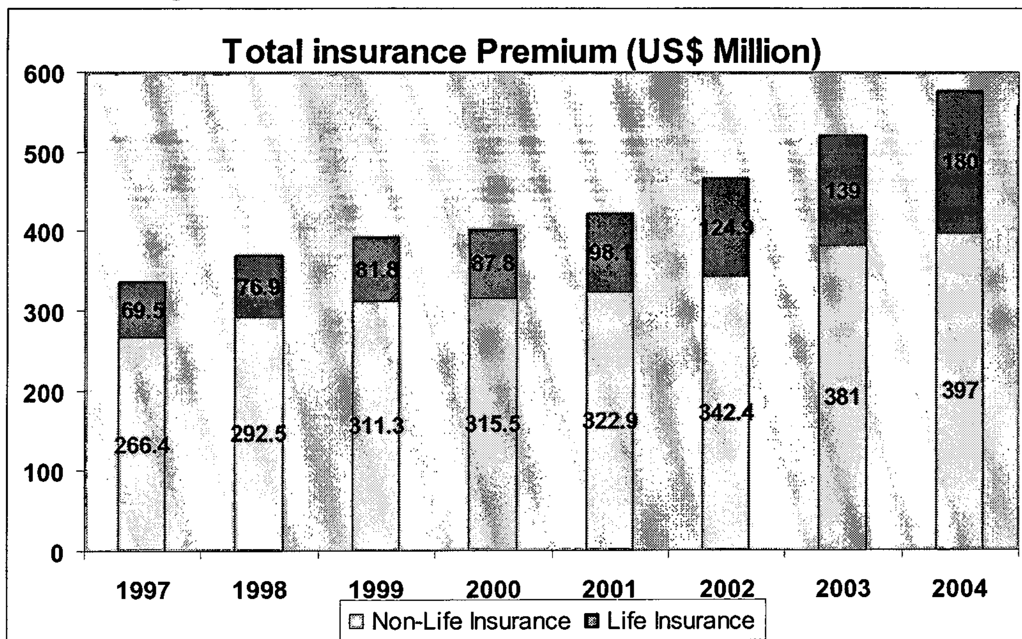
Non-life premiums continue to dominate total premiums despite the increasing share of life premiums. Non-life premiums accounted for 68.8% of premiums in 2004, falling below the 70% level for the first time since such figures started to be compiled.

Figure 2.6



Total life and non-life premiums grew from $336 million in 1997 to $577 million in 2004, posting a Compounded Annual Growth Rate (CAGR) of 6.99% over the 1997-2004 period (worldwide around 15%). This reflects the slow growth that has characterized the sector over the 1997-2004 period.

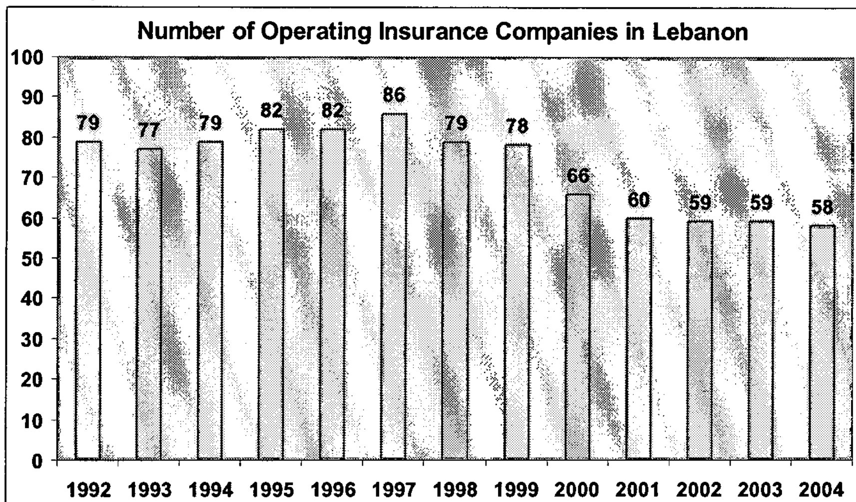
Figure 2.7



Market Structure

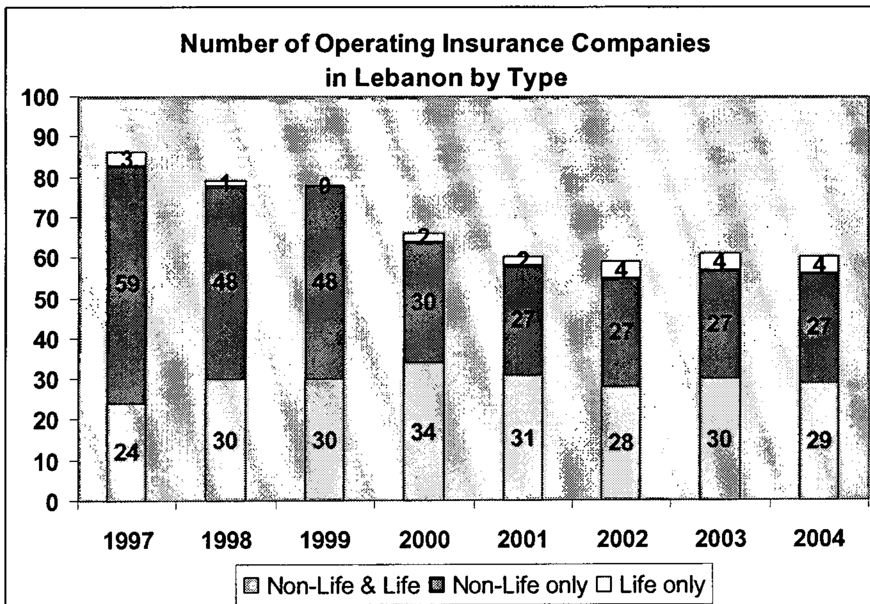
The insurance market in Lebanon is highly fragmented. The number of insurers increased significantly after the end of the 1975-1990 war due mainly to lax regulations and an attempt to fill market demand. There were 113 licensed insurers in 1992, of which 79 were operational. The number of operational firms peaked at 86 in 1997 and contracted to 58 in 2004. The reduction in the number of insurance firms has been caused by bankruptcies, the revocations of licenses by the Ministry of Economy & Trade, and by the implementation of the 1999 insurance reform law mandating insurers to raise their capital.

Figure 2.8



In 2004, there were 29 firms that provided life and non-life insurance products, 27 offered only non-life insurance, and 4 insurers provided only life insurance products.

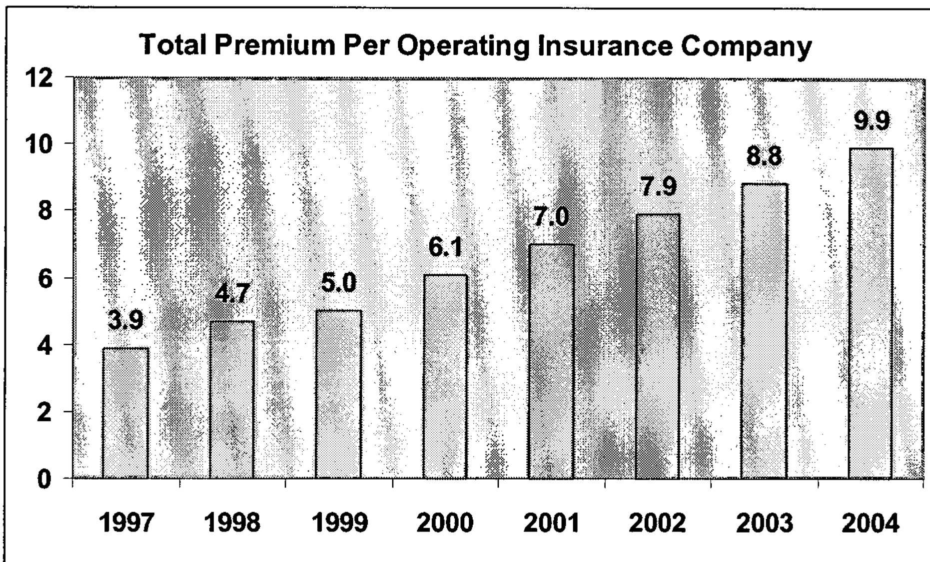
Figure 2.9



Despite a reduction in the number of insurance firms, the sector is still characterized by an unjustifiably large number of players.

Gross premiums per operating company have steadily improved between 1997 and 2004, rising from $3.9 million in 1997 to $9.9 million in 2004. Although this growth reflects the reduction in the number of operating insurers in the Lebanese market, the low figures per firm point to the need for further consolidation, as small and medium-size insurers are under increasing pressure to have the necessary technological infrastructure and human resources to compete on products, market share, as well as profitability levels.

Figure 2.10



A total of 28 firms, or 48.27% of the providers of general insurance in Lebanon, had premiums of less than US$5 million each in 2004, while 9 companies, or 15.52% of the total, generated less than $1 million each in premiums in 2004.

Figure 2.11

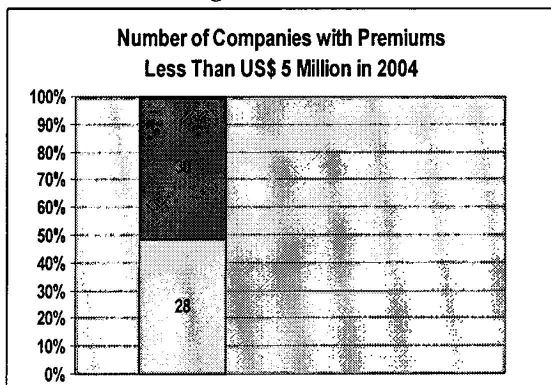
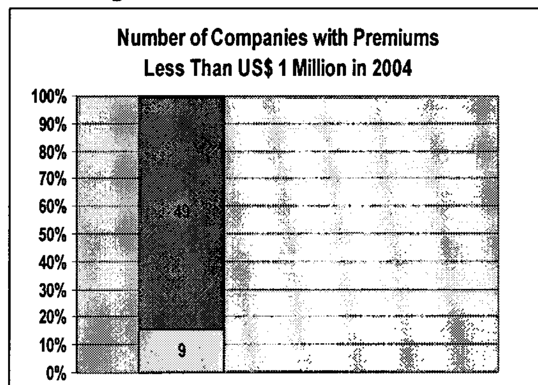


Figure 2.12



The concentration of revenues, among other reasons, is putting pressure on smaller insurers to expand organically or follow the less costly and more logical road of merging with bigger players. This trend is becoming more evident since the top 10 companies control nearly 61.4% of the market with the top 20 firms accounting for 83.3% of non-life revenues in 2004.

The top 10 insurers controlled 61.1% of the non-life insurance market in 2003, 60.5% in 2002, 59.9% in 2001, 59% in 2000, 48% in 1999 and 49% in 1998. Their aggregate non-life premiums reached $243.75 million compared to $232.79 in 2003, $207.15 million in 2002, $193.42 million in 2001, $186.15 million in 2000, $149.42 million in 1999 and $143.33 million for 1998. *(AXCO Report)*

Figure 2.13

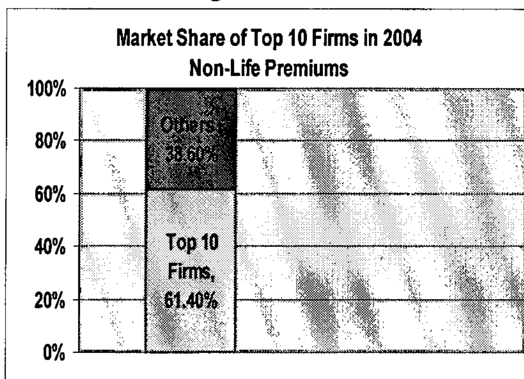
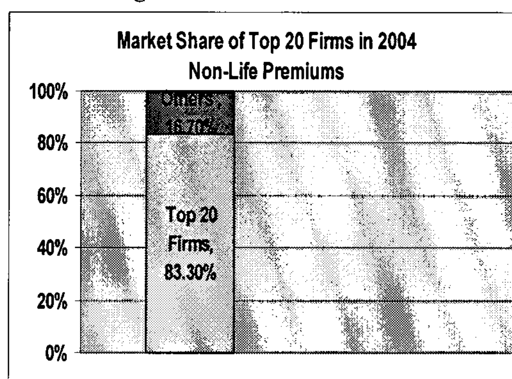


Figure 2.14



Pressure on small providers of life insurance is more pronounced, as the life insurance category is even more concentrated than the general insurance sector. The top 5 life insurers in Lebanon control 77.5% of the market with the top 10 capturing 91.1% of premiums.

Furthermore, one company, ALICO, controls 38.8% of the life market, down from 45.3% in 2003. The market share of the five largest life companies is stable, but was slightly down from 84% during the 1998-2000 period. Their aggregate life premiums reached $139.5 million in 2004 compared to $114.4 million in 2003, $103.3 million in 2002, $80.21 million in 2001, $73.4 million in 2000, and $68.64 million in 1999.

Figure 2.15

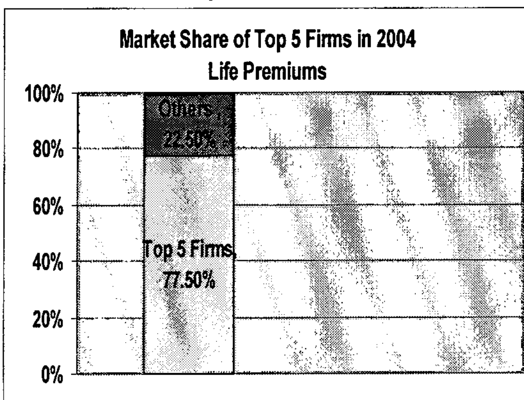
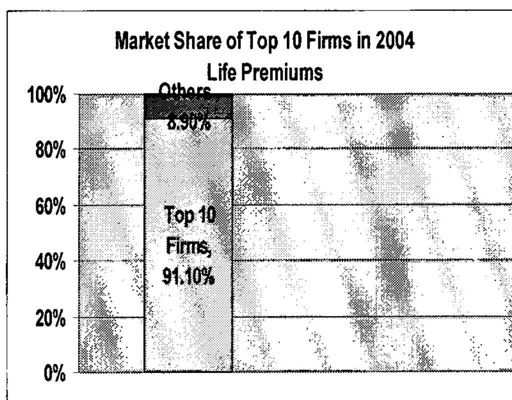


Figure 2.16



Generally, insurance companies need to generate premiums equivalent to at least about 4 to 5 times their capital in order to cover expenses *(Swiss Re)*, maintain their financial health, and post sustainable profitability. When applying this standard to the Lebanese market, and based on a minimum required capitalization of $1.5 million per insurer as well as on the market structure in 2004, a total of 23 insurers would meet this standard, leaving 35 firms below this threshold.

As the growth of the insurance sector has not been significant over the 1997-2004 period, the structure of the market remained largely unchanged in terms of market leaders. Indeed, the top 10 firms in overall premiums control 64.5% of the market, while the top 20 insurers account for 84.6% of aggregate revenues (Life & Non-Life).

Figure 2.17

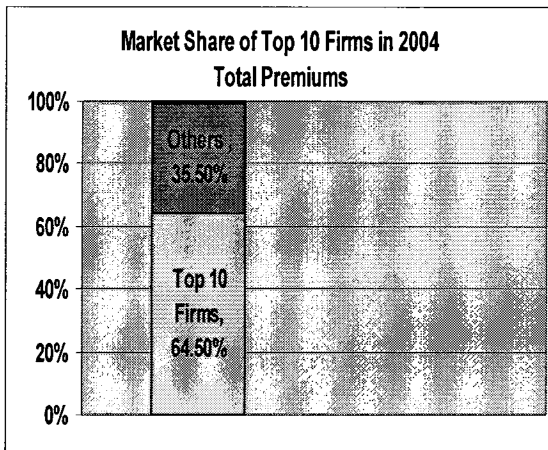


Figure 2.18

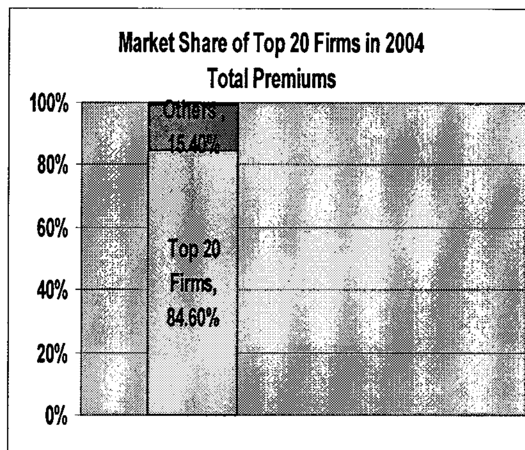
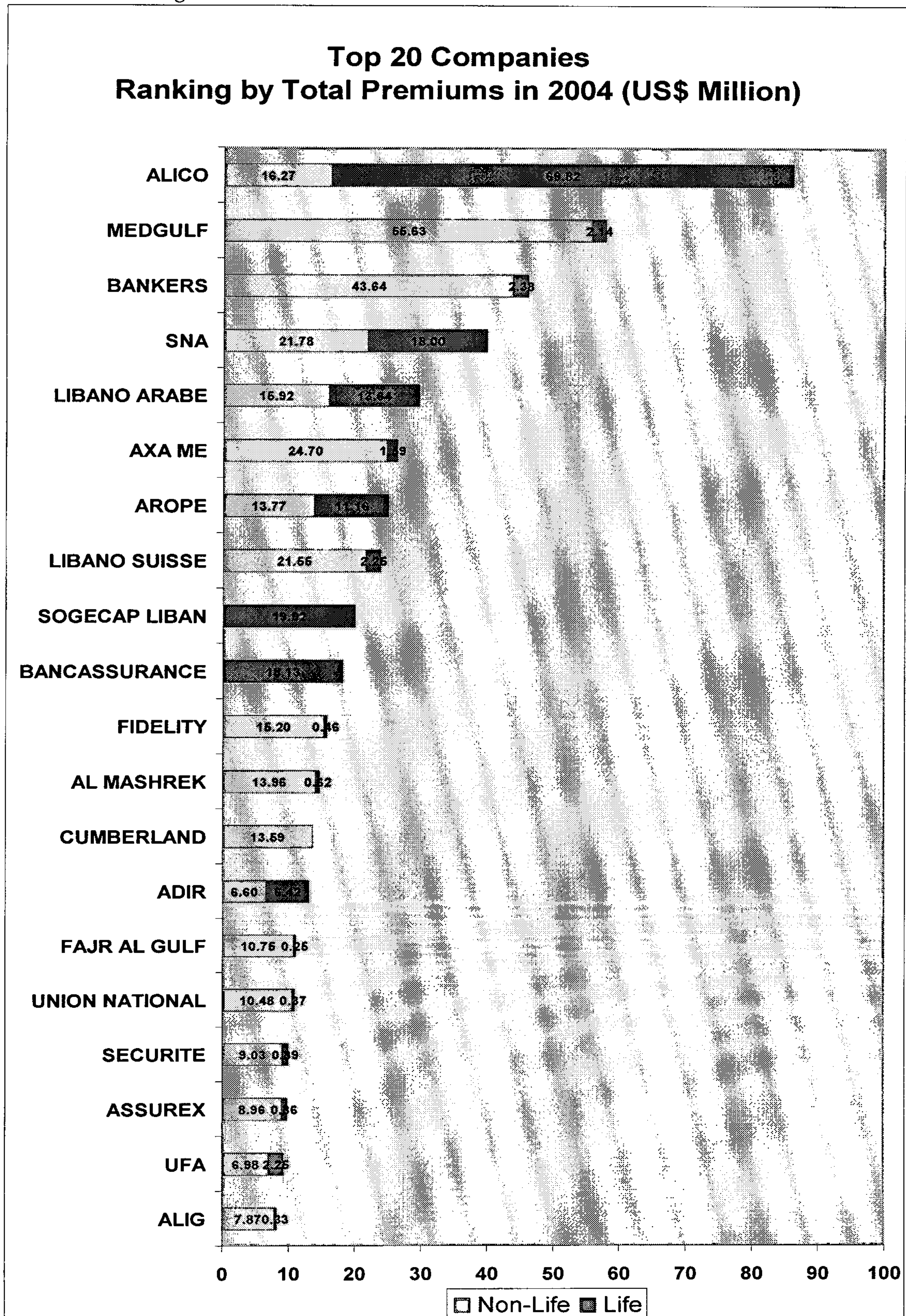


Figure 2.19

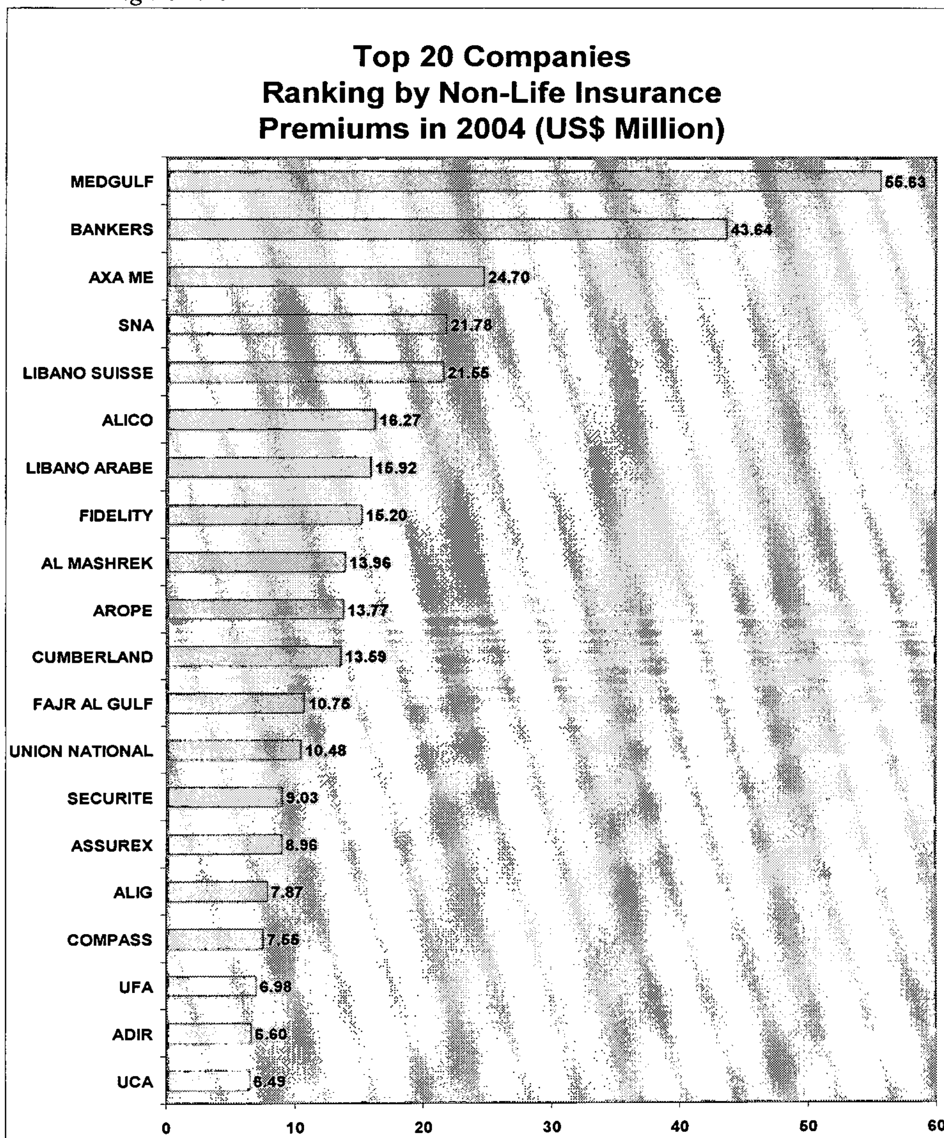


I. NON-LIFE INSURANCE MARKET

General, or non-life, insurance premiums amounted to around $397 million in 2004 up 4.2% from $381 million in 2003 *(Muhanna DAIR Magazine)*. The growth rate is mainly due to the constant increases imposed by reinsurance companies on local insurers following the September 11 attacks in the United States. As a result, non-life premiums could have increased by up to 10% in 2004 were it not for the economic slowdown in the country.

Furthermore, cost cutting at companies led to a reduction in their staffs insurance coverage in some insurance categories. This has particularly affected complementary health insurance whereby cost-conscious firms have limited their staffs insurance to coverage provided by the National Social Security Fund (NSSF), thereby resulting in lost opportunities for insurers.

Figure 2.20

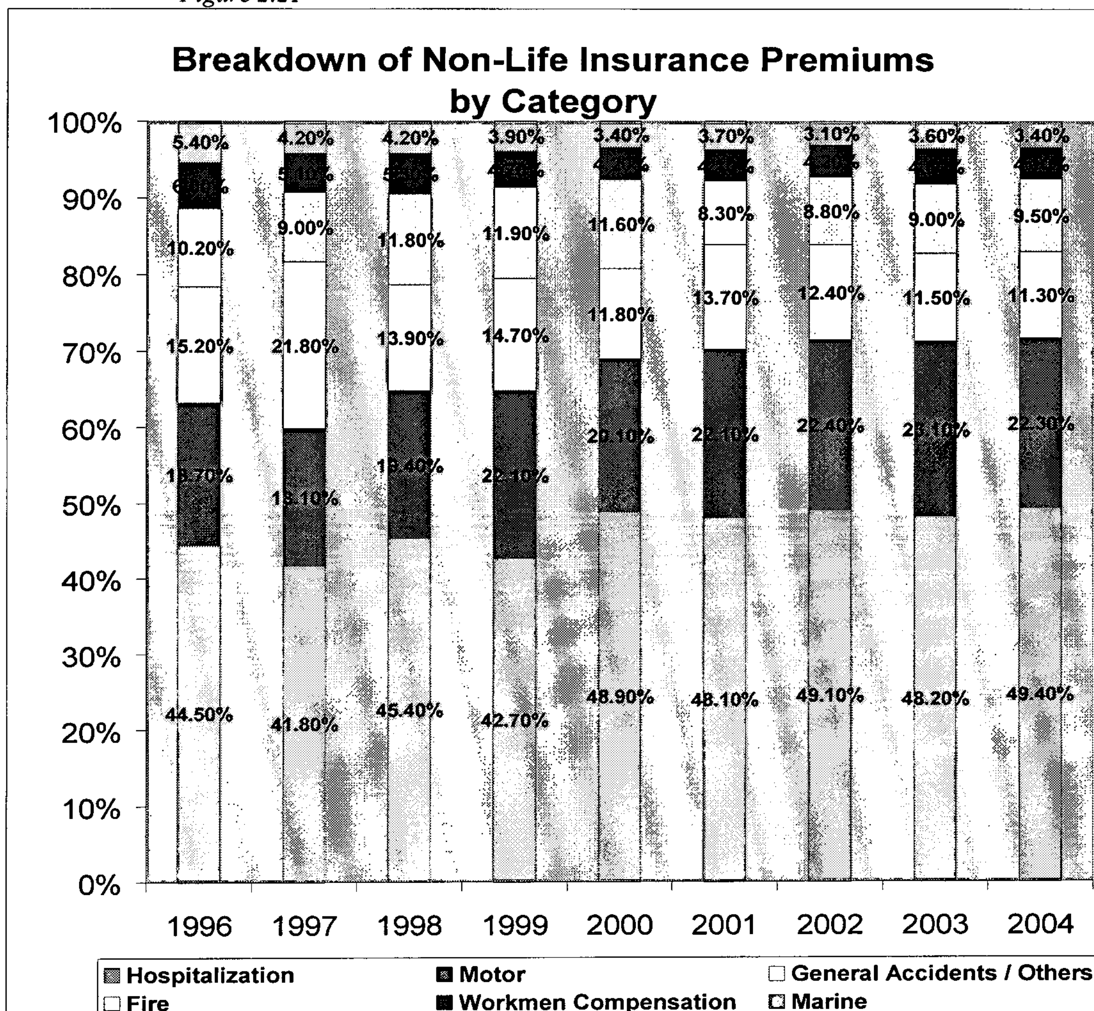


MEDGULF maintained its first place in 2004 with $55.63 million in non-life premiums. It was followed by Bankers ($43.64 million), Axa Middle East ($24.7 million), Société Nationale d'Assurances ($21.78 million), and Libano-Suisse ($21.55 million) as the top 5 non-life insurers.

Some of the top 10 insurers interchanged rankings compared to 2003, while Cumberland falls back to 11th position and Arope took its place in the 9th position. 9 of the top 10 insurers posted increases in their premiums. Among the top 10, ALICO and Axa ME recorded the biggest rise in 2004 at 18.2% and 13% respectively, while Al Mashrek registered a decline in premiums of 8.8%.

Medical insurance has achieved the highest level of penetration across the Lebanese market and accounts for almost 50% of non-life insurance premiums, followed by motor insurance at around 20%. Other active branches include general accident, fire, marine and workmen's compensation. New categories introduced by the insurance reform law of 1999 include agriculture insurance and credit insurance. Further, a new category dealing with construction insurance is expected to be introduced in 2006.

Figure 2.21



MEDICAL INSURANCE

Many insurance companies in Lebanon provide medical coverage. The services covered vary but usually include hospitalization and the cost of operations, maternity benefits, laboratory, ambulatory and diagnostic tests, as well as outpatient visits, doctor consultation and medicine, among others.

The main benefit is hospitalization, and the limits for the additional coverage are normally quoted as a percentage of the hospitalization limit.

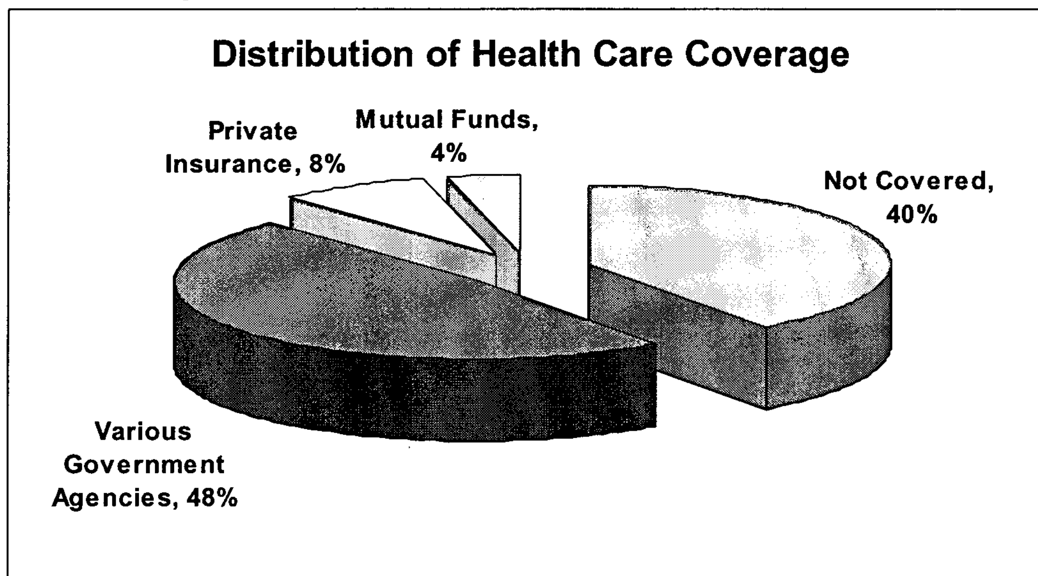
Excluded benefits may be any or all of dental care, alcoholism and use of drugs, nervous and mental diseases, pre-existing conditions, self-inflicted injuries, dangerous sports, and occupational diseases.

Health insurance in Lebanon is not compulsory and is mainly provided by private insurers. Medical insurance has historically represented the bulk of general insurance premiums, averaging, for about 46.45% of total premiums over the 1996-2004 period. Health care premiums accounted for 49.4% of the non-life insurance market in 2004, the year with the most recent figures. The growth in private medical insurance premiums has been significant over the years and highlights the continuing concern over the ability of the state to provide an adequate health system or to finance public health care.

There are no official statistics available, but the major part of private medical insurance is thought to be sold on a group basis, as part of companies' employment packages.

Lebanon is still an under-insured country with 40% of its population still without any health coverage. Another 48% of the population is insured by various government agencies with around 12% of the population holding private medical coverage, of which 8% are covered by insurance companies and the rest covered by mutual pools.

Figure 2.22



Additionally, some large employers such as Middle East Airlines and Banque Libano-Francaise have their own self-funded health care plans. They tend to buy some insurance coverage on a stop-loss basis and use third-party administrators to service their plans.

The National Social Security Fund is the biggest public-sector insurer, covering 1.2 million residents. Government agencies are responsible for financing 40% of the health care bill.

<u>Competition</u>

Although many non-life companies write medical business, only a few can claim to have a sizeable portfolio.

In the early to mid 1990s, the rapid growth in demand for medical coverage, the largely untapped market and profit potential led to competition among insurers based on acquiring, expanding, and retaining market share in this category.

At the time, the large number of existing insurers in the market amplified the competition and led to price wars where insurers tried to acquire clients by essentially offering lower prices on policies, even at the expense of long-term profitability, and irrespective of the reliability of service or the efficiency of essential back-office operations to process claims.

The ensuing high profile bankruptcies of large players MESIR and Phoenix, as well as the bailout of Strikers and American Underwriters Group, ushered increased awareness from insurers about the need to raise the trust of policyholders as well as from the general public for the need to deal with well- managed and reputable firms.

Following a wave of consolidation in the late 1990s, the market has largely stabilized. The evolution of the sector has not reduced the level of competition but today, large insurers are competing on product offerings and brand value rather than on price alone.

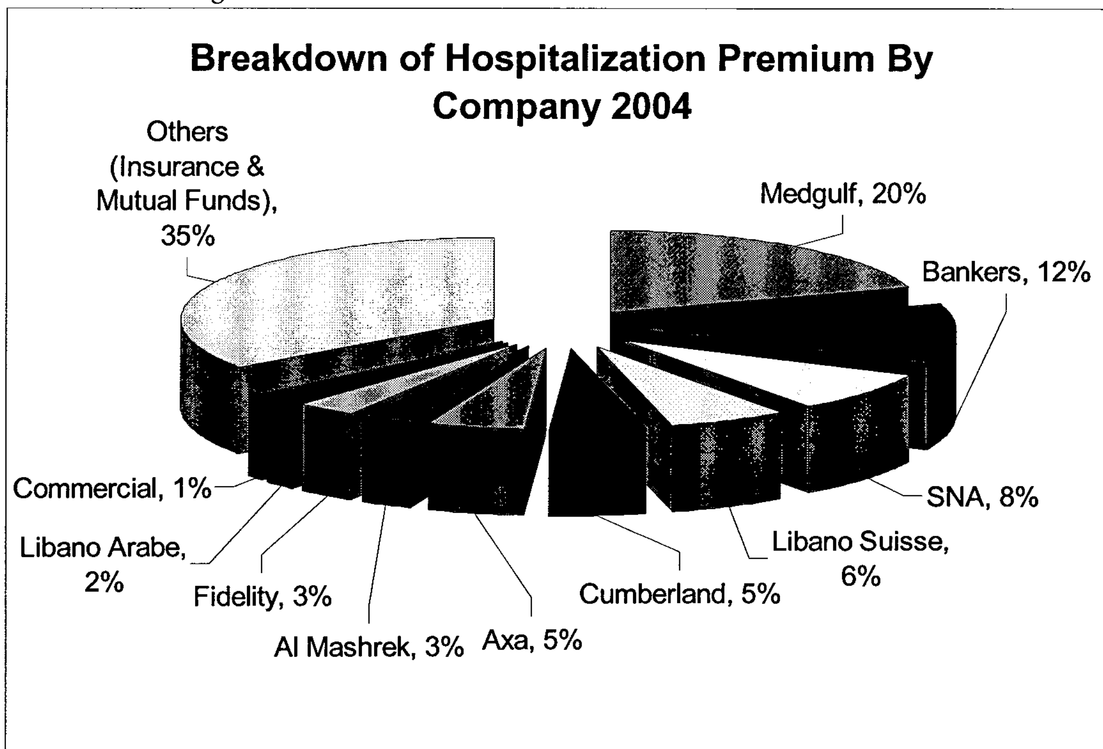
Additionally, the limited margin available for the pricing of medical insurance is leading players to compete on other factors such as reliability, competence, expertise, reputation and the ability to deliver as group and individual clients are increasingly expecting long-term commitment such as the feature of automatic renewal of policies.

About 6% of the Lebanese population are members of mutual societies, which are funded through voluntary contributions. They are non-profit organizations that provide limited cover for consultations, drugs, inpatient care and hospitalization. They do not exclusively provide health benefits to associates so it is difficult to calculate the health component of the contributions. There is also a small amount of charitable healthcare provision, although this tends to be more of a social care and rehabilitation type of service.

Furthermore, the conditions of competition between private insurers and the mutual societies are not the same. The medical mutual funds, other than having a monopoly over certain categories of workers, are not subject to the same obligations as insurance companies both in the technical and financial fields. For example, medical mutual funds are not taxed on premiums and do not have to meet the same capital and reserve restrictions. A mutual society cannot guarantee medical coverage if the pool of contributions has been fully consumed and hence, members might be required to cover medical expenses from their own pockets in spite of the contributions made to the fund. Mutual societies have become increasingly aware of the benefits of third-party administration, as some well-organized mutual pools have appointed third-party administrators to administer their operations and others have entered into quota share agreements with insurance companies.

The top 10 companies in the medical insurance sector produced an aggregate premium in 2004 equivalent to US$ 125 million.

Figure 2.23



Pressure from the Public Sector

The public health care delivery sector is characterized by a small number of public hospitals and lower quality of medical services at such hospitals. Further, the limited number of beds covered by the Health Ministry at private hospitals, long delays by the state in reimbursing the cost of hospital treatment, as well as partial reimbursements have increased pressure on private health care providers.

The National Social Security Fund (NSSF) is the main state organization that provides health care benefits and covers about 1.2 million subscribers. It provides inpatient sickness and maternity benefits as well as coverage for outpatient services such as examinations, laboratory tests, radiology and drugs.

A big share of public health care financing comes from corporate payrolls through mandatory contributions to the NSSF.

The economic slowdown has led many employers to reduce the medical benefits they offer to their staff through private insurance and have them rely on the benefits provided by the NSSF, thereby increasing pressure on the fund.

The increase in patients' expectations for quality medical care, political interference, and the rise in health care cost have combined to increase the fund's inpatient and outpatient medical bill.

Several reasons are given to the fund's financial problems to mane a few:

• Many companies do not register their employees at the NSSF because of the high subscription rates despite the fact that enrolment is mandatory. Others if their employees are registered they disclose the minimum wage. It is estimated that about 200,000 private sector employees are not registered in the fund.

• In a bid to reduce the cost of doing business in Lebanon and encourage companies to declare their total number of employees to the NSSF, the government reduced by 40% private sector contributions to the fund from 38.5% to 23.5% starting in 2001. More specifically, it reduced subscription rates from 15% to 9% of salaries for health care and from 15% to 6% of salaries for family benefits.
But according to fund officials, the measure did not lead to enough companies registering their employees, which reduced the fund's overall contribution revenues while the costs of the services provided by the fund continued to increase.

• Furthermore, fund officials have been complaining about frequent rumors that the government might offer an amnesty to firms from paying overdue contributions in order to alleviate the companies' difficulties in view of the economic situation. Such rumors have encouraged companies to delay even more their contributions to the NSSF.

• The government and various public agencies owe the NSSF a total of about US$800 million, while the private sector's overdue payments to the fund are estimated at USD$200 million, leading to a total of USD $1 billion in dues in 2004. *(AXCO Report)*

• Other problems for the fund include overstaffing, high administrative costs, limited computerization of records, and difficulties in supervising hospitals, laboratories, and physicians.

Medical Cost Control

Health insurance is generally a low frequency, high cost segment for the general population that turns into high frequency, high cost in the case of elderly people. Therefore, health insurers are in a perpetual race to keep premiums ahead of medical costs in order to maintain a healthy profit margin. With an eventually aging population, increasing demand for diagnostic procedures, acquisition of new technologies by health care providers and the resulting increased rate of utilization, there is no significant let up in this trend.

The relatively small margin available for the pricing of medical insurance is leading players to increasingly focus on cost control and on improving efficiencies. This is most evident in the rise of managed care, or pooling, which is being used to control costs and to keep premiums from rising to levels that would be unaffordable to consumers. The challenge for Lebanese insurers has been to contain cost without compromising on the quality of health care.

Cost control begins with proper management, an essential component of health insurance, which leads to a better risk selection process and to improved monitoring and measuring of consumption of services by the insured. The rationalization of costs and expenditures by insurers involves prevention, reducing waste and over-consumption, limiting utilization and eliminating fraud, therefore reducing the loss ratio. Technology plays a key role in this regard.

Medical Claims

The medical insurance category in Lebanon has one of the highest loss ratios (ratio of claims to premiums) in the insurance sector because of the high cost of health services, mainly hospitalization, and due to the increased risks associated with the health care sector.

Improving the level of claims service is becoming increasingly important in medical insurance. Trends in advanced markets show that, after pricing, the poor quality of the customer claims experience is generally the second most common reason for policyholders to change insurers at renewal.

The high cost of claims can get out of hand and hurt the profitability of Lebanese insurers. Generally, claims account for about 80% of total insurers' costs. The local market has responded with the establishment of third-party administrators, which play a major role in cost containment the Third Party Administrator (TPA) can be an in-house or an external one.

Technology's Impact on Medical Insurance

The growing impact of information and communication technologies on insurance is now for insurers a strategic concern and not only a technical problem. The impact of new technologies, important for the sector as a whole, is particularly significant in health insurance.

The consequences and impact of such technologies on the exercise of medical activities and medical liability is making it possible to contain costs, particularly for the management of contracts and the processing of claims, as well as to improve the services rendered. Furthermore, the leveraging of information technology by the larger players in Lebanon is gradually leading to better risk selection. But such technology is less affordable for the smaller players. Here also, the role of TPAs is becoming increasingly evident.

Premium Concentration

The concentration trend in the health category is evident, as the top 5 insurers account for about 51% of health premiums while the top 10 firms generate nearly 66% of health premiums.

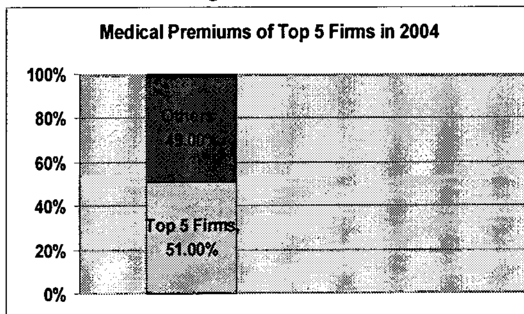


Figure 2.24

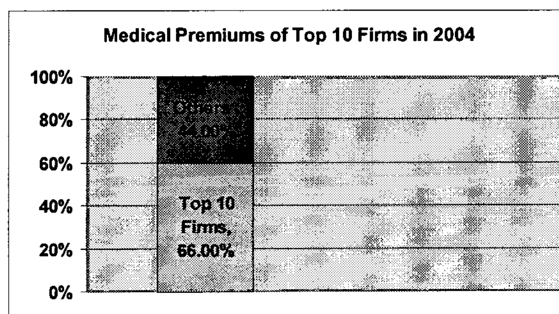


Figure 2.25

MEDGULF is the largest provider of health insurance in Lebanon with a market share of about 20% of health coverage. It has followed an aggressive strategy, attracting trade associations by offering favorably priced group packages due to economies of scale, good capitalization and market reach. Some of its clients include the major professional orders and syndicates in Lebanon such as the Order of Engineers, the Order of Pharmacists and the Syndicate of Lawyers. MEDGULF has its captive third-party administrator MEDGULF Assistance that manages and services its medical portfolio.

MedNet on the other hand acts as a third-party administrator between insured, insurance firms (such as AXA, Bankers, and Libano-Suisse), and the healthcare providers and the facilities they need.

The other small players that together account for a mere 35% of health premiums are facing increasing pressure from market forces. While the larger health insurers are better capitalized, have more resources to compete for large contracts and public tenders, and have more leverage with hospitals, the smaller players are left to compete on little more than pricing.

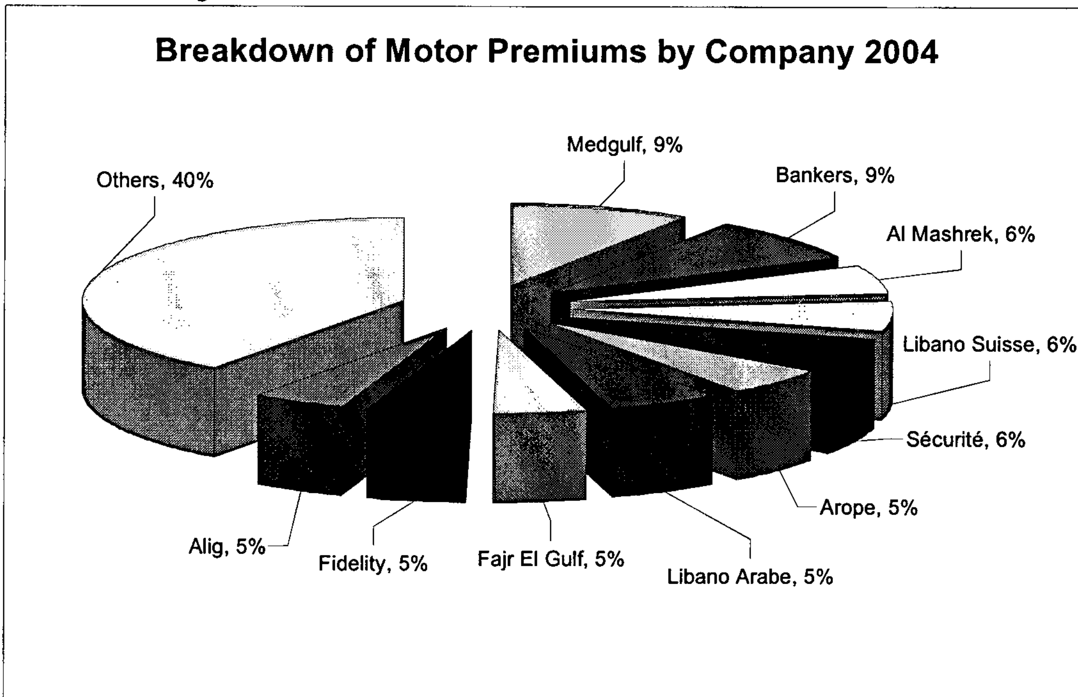
Larger players are becoming more competent and are trying to improve their ability to deliver services, which increases the level of trust of current and potential policyholders. Over the long term, this will help improve profitability, and will widen the gap between large and small players in the medical insurance sector.

AUTO INSURANCE

During the 1996-2004 period, motor insurance accounted on average for about 21% of general insurance premiums and for nearly 15.4% of total premiums written in Lebanon compared to 30% in the Arab world. *(Insurance Control Commission)*

Unlike the medical and life insurance categories, the auto line does not have one major player. The main underwriters of auto insurance in Lebanon are the larger non-life players like Medgulf, Bankers, Al-Mashrek, and AROPE, among others.

Figure 2.26



Even though the market for auto insurance is very competitive, the category is relatively concentrated, with the top 10 Lebanese insurers accounting for 60% of motor premiums.

Figure 2.27

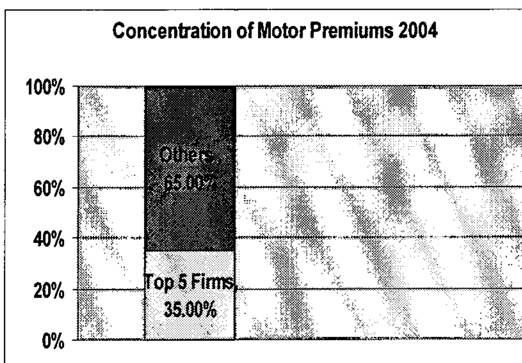
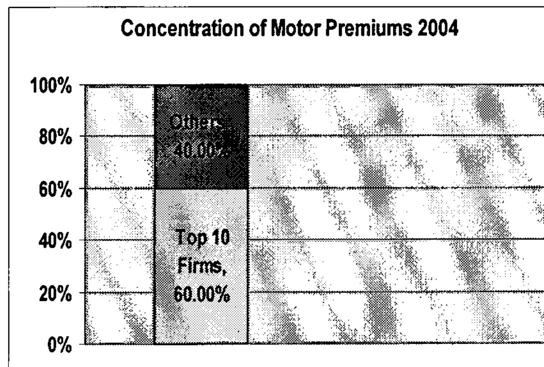


Figure 2.28



Vehicle insurance in Lebanon is divided into three categories:

1) Third-party liability insurance (Bodily Injuries and Material Damage): The insured is covered against injuries caused to third parties and/or damages caused to third party vehicles. Third-party liability is the most common form of car insurance and is the minimum legal requirement in countries where auto insurance is obligatory. The auto insurance premium for third-party liability coverage usually depends on the vehicle's brand and model, horse-power, age of the driver and the sum insured.

2) Total loss insurance: It covers, over and above third-party liability insurance, fire, theft and loss of more than 65% of the vehicle's value.

3) All risk or comprehensive insurance: It covers, over and above total loss insurance, partial damages caused to the vehicle. Certain risks are excluded from all risk policies; however, coverage may be obtained for an extra premium. All risk insurance is available only for cars that are less than ten years old. The auto insurance premium for all-risk coverage usually depends on the vehicle's brand and model, year of production and market value.

Loss Ratio

Auto insurance has a high loss ratio (ratio of claims to premiums) because of the high accident rates in Lebanon, which is mainly due to the unregulated driving, weak law enforcement, below standard road conditions and poorly maintained vehicles.

Third Party Bodily Injuries

Compulsory vehicle insurance law was introduced in Lebanon in 1972 but never implemented. A law requiring motorists to have third-party automobile insurance against bodily injuries went into effect in April 2003. The new rates, which cover bodily injuries only and exclude damages to the car, range between LBP 65,000 ($43) and LBP 90,000 ($60) a year with full medical coverage covering liabilities of up to LBP 750 million, or $500,000.

The Orange Card

In late 2001, Lebanon joined the Orange Card system, a unified auto insurance plan offering automobile coverage in 14 Arab countries that include Syria, Jordan, Palestine, Iraq, Egypt, Bahrain, Qatar, Kuwait, the UAE, Algeria, Libya, Morocco, and Tunisia.

The Orange Card is applicable only in countries that have mandatory car insurance, yet Lebanon was authorized to join despite the fact that obligatory auto coverage was not implemented by then. The card allows Lebanese insurers to issue auto insurance policies for vehicles traveling among the participating Arab countries, and is equivalent to the Green Card Insurance in Europe. The type of coverage varies between countries depending on the prevailing insurance laws in each country.

A total of 33 Lebanese insurers participate in the unified auto insurance plan that is administered by ACAL. The Orange Card plan generated around $2.5 million in premiums and $500,000 in net profits during 2004.

Profits are distributed among the participating companies according to a pre-set formula. But, because of a confidentiality clause in the pool agreement, the full mechanism of profit sharing is not clear. Every participant cedes 100% of the net written premium to the pool and receives a fixed commission. The profit sharing formula among members depends on the overall results and each company's contribution. It also takes into consideration premiums, premium reserves, paid claims, outstanding claims, reinsurance fees, and ACAL's administrative expenses.

Many Lebanese insurers have expressed concern that the Orange Card system has not been balanced, as Lebanese vehicles were mandated to carry insurance once crossing into an Arab country, while Arab cars incoming to Lebanon were not obliged to be insured.

Trends

The Ministry of Economy & Trade estimates that only 40% of registered cars in Lebanon (i.e 1.3 million) are covered by insurance for Material Damage. Some insurance firms say an additional 300,000 cars are not registered. ACAL estimated that premiums for the auto insurance category could jump by up to $50 million if another law for Third Party Material Damagee is applied in the country.

Warnings from Insurers

Some insurers claim that there are two main points of contention regarding the new law of Third Party Bodily Injuries:

1) It covers many of the exclusions of the old terms and allows for near unlimited inclusions while liability coverage has been set at a very high rate of $500,000.

2) The second point is directly related to the first. Many insurers have argued, unsuccessfully, with the Ministry of Economy & Trade to have a minimum mandatory rate of about $120 per vehicle, a reasonable range to cover potential losses and claims, particularly that auto accidents claims have a high frequency compared to other lines.

Others have argued that mandatory auto insurance would have been more competitive if the law did not mandate a fixed amount. In the case of collisions, auto insurance has a high frequency, low severity loss profile but in the case of third-party liability, it becomes a high frequency, high severity loss. However, pressure from syndicates and unions has led to a much lower rate ranging from $45 to $60 per year. But in reality mandatory auto insurance is selling for even lower rates as some players were trying to gain market share through aggressive price competition.

Over the short term, the mandatory rates may be low enough to cover a large part of the uninsured vehicles and, therefore, provide Lebanese auto insurers with a relatively stable demand for their product and help increase premium revenues. But the high liabilities coverage of $500,000 will put a serious dent in the profitability of insurers over the long term. This will also tempt the courts to award high claims. One judgment reportedly ordered the payment of $ 100,000 to the beneficiaries of a car accident victim. The award is several times higher than the more usual range between $10,000 and $17,000.

Profitability Concerns

According to Fitch Ratings, auto insurance has a relatively 'short tail', meaning losses are identified, adjusted and paid quickly. Auto physical damage claims, in particular, have a short tail while auto liability claims have a somewhat longer tail. The economic implication of this factor is that auto insurers have little opportunity to earn investment income from auto premiums. As a result, underwriting profitability becomes more important to auto insurers.

Incomplete Coverage

Over the long term, compulsory auto insurance laws have had only relative success in reducing the uninsured driver population even in very mature markets. According to the Insurance Research Council, 14% of drivers in the United States are still uninsured despite penalties for driving without liability insurance. Therefore, it is unrealistic to expect a near 100% compliance with mandatory third-party liability insurance in Lebanon over the long term.

Although the number of uninsured drivers declines when a compulsory law goes into effect, some drivers allow the coverage to expire and gradually the number of uninsured drivers increases again, leaving people who obey compulsory auto insurance laws subsidizing those who do not.

Enforcement of Compulsory Laws

The Ministry of Economy & Trade and the Association of Lebanese Insurance Companies (ACAL) set up the National Mandatory Car Insurance Institute to supervise the implementation of the new law. However, a number of organizational and regulatory difficulties slowed down the law's implementation.

The Lebanese market is characterized by poor enforcement of auto insurance laws. Strict enforcement of compulsory auto insurance laws, with mandatory and significant fines for first time offenders, may be the key to lowering the uninsured motorist population.

Penalties for noncompliance should include fines, jail time, license or registration revocation, confiscation of license plates and vehicle impounding.

Enforcement laws should be strict enough to foster awareness among motorists that there will be a penalty for driving without insurance. However the dilemma lies in the fact that if the penalties are too punitive, courts and law enforcement agencies may not be disposed to enforce them.

Third Party Material Damage

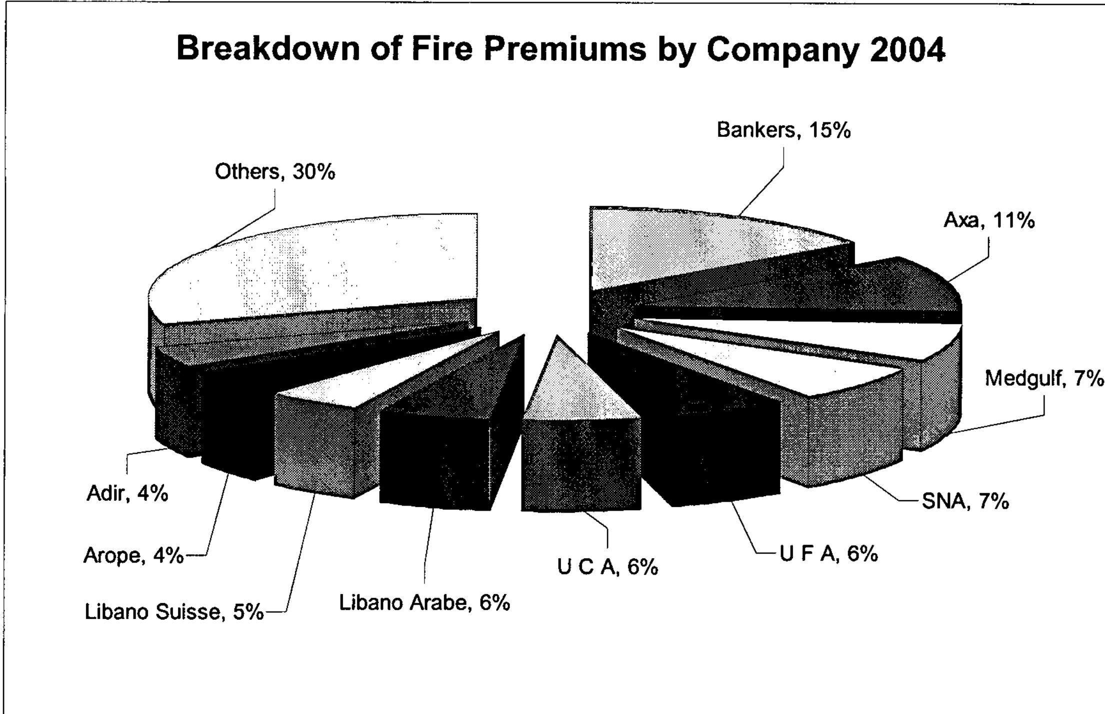
There are ongoing deliberations about the expansion of mandatory auto insurance to include third-party property damage liability. It may be premature to impose compulsory bodily damage so soon after the introduction of third-party liability, simply because insurers have not had enough time to see the full results of the new law or review the resulting claims ratios. Further, many insurers have low capitalization, which would hurt them in case they must pay multiple claims. Additionally, reinsurance firms have increased the retention rate on local insurers.

FIRE INSURANCE

During the 1996-2004 period, fire insurance accounted on average for about 10% of general insurance premiums and for nearly 6.5% of total premiums written in Lebanon. *(Insurance Control Commission)*

The main underwriters of fire insurance in Lebanon are Bankers, Axa ME, Medgulf, and SNA, among others.

Figure 2.29



No insurance company dominates the fire insurance market, yet the category is relatively concentrated, with 10 Lebanese insurers accounting for 70% of premiums.

Figure 2.30

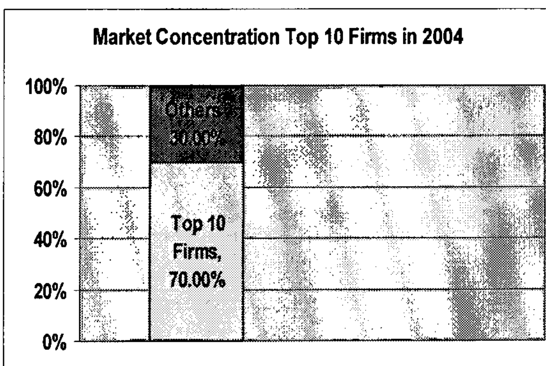
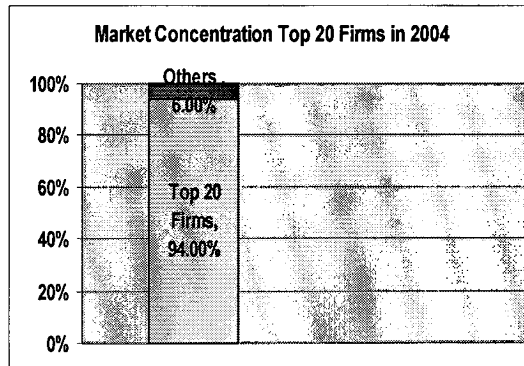


Figure 2.31



Historically, results have been good, although loss ratios are not available, and despite pressure from reinsurers to increase premiums, the class remains extremely competitive.

In comparison to many other countries the volume of business is still low. This is due to the almost complete absence of householders business and partly to the fact that most Lebanese industry is made up of small scale, family enterprises. The largest property risk in the country has a sum insured of only USD 100mn. Some Syrian business is also written.

Building Regulations

Lebanon's building regulations have not been developed or enforced for over 20 years, and despite the country's seismic exposure, there is said to be no earthquake code. Some market insiders state however that as Lebanese engineers have either been trained in the American University in Beirut or in French universities, they automatically apply international building codes to the construction of local buildings. This applies particularly to structures of four floors and over. Many are said to follow the US Uniform Building Code (UBC) requirements as prescribed for zones 2 and 3. (Lebanon is Zone 2)

Built Environment

Lebanon's cities and towns suffered massive destruction during 16 years of civil war and Israeli bombardment. Enormous progress has been made in rebuilding Beirut and parts of the city are now indistinguishable in appearance from any other modern Middle Eastern city. However, quite large areas continue to show extensive war damage.

Apartment blocks, hotels and offices rise to an average of 10 to 12 storeys, and there are 10 skyscrapers exceeding 25 storeys. Lebanon's tallest building is Marina Towers.

One hazard mentioned by local underwriters is the practice of locating warehouses and workshops in basements which had been converted to bomb shelters during the war. These basements normally have only one entrance, making fire-fighting access almost impossible. Basement fires normally produce a total loss on contents.

As a result of security concerns and the better returns available in speculative building, very little private investment has gone into the industrial sector since the war. The quality of factories is therefore extremely variable, and many are poorly maintained and lack reliable supplies of electricity and water.

Modern private dwellings, usually apartments, are of concrete framed fire resistant construction mainly of concrete.

Terrorism

Terrorism has rarely been provided for Lebanese risks and all treaties now carry war and terrorism exclusions. Lebanon is complying fully with the relevant United Nations resolutions and is fully co-operating with the Security Council in the implementation of Resolution 1373 passed in 2001 concerning counterterrorism.

The demand for terrorism used to be very limited and usually confined to multinational risks (McDonalds and Burger King, for example) where global programs require coverage. When written, cover is believed to be sought from the London market.

McDonalds was the target of a terrorist attack in 2003 when a car bomb outside a Beirut branch was defused. There was also another small bomb inside the restaurant, which did explode, causing damage.

The latest assassinations and bombs in Lebanon increased tremendously the demand for terrorism cover most of the quotations provided were not bought due to the fact that the rate requested by reinsurers are quite expensive.

WORKMEN'S COMPENSATION INSURANCE

Until the introduction of mandatory third party auto insurance in April 2003, workers' compensation was the only compulsory insurance category in the country. Lebanese laws oblige employers to subscribe to insurance policies that cover employees against accidents sustained at work as well as those sustained on the way to and from work.

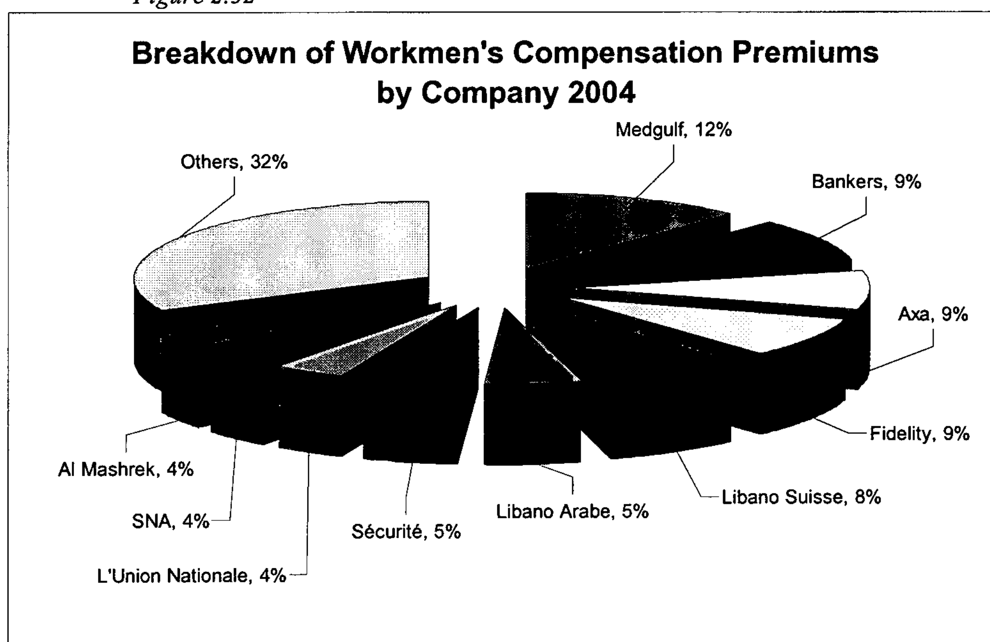
However, the law has not been enforced, but a new agreement between the Association of Insurance Companies and the Ministry of Economy & Trade will result in the implementation of workmen's compensation on a large scale. According to ACAL, companies of all sizes and in all sectors will have to provide coverage to their staff and workers.

Workmen's compensation insurance covers loss of employee's income, medical care, death, disability and rehabilitation. Premiums are calculated based on total salaries paid by employers, occupation of employees and the employer's history of claims.

Workmen's compensation, like medical insurance, has one of the highest loss ratios in the sector (ratio of claims to premiums). Workmen's compensation insurance has accounted for around 5% of non-life insurance premiums, on average, over the period 1996-2004.

Workmen's compensation in Lebanon covers mainly blue collar workers in sectors such as construction and manufacturing, and has faced various challenges in addition to rising medical costs. Given the slowdown in construction activity in the country relative to the early and mid 1990s and since Lebanon has a limited manufacturing base, this line of insurance has been dependent on sustained economic growth.

Figure 2.32



The main underwriters of Workmen's Compensation in Lebanon are Medgulf, Bankers, Axa ME, and Fidelity, among others.

Even though no one player dominates this insurance line, the category is relatively concentrated, with 10 Lebanese insurers accounting for 68% of workmen's compensation premiums.

Figure 2.33

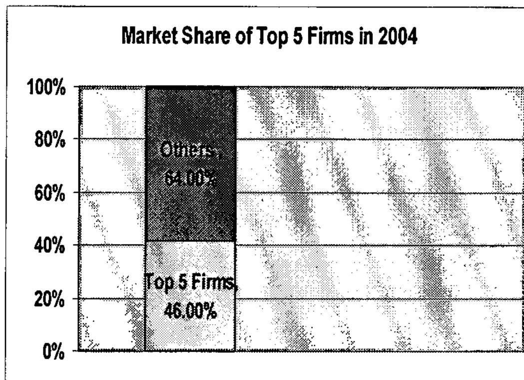
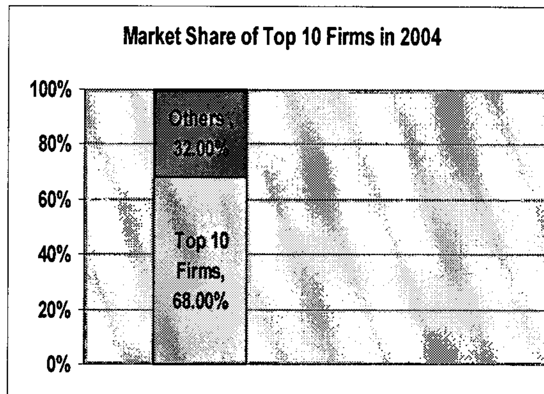


Figure 2.34



CREDIT INSURANCE

Credit insurance is the coverage of receivables in business-to-consumers and business-to-business loans. The insurance reform law of 1999 instated credit insurance as a separate line with LL 1.2 billion, or $0.8 million, in reserve requirements. The advantage of a well-managed credit insurance operation is essentially to allow better cash flow management at the creditor's level. There are two types of credit insurance in Lebanon:

1) Consumer Credit Insurance
2) Trade Credit Insurance

1) Consumer Credit Insurance

Consumer credit insurance has been linked to many consumer loans such as mortgages, automobile loans, personal loans, revolving lines of credit and credit cards. With the end of the war and the resumption of economic growth in the country, Lebanese banks' lending increased and they started to extend consumer credit such as car loans, mortgages and personal lines. Simultaneously, banks started to get credit insurance policies as a way to reduce their exposure and better manage their risk.

It was supposed to be mutually beneficial for banks and insurers. The insurance company would recover a significant proportion of claims at a cost advantage to the bank, while the bank would get regular payments from the insurer less the hassle of recovery. Further, the insurance company makes money on better than anticipated and quicker recoveries as well as fees and charges. Consumer credit insurance is management intensive, which saw the formation of two specialized organizations.

a) Companie Libanaise pour la Protection du Credit sal (CLPC)

A third-party administrator for credit insurance, CLPC was established in 1994 to centralize the business and pool the resources of 8 large insurers. The companies are ADIR, Assurex, Bankers, Libano-Arabe, Libano-Francaise (now AXA Middle East), Libano-Suisse, and Al-Mashrek. It acted as a center for processing claims, handling management and issuing policies on behalf of its institutional shareholders.

b) Credit Systems & Techniques sarl (CST)

CST was established in 1997 as a third-party administrator for the implementation and creation of consumer credit plans. It acts as a back office for insurers and banks involved in consumer financing by evaluating credit risk, processing claims, handling recoveries, and providing technical support. The firm focuses exclusively on consumer credit for periods not exceeding 60 months. It covers a variety of loans such as auto, personal, travel, home appliances, and school tuition loans, as well as credit cards.

2) Trade Credit Insurance

Trade credit insurance covers business-to-business loans, or the receivables of trade credits. It covers manufacturers, trading companies and providers of services against the risk of partial or total non-payment by their domestic or foreign customers. This category targets companies that have significant receivables exposure or that plan to extend more credit, firms with thin margins, export-oriented companies, and fast-growing firms. Like consumer credit insurance, trade credit insurance is management intensive and requires a lot of know how. It also requires systematic risk analysis and a pre-sign of policy before and after the policy is signed. It accounted for about 25% of overall credit insurance in Lebanon during the 1994-2004 period.

Trends

Consumer credit insurance generated at first significant premium income for insurers and accounted for about 90% to 95% of overall credit insurance. Aggregate net premiums totaled about $10 million over the 1994-2004 period, of which nearly $5 million, or 50%, were underwritten by the CLPC firms. Other players include Cumberland, Union Nationale, and North Assurances. But the line turned out to be costly to administer, as it accounted roughly for 10% of overall premium revenues but for 50% of operating expenses. The process faced several challenges: *(AXCO Report)*

• The line requires a complicated mechanism as insurers assumed the risk of delay of payment, and resulted in cash flow drain due to the high number of defaults.

• It is a line that has a small insurance component, smallest of all insurance lines, and requires a high management component such as credit management.

• The type of risk it assumes is different from other categories, as it fluctuates significantly.

• There are no reinsurance treaties worldwide that specialize in consumer credit insurance.

• Credit insurance made banks less severe on risk selection, while insurers priced the risks below what bank experience suggested it would be.

• The large number of defaults on various consumer loans only compounded the problems.

Because of these factors, results were negative, leaving many insurers with large losses. This prompted many of the Lebanese insurers to pull out of this category and led to the dissolution of CLPC.

Currently, AROPE, MEDGULF and Al-Mashrek are still active in providing consumer credit insurance, and CST remains the only TPA for the line. The banks active in credit insurance include BLOM, Standard Chartered, Federal, Lebanon & Gulf, and the Lebanese Canadian Bank.

Many insurers that were involved in consumer credit insurance turned their focus on trade credit insurance as it provides a significant potential with a domestic market of about $5 billion in insurable receivables and an additional $1 billion in insurable exports receivables. This line is concentrated in a specialized firm named Lebanese Credit Insurers.

Lebanese Credit Insurers sal (LCI)

LCI is a specialized credit insurance company that operates as a proper insurance firm covering domestic and export trade credit. It received its license from the Ministry of Economy & Trade in 2001 and started operations in January 2002. It covers Lebanon, Jordan, Syria, Egypt and Saudi Arabia.

LCI's main shareholders are the International Finance Corporation (IFC), the private sector arm of the World Bank, and Atradius, the world's second largest credit insurance and receivables management firm.

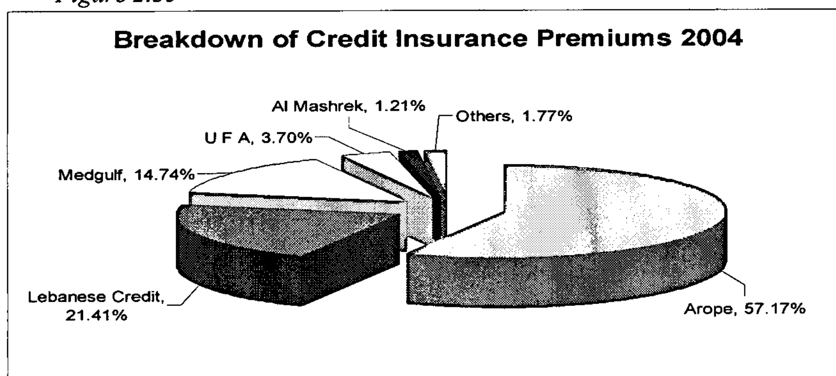
Atradius, formerly Gerling NCM, and the IFC hold through a joint holding firm 49% of LCI.

Al-Mashrek, Assurex, AXA Middle East, United Commercial Insurance, Libano-Arabe, Libano-Suisse, UCA Insurance (Bahrain), and other private investors hold the remaining 51% in the firm.

Atradius is also the technical partner of LCI, providing reinsurance support, staff training, product development, underwriting, international debt collection as well as leads through its global database.

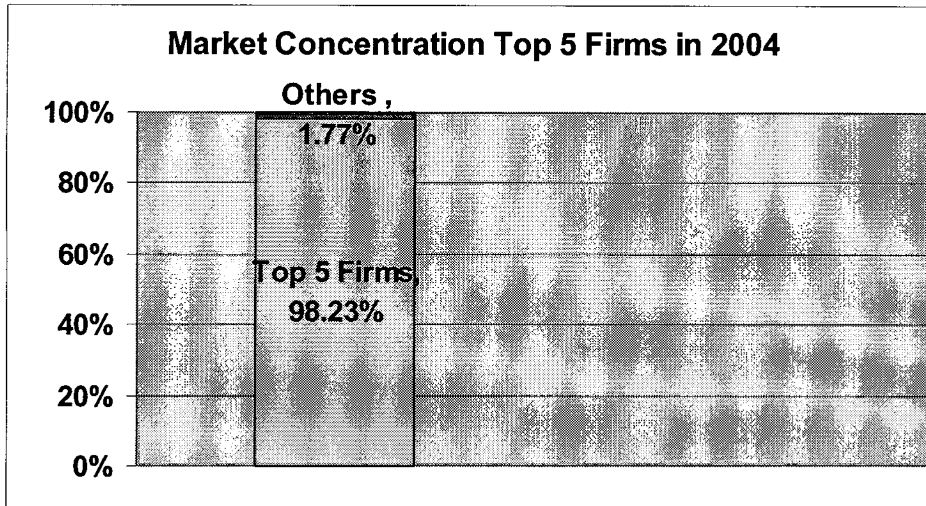
The main underwriters of Credit Insurance in Lebanon are Arope, LCI, Medgulf, and UFA, among others.

Figure 2.35



Because the market is thin for this insurance line, the category is very concentrated, with 5 Lebanese insurers accounting for 98.23% of credit insurance premiums.

Figure 2.36



MARINE INSURANCE

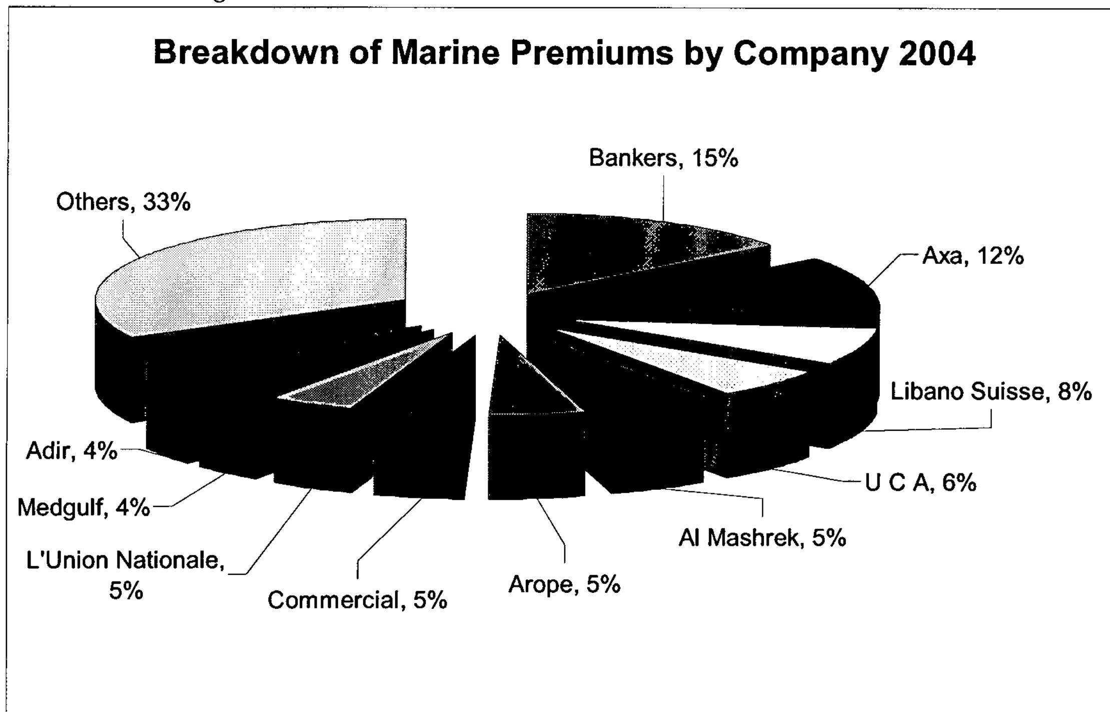
Marine insurance is constituted of both hull and cargo. Cargo businesses involves import/export take out marine insurance, which covers damage to merchandise during marine transportation. The Lebanese law allows companies to subscribe to marine insurance with overseas agencies. Premiums depend on several factors including the nature of the merchandise, the time needed to reach the final destination and the packaging. Marine insurance has accounted for a almost 4% of non-life insurance premiums, on average, over the period 1996-2004.

Most hull risks are placed directly in the Greek or London markets, although an ageing merchant shipping fleet means that insurance is increasingly difficult to place.

It is reported that many cargo contracts are negotiated with local insurers who then issue offshore company documents to avoid tax.

The main underwriters of Marine Insurance in Lebanon are Bankers, Axa ME, Libano Suisse and UCA, among others.

Figure 2.37



No one player dominates this insurance line, moreover most of the business is placed offshore and not reported in the Lebanese books. As for the reported premium, the marine category is relatively concentrated, with 5 Lebanese insurers accounting for 46% of market.

Figure 2.38

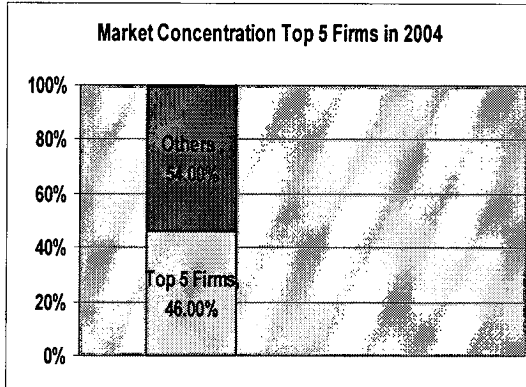
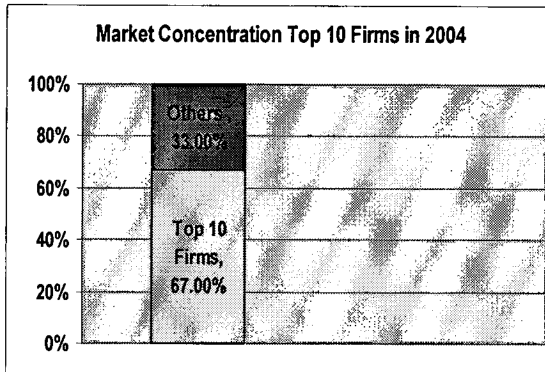


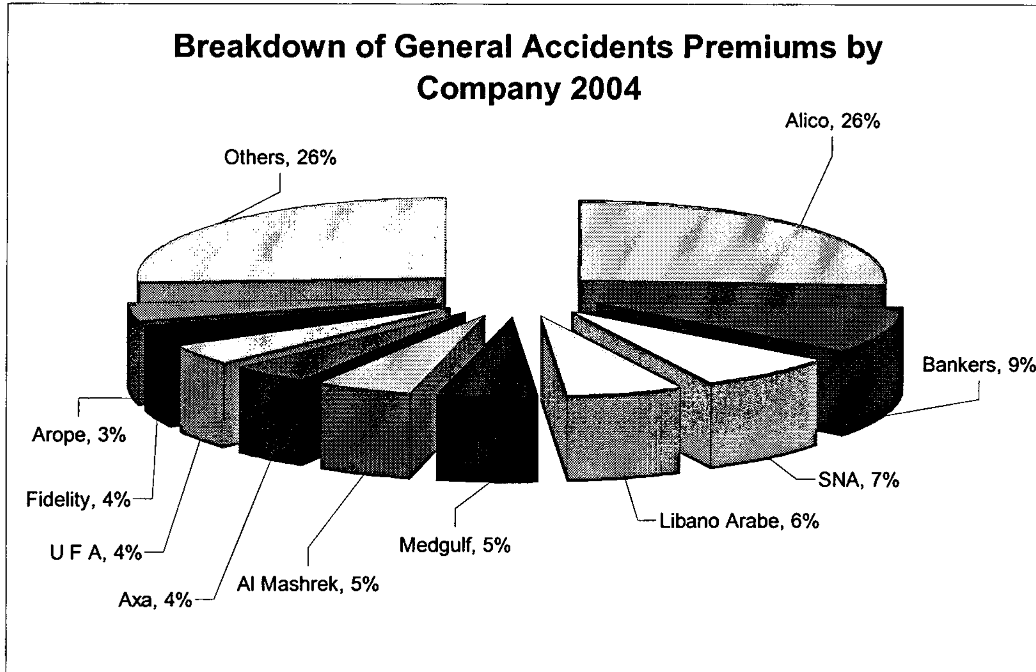
Figure 2.39



GENERAL ACCIDENTS INSURANCE

Personal Accident insurance, which constitutes the bulk of general accidents (in addition to Miscellaneous Accidents, General Third Party Liability...), covers a policyholder against accidental injury or sickness resulting in an unexpected drop in income. This type of insurance is essential for the self-employed who are not otherwise covered. Benefits include a lump sum payment in case of temporary disability or payment of regular income until the policyholder is able to return to work.

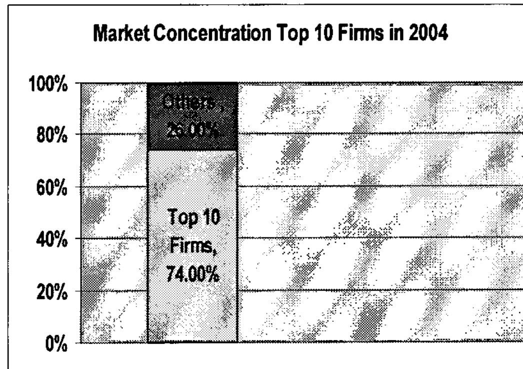
Figure 2.40



The general insurance category is relatively concentrated, with the top 5 Lebanese insurers accounting for about 54% of premiums.

Figure 2.41

Figure 2.42



ENGINEERING INSURANCE

Since 1994 the Beirut Central District (BCD) has been one of the largest building sites in the world. The government's post-war reconstruction program, known as Horizon 2000, had an initial budget of USD 60bn, with USD 18bn to be spent by the public sector. The program has been repeatedly criticized as being over ambitious especially as continued instability in the region has cast a shadow over Lebanon's desire to regain its status as a major financial centre.

The two main sources of government-funded construction business are the Council for Reconstruction and Development (CDR) and Solidere. CDR is responsible for implementing Horizon 2000 and principally concerns itself with infrastructure developments.

Solidere is a publicly-quoted real estate company charged with transforming central Beirut into a regional business centre and is funded partly by the sale of property to private developers. Solidere, which based on current plans will be dissolved after 25 years.

Notwithstanding concerns that the high prices demanded for Solidere properties would lead to a half-empty city centre, demand continues to rise and more than 400 businesses have relocated to the new area, as well as hotels, clubs and restaurants. Additionally, high spending Gulf Arabs have been buying and developing plots for luxury hotel and apartment blocks, with those already on sale attracting prices of up to USD 2.5M. *(Al-Bayan)*

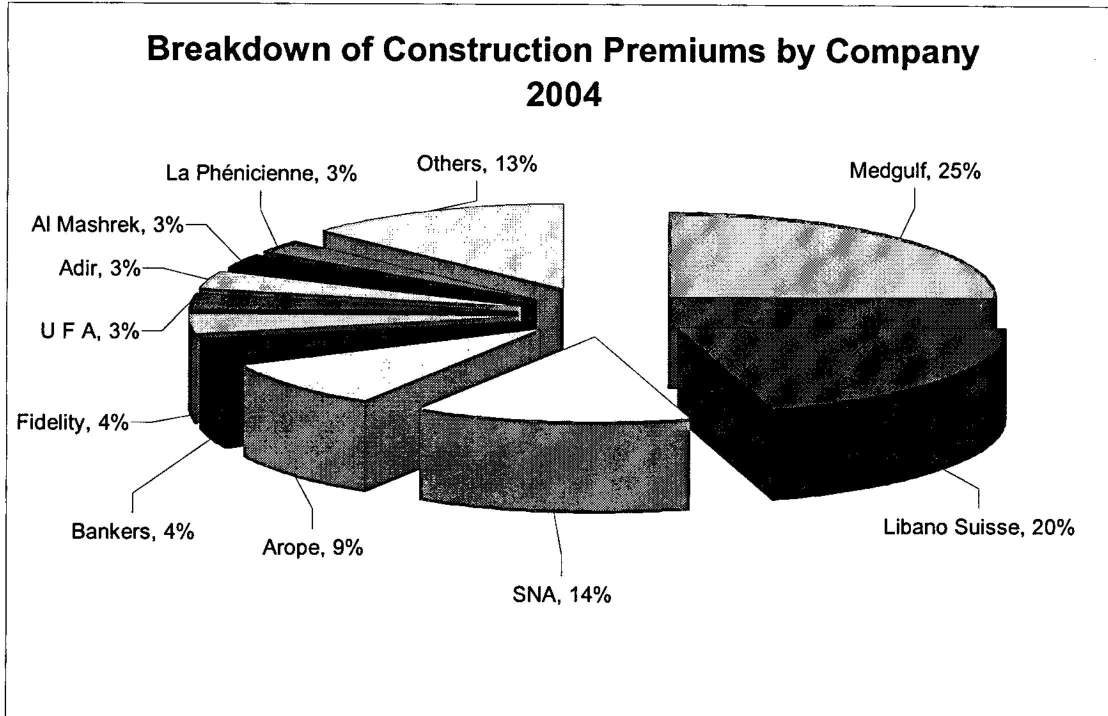
Although some new contracts are still being awarded, the building boom has passed its peak. Most of the largest projects were started in 1994 and 1995 and the insurance premiums have already been booked.

Outside of the Solidere panorama, there has been some new construction development, mainly involving tourism and retail projects.

The bulk of Lebanon's Contractor's All Risk business has been fronted into the international facultative market. The insurance association ACAL established a domestic engineering pool in 1994 in an effort to retain more business, especially that relating to the Solidere project, and an experienced underwriter was brought in to quote rates locally. The premiums were widely considered to be too conservative, however, and as a result the pool was regularly undercut by an aggressive international market; the volume of business written locally has been disappointingly small.

The main underwriters of Construction Insurance in Lebanon are Medgulf, Libano Suisse, SNA, and Arope, among others.

Figure 2.43



Huge engineering projects in Lebanon are limited, and they are usually insured with specific firms in Lebanon so it is somehow concentrated, with 5 Lebanese insurers accounting for 71% of construction insurance premiums.

Figure 2.44

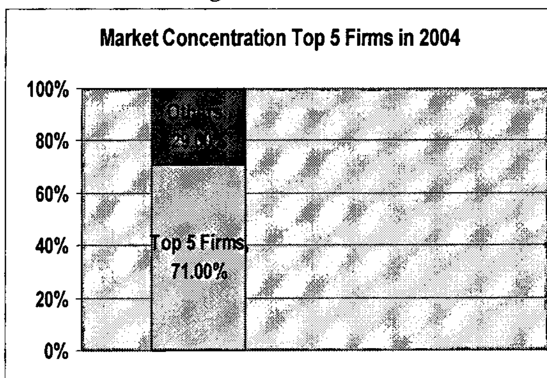
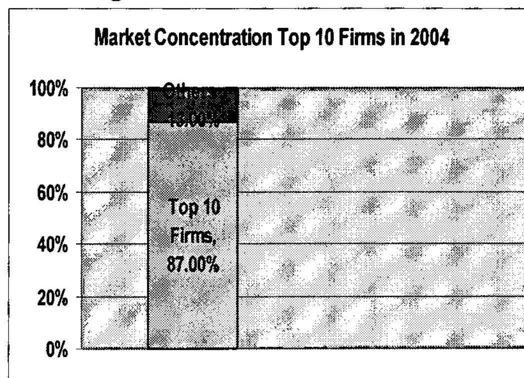


Figure 2.45



AGRICULTURAL INSURANCE

Agricultural insurance was introduced in the amended law of 1999. Agricultural insurance policies cover against hazards associated with agricultural businesses including loss or damage to growing crops as a result of floods, fire, drought, disease, wind and hail. Measurement of loss may be based on yields, production costs, an agreed value or rehabilitation costs.

II. LIFE INSURANCE

Life insurance products have been present in the Lebanese market since the 1950s, starting when the American Life Insurance Company (ALICO) established a direct presence in Lebanon in 1953. Today, a total of 31 firms provide life insurance products in Lebanon.

• Life insurance premiums amounted to $180 million in 2004, growing nominally by 29.4% from $139 million in 2003 and posting a real growth rate of 27.4% in 2004. The growth rate was one of the highest among Arab countries in 2004, as the other markets that posted comparable increases in life insurance are Qatar with 17%, Saudi Arabia with 16.2% and Egypt with 16.9%. *(Insurance Control Comission)*

• Nine of the top 10 life insurers in Lebanon posted growth in their premiums, with Libano Arabe and Arope recording the biggest rise in 2004 at 327.7% and 563.1% respectively.

• Life premiums posted a Compounded Annual Growth Rate (CAGR) of 12.6% during the 1997-2004 period, nearly grew 2.5 times form $69.5 million in 1997 to $180 million in 2004.

• Life insurance premiums account for 31.2% of aggregate premiums generated in the Lebanese market. This ratio is not in line with trends in developed markets where the life category accounts for about 60% of total premiums.

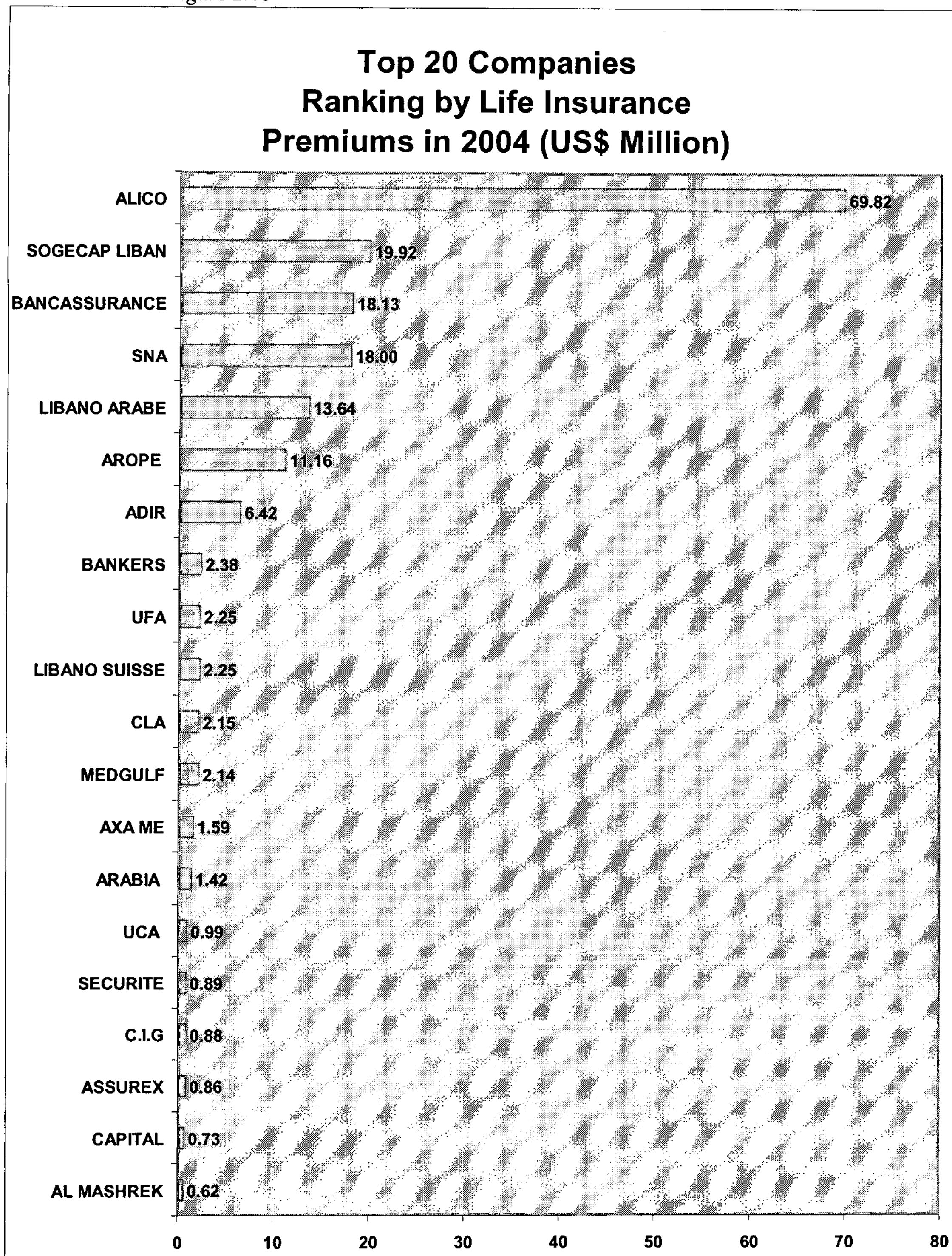
• Penetration was still low at 0.95% of GDP and density remained modest at $39.6 per capita in 2004.

• Life insurance premiums in Lebanon accounted for about 11.5 % of total life premiums generated in the Arab world during 2004.

• There is no pension system in Lebanon and the state does not provide old-age pension. Further, there is no specific legislation in Lebanese law that relates to pension plans. The NSSF provides old age, disability and survivors' benefits according to a 1963 law. Both the government, through the NSSF. and the employer pay a lump sum to an employee upon retirement. The amount disbursed is based on a combination of the employee's final salary and the contributions made during his or her career by the employer to the NSSF. One of the weaknesses of this approach is that it penalizes employees who decide to change employers during their career.

• Insurance regulations require a minimum of 50% of mathematical reserves from life premiums to be invested locally.

Figure 2.46



Market Structure

The market structure of the life category is heavily concentrated. The top five life insurers in Lebanon control 77.5% of the market with the top 10 capturing 91.1% of premiums.

Figure 2.47

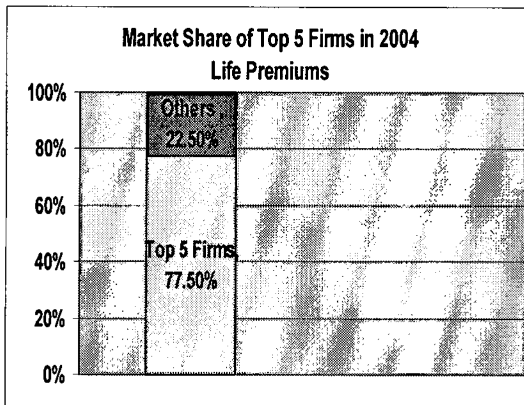
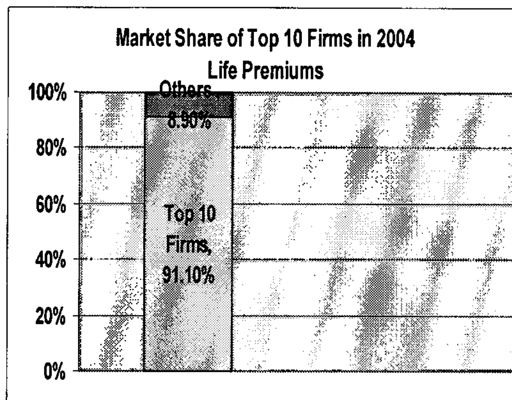


Figure 2.48



Nearly 87% of firms providing life insurance posted revenues of less than $5 million and 55% generated less than $1 million worth of life premiums in 2004, further reflecting the sector's concentration.

Figure 2.49

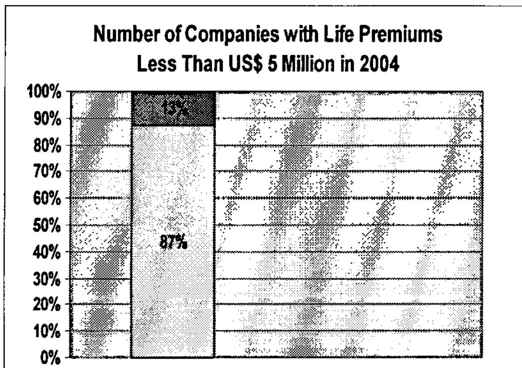
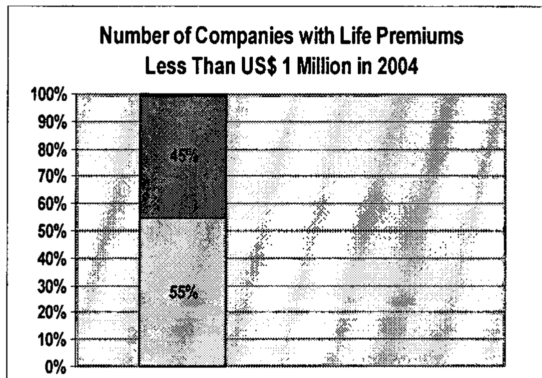
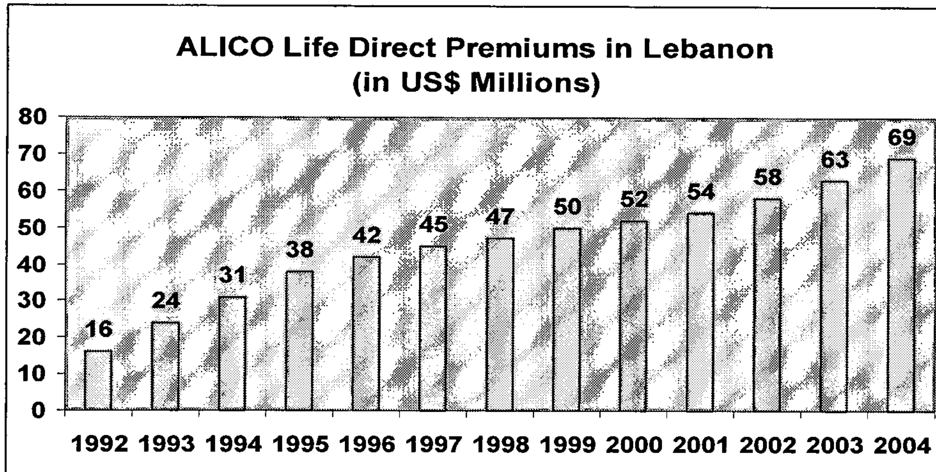


Figure 2.50



Additionally, one company, ALICO, controls 38.7% of the life market, down from 45.3% in 2003. Given that ALICO has traditionally dominated the Lebanese life insurance market, the growth in its direct life premiums is a useful indicator of the overall trend in this insurance category over the past 10 years.

Figure 2.51



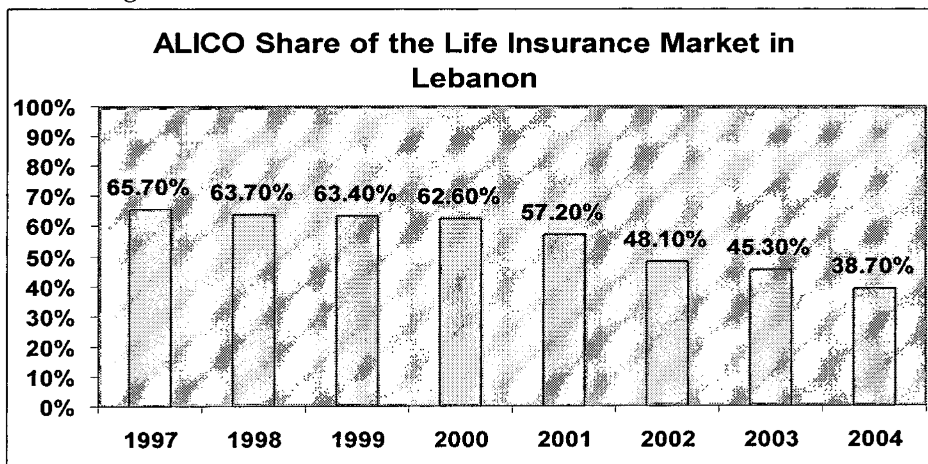
However, ALICO's once dominant position is being challenged by other players that have seen the sector's potential. First, global and European insurers that have entered the Lebanese market in recent years through the acquisition of stakes in local insurance firms, or established a direct presence, have started to structure and launch unit-linked life products, the new generation of life products in the Lebanese market.

Second, some local firms are following suit and forming life and retirement divisions to offer group and individual life and retirement plans linked to global investment funds.

Third, the development of bancassurance, or the sale of insurance products through bank branches, has contributed to the rise in the sale of life products in general and of term life policies in particular over the past few years.

ALICO is unlikely to lose its status as the market leader in the near term, but it will have to take into consideration the emerging competition over the medium to long term, as its market share has somewhat regressed since 1997.

Figure 2.52



The Lebanese insurance market is in line with the global trend of foreign insurers holding in domestic emerging markets a higher market share in life insurance than in non-life business. The life premiums of ALICO, AXA Middle East and SNA-AGF/Allianz generated in Lebanon totaled $75.5 million and accounted for 60.4% of aggregate life premiums in the Lebanese market for 2002.

In comparison, the three firms' non-life premiums generated in Lebanon totaled $55.6 million and accounted for 16.2% of aggregate general premiums in 2002. This trend is likely to increase given that 'bigger is better' in life insurance, meaning that global players have key advantages relative to their local counterparts in terms of capital, skills, technology, innovation and image.

Figure 2.53

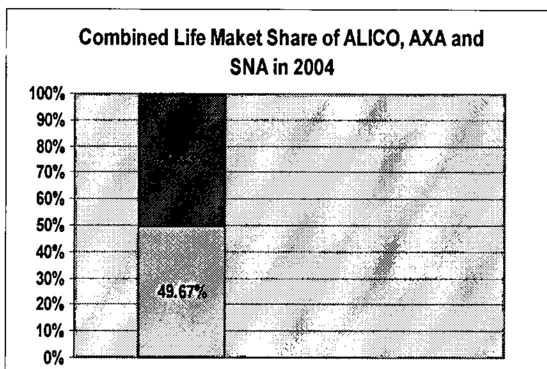
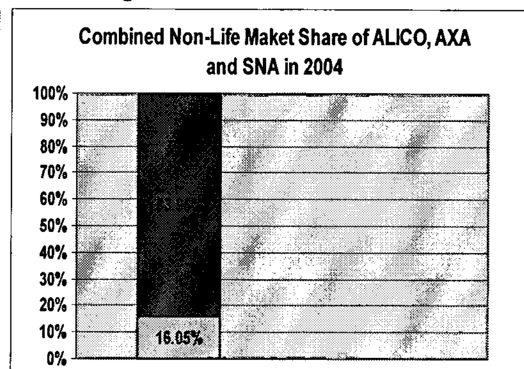


Figure 2.54



<u>Product Categories</u>

The Lebanese insurance market has offered throughout the years various types of life products.

a) Term Life

Term life policies are widely available in Lebanon. It is the most basic form of life insurance and covers the insured person for a certain period of time, which is the 'term' specified in the policy. It pays a benefit to a designated beneficiary only when the insured dies within that specified period. Contracts can be issued over one, five, 10 or even 20 years. Generally, term life policies are renewable but premiums increase with age. Some term life plans have a guaranteed level premium for the duration of the coverage. Critical illness coverage, along with other additional benefits that can be attached to term life plans, are usually offered as a rider to both individual and group term policies.

b) Whole Life

This category combines protection against premature death with a savings account known as a cash value account. Generally, the policy is purchased for life and builds cash value that the policyholder is partially entitled to while the policy is in force, and is entirely entitled to it if the policy is cancelled before its maturity date.

Whole life policies guarantee the death benefit premium that the insured pays throughout the life of the contract, so there are no premium increases with age. In other words, the premiums are fixed and guaranteed and remain level for the policy's duration.

Whole life policies also guarantee a minimum interest rate and/or dividends on the cash value build-up in the policy.

c) Universal Life

It is a flexible premium policy that combines protection against premature death with a fixed income savings component that typically earns a money market rate of interest. Death benefits can, within limits, be increased or decreased throughout the policy years. Changes in the coverage amount of the policy are generally subject to a medical examination. Premiums can be paid throughout the policy duration or can be pre-paid over a few number ofyears. The policy remains in force even if regular premium is not being paid, as long as the policy has enough funds to cover the monthly cost of insurance and administrative charges.

d) Variable Universal Life and/or Unit Linked

It is a policy that combines protection against premature death with a savings account that can be invested in global stock or bond funds at the policyholder's discretion. Variable Universal and Unit-Linked policies tend to be linked to a fixed income account with a minimum guaranteed rate of return.

In the current global interest rate environment, companies offering such policies are not extending their fixed income guarantees beyond five years. The policies tend to offer a broad selection of well-diversified global funds in many currencies and sponsored by leading international money managers. Policyholders can choose their premium allocations depending on their investment profile and appetite for risk. Such policies provide policyholders access to global financial instruments that are packaged with their life insurance needs.

e) Group Plans

Life insurance providers can offer group term life and group retirement policies that cover company employees and their families. Such plans can be distributed at low cost because of the economies of scale. They have become popular in developed markets and have generated large premium flow for insurance providers in recent years. For example, group life coverage currently accounts for about 40% of total life coverage in the United States compared to only 26% of total life insurance coverage in 1974.

Trends

• Banks have linked term life insurance to consumer loans over the past several years. They have required individuals who take out car loans. mortgages. and personal loans to have term life, also known as 'credit life' insurance, as a guarantee of repayment of a loan in case the borrower dies or becomes incapacitated. This led to a significant growth in the sale of individual simple life insurance policies.

• The marketing and sales of life and savings insurance products through commercial banks accounted for most of the increase in life premiums in 2004. This is reflected in the market share increase of insurance firms owned by banks and dedicated to selling life products through the branch network of their owners. SOGECAP Liban and Bancassurance are the largest two such firms in the Lebanese market.

• The two firms rank in the top 5 among the 31 companies that sell life insurance in Lebanon, as SOGECAP came second only to ALICO and Bancassurance ranked in 3rd place in 2004.

• SOGECAP posted a rise of 7.5% in its life premiums in 2004, while Bancassurance's premiums jumped by 31.3%, fourth highest among the top 10 life insurers in the country.

• The two firms accounted for 21.12% of total life premiums in 2004. They accounted for 23.2% of the aggregate premiums of the top 10 life insurers in 2004. They also held a 27.27% share of the aggregate premiums of the top 5 life insurers in 2004. When excluding ALICO from the top 5 firms, SOGECAP and Bancassurance accounted for 54.6% of life premiums of the next top 4 firms in 2004. Also, they accounted for 40.4% of the next top 9 firms in 2004.

• There are no official statistics available, but the major part of life insurance is thought to be sold on an individual basis.

• The success of foreign life insurers is due in large part to concerns of policyholders about the solvency of the local firms. Given the domestic economic uncertainties and the general lack of transparency of local firms, consumers have looked upon foreign players as providing added security for their funds and as a safe haven for their retirement money. However, this trend is changing as local providers become more transparent in their accounting and reporting.

• Insurance firms operating in Lebanon stopped selling whole life polices in the late 1990s, as it became increasingly challenging to meet the guaranteed interest rates and the minimum yearly dividends. Also, the introduction of variable universal life and unit-linked life plans helped put an end to the sale of whole life policies.

• In line with international trends, insurers have gradually shifted the investment risk to the policyholder through variable universal life and unit-linked policies. The premium and the long-term interest rate guarantees were replaced with premium flexibility and a broad investment choice.

• Lebanon's ageing population, the rise in pension and compensation packages of state employees, and the persistent fiscal deficits are putting pressure on the state provision of end-of-service indemnities and pensions for public sector employees. Retirement and compensation salaries totaled about $733 million in 2003, equivalent to 11.6% of the 2003 budget expenditures, up from 4.8% in 1994. Further the aggregate amount paid to public sector retirees over the 1994-2003 period adds up to $4.2 billion.

• The inadequacies of the social security system and the low level of retirement benefits provided by the NSSF to private-sector individuals has led people to increasingly rely on private life insurance and savings policies as retirement alternatives. As a result, individuals and households have bought long-term savings products related to insurance policies so they can receive a lump sum or pension when they reach the retirement age.

• Several insurance firms operating in Lebanon have launched or are preparing to introduce individual and group variable universal life, unit-linked life and retirement products in the market. ALICO offers the Vision Plan, Bankers Assurance has launched Choice Plus (for individuals) and Directors (for groups of employees) in 2003, SOGECAP Liban has its Cape Entreprise (for groups) and Cape Investissement (for individuals) plans, AXA Middle East introduced its VIVA Plan in 2004, Arabia has the Arabia Lifestyle plan, SNA launched in 2001 its single-premium Multi-Fund series, and ADIR is getting ready to deploy a range of sophisticated products.

OPERATIONS

Overview

One indicator of the operational efficiency of insurance firms was developed by a rating agency *(Muhanna DAIR Magazine)*. The firm structured a tool that measures the relative efficiency of insurance companies in Arab countries as well as per insurance category. The index is a first step to measure the efficiency of Arab insurers and will be refined and improved gradually. It is based on the average gross premiums per employee per country. The premiums were written in 2004 by a representative sample of insurance and reinsurance companies from 10 Arab countries, including firms from Lebanon.

The index shows three categories of efficiency, with the most efficient markets being Kuwait, Qatar, Oman and the United Arab Emirates. The countries showing an average level of efficiency are Saudi Arabia, Lebanon and Tunisia, while the least efficient ones are Jordan, Yemen and Egypt.

Lebanon posted an average of $ 165,628 in premiums per employee and ranked 7th out of 10 countries surveyed in terms of operational efficiency. Its premiums-per-employee figure is significantly below the simple average of $580,635 for the 10 covered countries.

According to the rating agency, the results indicate a substantial divergence in the efficiency in Arab insurance markets.

The most efficient insurance markets are oil-producing countries with large contracts and industries and where personal lines are less developed, therefore that have large premiums per employee. The least efficient markets are those with limited natural resources, less developed life markets and state-owned insurers.

Table 3.1

Insurance Efficiency Index 2004

Country	*Premium Per Employee (US$)*
Kuwait	920,218
Qatar	674,314
Oman	336,853
UAE	329,762
Saudi Arabia	203,787
Tunisia	178,896
Lebanon	**165,628**
Jordan	101,772
Yemen	69,943
Egypt	41,795

The operational efficiency of the Lebanese insurance sector is positively influenced by the fact that the industry is totally in the hands of the private sector. Efficiency is negatively affected in countries with state-owned insurers, as the usually over-staffed firms yield a lower premium per employee, which explains the low efficiency of the Egyptian insurance sector. On the other hand, Lebanon does not have the advantages of the more efficient Arab markets in terms of large industries related to oil production.

Further Lebanon has one of the more developed life insurance sectors relative to other Arab countries, which increases the comparative efficiency of the Lebanese market. In absolute terms, the presence of global players life insurance in the local market like ALICO, AXA and AGF Allianz will help develop the life category in particular. In turn, this will help generate more premiums per employee to reflect the firms' economies of scale.

Additionally, Lebanon represents a specific case in the Arab world due to the fact that medical premiums account for nearly half of non-life premiums and to the presence of third-party administrators that service several insurers and provide integrated managed care, therefore providing external operational efficiency.

MARKETING

Overview

Lebanon does not have a strong insurance culture and insurance awareness is still relatively low. People have traditionally looked at insurance as a luxury rather than as a necessity, especially with the economic slowdown, elevated cost of living and declining disposable income. Further, the high profile bankruptcies of MESIR and Phoenix have worsened the sector's image and further decreased the already low level of trust in both insurers and brokers.

But the country's relatively high insurance penetration rate (i.e. 3.06) by Arab standards is caused by necessity rather than due to attitude or a high level of awareness. This is strongly reflected in life and medical insurance, the two largest insurance categories in Lebanon, that constitutes 65% of total premiums mainly due to the following reasons:

• The poor quality of state-provided medical care and increasing pressure on public finances are putting growing constraints on the funding of public health care. Further, the high cost of medical procedures and in-patient treatment has increased people's reliance on private medical insurance and its benefits.

• The inadequacies of the social security system and the low level of retirement and benefits provided by the National Social Security Fund has led people to increasingly rely on private life insurance and savings policies as retirement alternatives.

• The traditional reliance on family members for funds whether for higher education or for buying a house has decreased, which encouraged people to look for alternative savings vehicles. More specifically, the level of public education and the high cost of private education at all stages are encouraging families and individuals to seek insurance savings plans for the future.

Trends

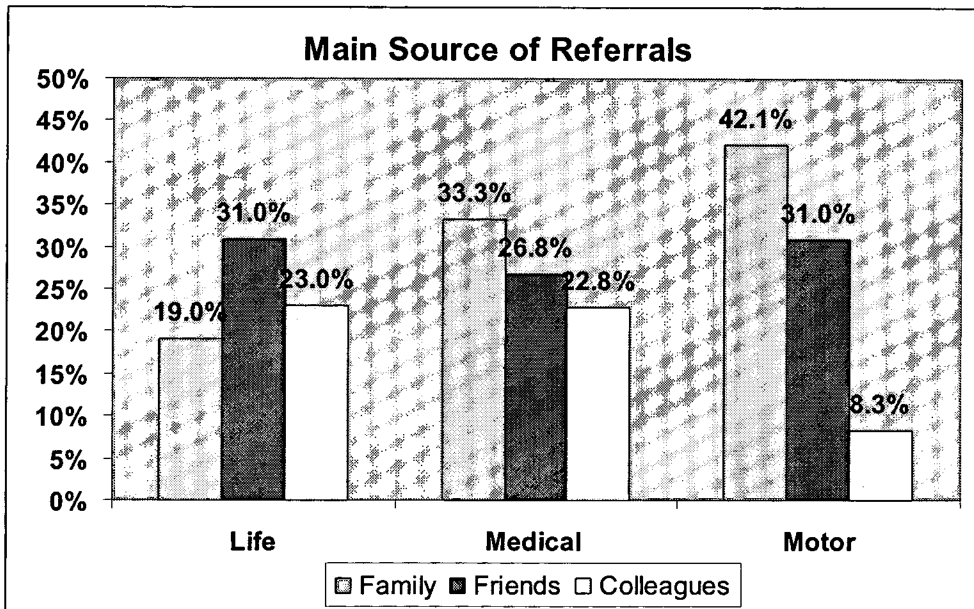
The population's level of trust in insurers remains low, as evidenced by the trend of individuals relying on family or friends as a source of referral to choose an insurance firm. This is especially true in areas where personal safety, stability and financial protection are involved, such as in medical, life and motor insurance.

A poll conducted in April 2003 in the Greater Beirut Area by research firm *(Information International)* shows that the majority or respondents looking for health insurance learned about their insurer through leads from friends, family members or colleagues at work rather than from brokers, advertising, or banks. More than half of respondents, or 60.1%, followed the lead of friends and family members in selecting an insurer, with family accounting for 33.3% of referrals and friends with 26.8%, followed by colleagues at work with 22.8%. Other channels dropped significantly in importance, as brokers and

advertising accounted for 4.9% each, followed by banks with 3.3%, business associations with 2.4% and syndicates with 1.6%.
The same trend is clearly visible in life insurance, where 50% of respondents said friends and family members introduced them to their current insurance company. Friends took the lead with 31% of referrals and family members with 19%. Colleagues at work played an important role, accounting for 23% of referrals, followed by agents/brokers 17%, banks 6% and advertisement 2%.

The trend is more noticeable in the case of motor insurance, where 73.1% of respondents relied on friends and family members to choose an insurance firm compared to 10.3% who relied on brokers, 8.3% on employers, 4% on advertising and 2% on banks.

Figure 3.1

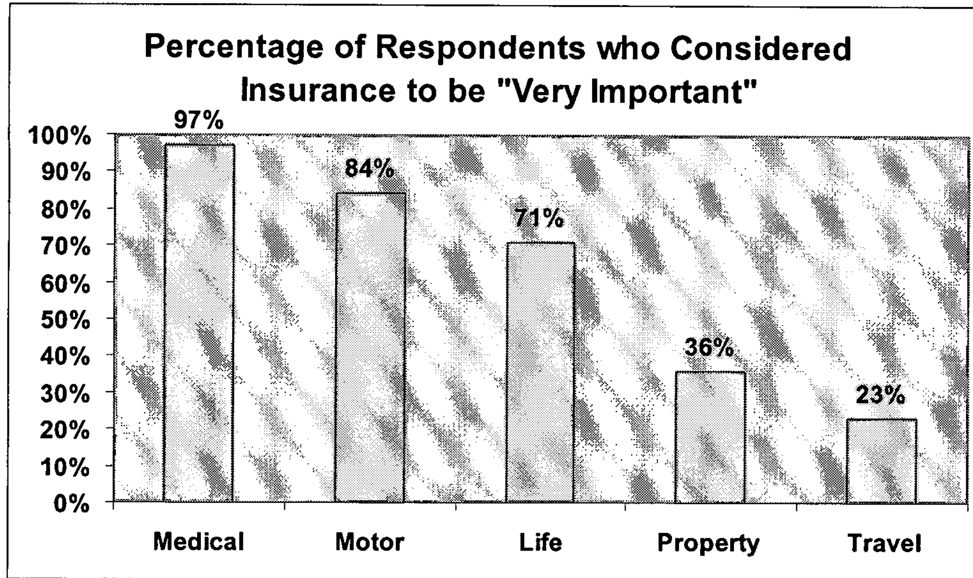


The results of the poll clearly reflect the higher level of trust that individuals put in their friends, family and colleagues than they do in more traditional and external marketing channels of insurance products.

Insurance Awareness

The same poll shows that life, medical and motor insurance were considered to be very important by a clear majority of respondents, reflecting an increase in the awareness towards the need of having insurance as protection against uncertainty, and the associated financial consequences of accidents and losses.

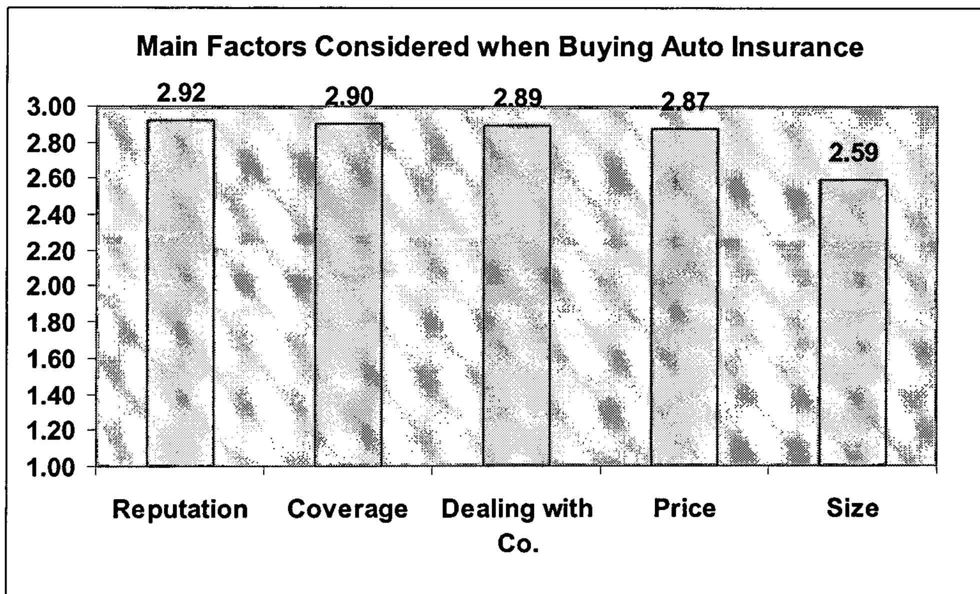
Figure 3.2



Insurance Perception

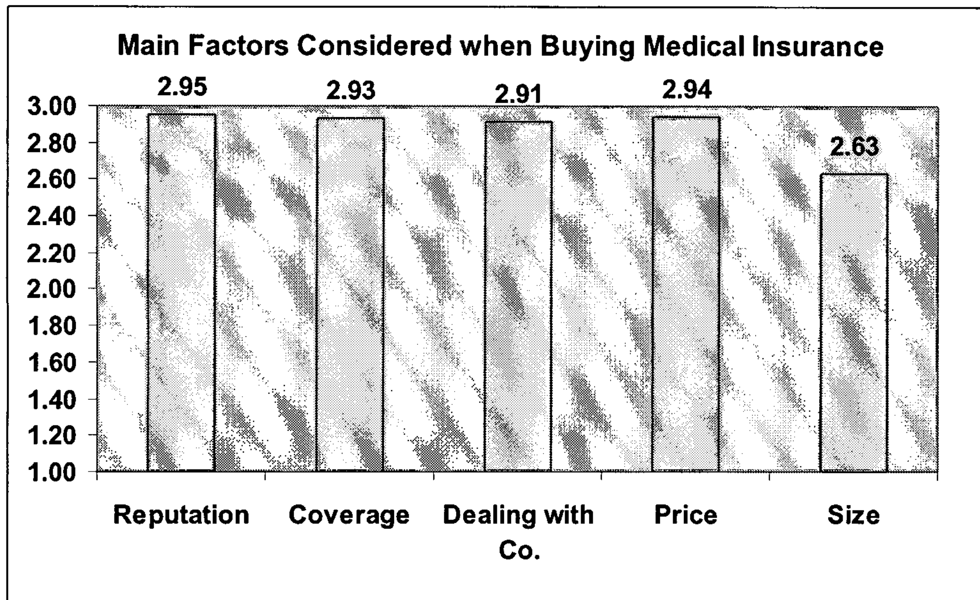
Respondents were asked to rank the importance of factors when buying auto insurance on a scale of 1 to 3, with 3 being the most important. A company's reputation was the most important factor with an average rank of 2.92. It was followed by policy coverage 2.9, ease in dealing with the company 2.89, price of the policy 2.87, and the insurer's size 2.59.

Figure 3.3



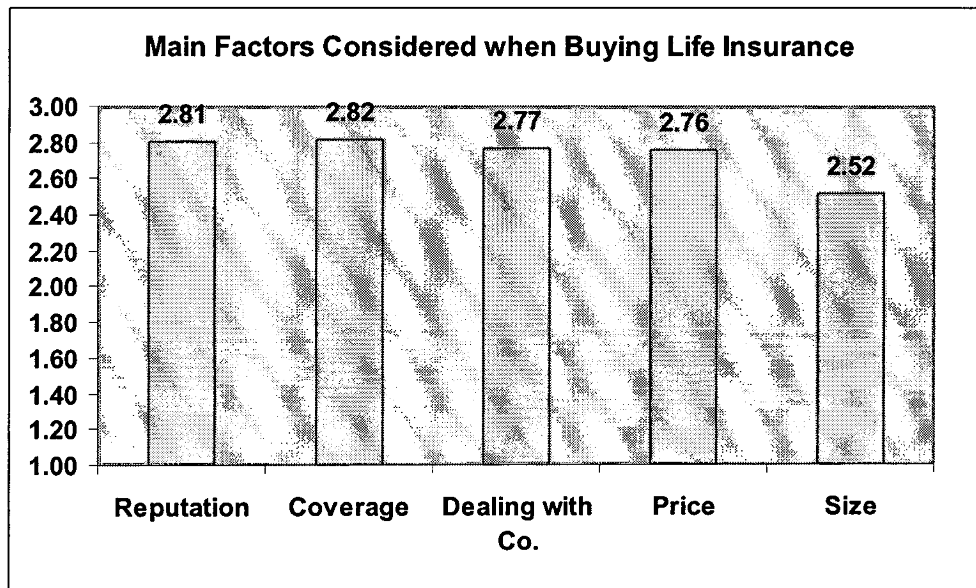
Regarding health coverage, an insurance firm's reputation was rated as the most important factor with an average rank of 2.95. It was followed by the price of the policy 2.94, policy coverage 2.93, ease in dealing with the company 2.91 and size 2.63.

Figure 3.4



In the case of life insurance, respondents ranked policy coverage as the most important factor with an average rank of 2.82, followed by company reputation 2.81, the ease in dealing with the firm 2.77, price 2.76 and size 2.52.

Figure 3.5



The gap is apparent in the level of trust that individuals have in insurance firms, as they rely overwhelmingly on relatives or close connections to select a company.
The degree of awareness is also visible in the importance people put on the reputation of an insurance company in the case of health and motor insurance.

DISTRIBUTION

Insurance products in the Lebanese market are distributed through three main channels, with a fourth channel as a long-term prospect. Direct sales, banks and brokers are the main selling outlets, with electronic distribution still far behind. Distribution of non-life insurance products takes place largely through brokers, while life products are sold through tied agents and the direct sales force of insurers and, more recently, through banks for basic life policies.

Direct Sales & Agents

It is the method of selling insurance directly to clients through an insurance company's own employees or tied agents. An agent represents only one insurance company and is restricted by agreement from submitting business to any other insurer. Insurers have usually preferred this channel for the sale of life insurance products.

Direct sales teams and agents are by far the main distribution channel for individual life insurance. They work out of the head office or from branches around the country. The leading individual life company, ALICO has a sales team of around 520 through more than 15 direct and associate agencies. Life insurance sales teams are mainly remunerated through commissions but certain managerial members receive salary and commission.

Insurance companies operating in Lebanon have about 200 branches in the country in addition to nearly 30 branches outside Lebanon. Branches are not considered pure sales outlets since most insurers prefer to rely on brokers due to the heavy capital investment required to establish branches and to develop a sales team.

Rather, the purpose of branches is to be closer to the clients and brokers to provide them with faster support and access to a decision maker in addition to the necessary administrative support (policy issuance, claims handling etc.), which are not normally delegated to a broker. Also, syndicates or corporate clients prefer to have a geographically convenient office of the insurance company they can deal with.

Brokers

A broker is an intermediary between a customer and an insurance company. Brokers typically search the market for coverage appropriate to their clients. They work on commission and usually sell non-life insurance.

Fragmentation

The brokers' market is highly fragmented. Unlike insurers, there are no dominant players in the market. There are about 350 licensed brokers in Lebanon with 94 brokers accounting for at least 50% of generated non-life premiums.

Of the total, 50 brokers are linked to banks or insurance firms, 250 are totally independent, and another 50 are dormant. About 150 brokers are considered to be active, with 25 to 30 brokers accounting for nearly 50% of the premiums generated by the 150 active brokers.

Family Businesses

The sector lacks institutionalization. Most brokers operate as individuals or family enterprises and entry barriers are extremely low. Only a few can be considered to be institutions.

Image

Brokers generally suffer from an image problem and there is a serious lack of awareness about the role they play. They are viewed as mere 'sellers' of insurance products with an eye on pushing products that generate high commissions rather than on providing advice about the product that best fits the client's needs. This enduring image was caused by the market presence in the early 1990s of individuals whose task was limited to referring businesses to insurers in exchange for a commission without the ability or desire to follow up or provide after-sales service. When cases arose for filing and processing claims, these intermediaries simply disappeared. Also, several cases of brokers' fraud in the early and mid-1990s led to the bankruptcy of some insurers, which tarnished the sector's overall image. The lack of any financial transparency did not help either.

Banks

Bancassurance is the strategy of a bank to cross-sell insurance products through its network of branches. Banks have entered into individual lines of insurance rather successfully. Such products include personal non-life lines and individual life and savings. Individual lines are divided in two categories: the 'commodity' or standardized products, where limited product differentiation exists apart from pricing and where advice requirements are limited; and the more complex products, which form part of overall financial planning and where the client benefits from financial advice in relation to the level of risk to accept, long-term savings, and how much to invest to generate a required return.

Bancassurance products in Lebanon have focused exclusively on the standardized products and have acquired a significant market share in a relatively short period of time. Such products accounted for some 10% of total premiums in 1996 and rose to about 38% of the market in 2004. Several reasons lie behind the success of banks in selling insurance products, but 8 main reasons stand out:

- The bulk of insurance products sold through banks have tended to be savings rather than risk-oriented and, therefore, banking in nature.

- Banks are very comfortable selling high volume, low margin retail financial products.

• A good reason for the success of bancassurance in Lebanon can be attributed to the 'new look' banks have given to the insurance business, as they have developed a strong customer focus, resulting in simple and transparent products that are generally designed for middle-income and upper middle-income people.

• Banks have a better reputation and are seen in general as generating more trust than brokers who are perceived as mere 'sellers'.

• Banks have used the unique advantage of their ability to extend credit and seized the opportunity to integrate insurance and credit. They have marketed auto insurance with auto loans and homeowners' insurance with mortgage loans, among others. In addition, they have required credit life insurance as a guarantee of repayment of a loan if the borrower dies or becomes incapacitated.

• Banks dispose of an extensive branch network that can be used to sell insurance products. This provides insurers with a stable distribution channel that has market reach across Lebanon. Today, an estimated 520 branches, or about 65% of the total branch network of Lebanese banks sell insurance products across the Lebanese territory.

• Banks have more frequent contact with their clients and have at their disposal a much more detailed database than brokers or the sales force of insurers. The data-mining capability of a bank consists of personal clients income details and, most likely, an indication of existing wealth levels. This allows a focused market segmentation and cross-selling strategy based on facts and figures.

Bancassurance is more cost efficient compared to other primary channels. Insurers have looked to develop the cheapest distribution channel to protect margins for products at the commodity end of the market. Over-the-counter sales at bank branches are generally cheaper than agency or brokers distribution given the small incremental cost of widening the banking product range to include 'commodity' or standardized insurance products. In fact, sales costs are estimated to be up to 50% lower via a bank than an agency. This is in large part due to the time saving advantage that banks have in the sales process. A broker or agent needs to spend about 30% of his time prospecting for clients, 15% to get an appointment, 40% to close the sale and 15% in after sales servicing. Banks can easily save up to 45% of the process simply because of their data-mining capabilities and their branch network.

Electronic Distribution

Insurance companies have developed websites but so far they are generally used for providing company and product information rather than for offering quotes. More recently, several insurers such as ADIR, Arabia, AROPE, UFA and SNA, among others, have developed online quotation services.

Additionally, insurance brokerage firm Affrad launched its portal Ta' minet that allows clients to buy insurance coverage online from a number of insurance firms. The portal also provides several other value-added services such as applying for car and personal loans, a branded credit card, wedding planning, real estate management, global money transfer, and ambulance service. The objective of Ta' minet is to be the online one-stop-shop link between consumers on the one hand and insures, banks, and service providers on the other. Ta' minet is not only the first online insurance portal, it also reflects the first step among Lebanese brokers towards assuifinance, which is the strategy ofan insurance intermediary to cross-sell financial products.

Estimates put the cost of using electronic distribution as low as 10% of selling through brokers or agents, reflecting the potential savings and the benefits for margins. Still, this channel of distribution is a long-term proposition at best despite the fact that the Internet is best suited for the sale of personal insurance lines and the relatively high Internet penetration in Lebanon. Lebanon has a high connectivity rate relative to the Arab world with 11.7 Internet users per 100 inhabitants compared to 2.4 for the Arab countries, and has 8.1 personal computers per 100 inhabitants compared to 2.2 for the Arab world. The two main barriers for the development of this sales channel are that people in Lebanon still prefer face-to-face discussions and, in the case of life insurance, there is a need for personally given advice.

Other Direct Channels

There are several telemarketing companies in Lebanon and some banks have their own in house call center. But telemarketing has not been used to sell insurance products and direct mail, which has become a viable selling channel in many developed markets, is far from being used in Lebanon. Also, several insurers have set up direct arrangements with car dealers, while the strategy of establishing point-of-sales at supermarkets, shopping malls and other high traffic retail outlets is being tested. Overall, less traditional distribution channels, or secondary channels, will need a substantial amount of time to become legitimate sales options even though they may be lower-cost channels.

THE REGULATORY FRAMEWORK

Overview

The insurance sector is regulated by the Ministry of Economy & Trade. Insurance activities are governed by the insurance law, Decree No. 9812 issued on May 4, 1968. The law was revised and amended in 1993 and again in 1999 (Law No. 94) after the bankruptcy of three major companies.

Insurance companies had two years to comply with the regulations of the amended Law No. 94 of June 1999, reaching 50% compliance by June 2000 and 100% compliance by June 2001.

The National Council of Insurance Companies (NCIC), a group formed of 12 members, is responsible for supervising the insurance sector. The NCIC is chaired by the Minister of Economy & Trade. The members of NCIC are appointed as follows:

- The Minister of Economy & Trade (President).
- A counselor from the State Council (Vice-President).
- Three senior public servants.
- A university professor.
- The President of the Insurance Control Commission (ICC).
- Two representatives of local insurance companies.
- Two representatives of foreign insurance companies.
- One representative of insurance brokers.

The NCIC has both a regulatory and an advisory role concerning all matters submitted to the Ministry of Economy & Trade. The NCIC covers, in particular, fiscal provisions, policy terms and risk management.

The insurance sector in Lebanon was highly under-regulated until the amendment of the insurance law in 1999. The insurance sector, like the banking sector before it, is regarded as overcrowded and having a surplus of at least 20 weak and inefficient operators.

The objective of revamping the overall legal framework was to protect the rights of the insured through the introduction of tighter regulations and better supervision as well as to improve the profitability and solvency of insurance companies. Various other texts were also issued to cover several aspects of the sector such as an insurance specific accounting plan, and texts to govern the insurance brokerage and agency businesses.

The main amendments of the 1999 law include the following:

• Minimum required capitalization was increased from $200,000 to $1.5 million. Foreign companies must have at least three times the capital requirements of Lebanese companies.

• Minimum solvency ratio (ratio of shareholders' equity to premiums) of 10%.

• The General Manager and Directors of an insurance company must have relevant experience in the field.

• Segregation of life and non-life insurance: newly licensed companies have to be specialized in either life or general (non-life) insurance. Existing composite companies are required to have separate management, accounting and funds, and to have their accounts reviewed on an annual basis by a life actuary.

• Creation of two new lines of business: credit insurance and agricultural insurance.

• Reinsurance with companies with a minimum rating of 'B'.

• Tax incentives for companies that merge.

The licenses of some insurance companies that were unable to comply with the new regulations were revoked. Other insurance companies gave up one or more of their licenses or even ceased operations voluntarily. Some foreign insurance companies that had representative offices in Lebanon decided to leave voluntarily because they considered the Lebanese market to be too small to justify greater investment.

On the other hand, the amended law encouraged consolidation among industry players. Consequent to the amended law, the number of operating insurance companies was reduced from a peak of 86 in 1997 to 58 in 2004.

Two organizations that were legislated under the 1968 insurance law but never implemented, the Insurance Control Commission and the Arbitration Council, were reintroduced in the 1999 amended law.

Insurance Control Commission

The Insurance Control Commission (ICC) is a supervisory body under the direct authority of the Ministry of Economy & Trade. It was part of the public administration's hierarchy but was given autonomous status and now reports directly to the Minister of Economy & Trade.

The ICC was created to ensure the proper implementation of the 1999 insurance law. The ICC team includes experts in accounting, finance, law, economy and business administration.

The role of the ICC is to supervise the activities of insurance companies and brokers in order to protect policyholders from unfair market practices. It is also responsible for ensuring that insurance companies comply fully with current laws and regulations. Also, it is mandated to monitor, test and enforce solvency of insurance and reinsurance companies. If financial weakness of these companies is identified, the ICC is vested with powers of intervention. In parallel, the ministry contracted international auditing firms Ernst & Young and PricewaterhouseCoopers to establish regulatory accounting procedures so that the inspection of insurance companies becomes detailed and transparent.

The ICC is expected to play an increasingly proactive role in regulating the insurance sector.

Arbitration Council

The Arbitration Council was established to deal with small claim disputes, mainly in health and auto insurance, not exceeding $50,000. This accounts for around 90% of all claims. The council has two judicial bodies, one to settle health and hospitalization claims and the other to settle disputes arising from car accidents.

Policy Wording

Article 10 of the insurance law states that all insurance policies must be drafted in Arabic but it allows the inclusion of a text in English or another foreign language. The law originally required that the text in Arabic must take precedent in case of a dispute, but subsequent decrees exempted insurance contracts from this requirement.

Policy wording in Lebanon has three sources:

1) Reinsurance firms impose general conditions on categories such as contractors and marine insurance policies.
2) ACAL writes certain general conditions for some other categories such as fire and motor insurance policies.
3) Individual lawyers or legal departments of insurers also write general conditions for medical insurance policies or other lines of business.

Case law, which is the legal framework for the quality of policy wording, is still not abundant in Lebanon. But contracts are generally well written and are often adaptations of foreign contracts.

The Current Law

The following is a summary of the principal laws and regulations relating to insurance companies in Lebanon.

Licensing Insurance Companies

Insurance operations in Lebanon cannot be conducted except by licensed entities. The conditions that must be fulfilled by Lebanese insurance entities as per the amended law of 1999 are listed below. Existing entities had two years to comply.

• The entity must be a joint-stock company.

• The entity must be suitably capitalized (minimum capital of $ 1.5 million).

• The Chairman - General Manager must be an experienced insurance professional holding a university degree.

• The entity must use the services of a certified actuary if it is engaged in life insurance.

• At least 70% of its shares must be nominal.

Similar and additional conditions apply to foreign insurance companies operating in Lebanon. The additional conditions to be satisfied by foreign insurance companies operating in Lebanon include:

• Reciprocity with country of origin.

• The entity must be licensed in its own country.

• The head office must have at least three times the minimum capital requirement of Lebanese companies (existing entities had three years to comply).

• The entity must have an office in Lebanon.

Capital and Adequacy Ratio

The reform law of 1999 increased the minimum required capitalization of Lebanese insurance companies from $200,000 to $1.5 million. Existing entities had three months to approve the increase of capital and two years to comply. The capital may not be decreased unless the Minister of Economy & Trade approves. Any losses incurred by an insurance entity that reduce its capital have to be compensated through a capital increase.

Insurance companies may not write premiums exceeding ten times their total capital (share capital, retained earnings and reserves), such proportion subject to change by the Council of Ministers.

Classification of Insurance Branches

Insurance and reinsurance operations are segmented into six branches:

• Branch 1: Life, Pension, Children, Spouses and Mutual Funds.

• Branch 2: Fire, Natural Disasters, Explosions and Riots.
• Branch 3: Transportation, Marine and Aviation.

• Branch 4: Accidents, Vehicles, Work Accidents, Personal Accidents, Hospitalization, Theft, Fidelity Guarantees, and Professional Risks.

• Branch 5: Credit Risks.

• Branch 6: Agricultural Risks.

Companies cannot conduct Branch 1 (Life) operations with any of the other branches, except in case the company existed prior to the amended law of 1999. In that case, separate accounting has to be kept for Branch 1 starting one year from the enactment of the law.

Guarantees

Insurance companies are obliged to present guarantees to the Ministry of Economy & Trade for each of the branches as follows:

Table 3.2

Category	Guarantees
Branch 1	LBP 1.2 billion ($800,000)
Branch 2	LBP 350 million ($233,000)
Branch 3	LBP 350 million ($233,000)
Branch 4	LBP 1.2 billion ($800,000)
Branch 5	LBP 1.2 billion ($800,000)
Branch 6	LBP 750 million ($500,000)

Guarantees can be cash, Treasury bills, real estate and accepted securities with certain limitations. The guarantees in cash or Treasury bills are subject to a minimum of LBP 750 million ($500,000), regardless of the number of authorized branches. Guarantees count towards technical provisions.

Foreign insurance companies must present as guarantee twice the amount required by Lebanese companies mentioned above.

Technical Provisions or Reserves

Technical provisions have to account for unearned premiums and outstanding claims. Liabilities provisions, net of applicable assets provisions, have to be kept in certain classes of assets with specific weights.

The different possible assets, with certain limitations, include cash deposits, real estate, Lebanese securities, loans on life insurance contracts, dues from reinsurers, Lebanese shares and bonds, and international shares and bonds.

Mergers

Mergers are covered specifically under Article 65 of Chapter 9 of the revised insurance law. A merger has to have an "acquiring entity" and one or several "acquired entities". All entities have to officially file a request for the merger with the Ministry of Economy & Trade. The minister then evaluates and gives his approval or disapproval for the merger and requests additional documents and information. Within three months of submitting all requested information, the minister gives his final approval or disapproval. The acquiring entity immediately replaces all the acquired entities in their rights and obligations, and assumes their assets and liabilities. No third party approval (such as policyholders and debtors) is needed for the merger. The merger has to be published in the official gazette and two other papers.

Employment contracts may be terminated within six months. All concerned employees have to be notified about their termination in one go. The notification has to state clearly that the termination took place within the scope of the merger. Laid-off employees take advantage of all rights and advantages provided by the law and by collective labor agreements, if any. Laid-off employees are entitled to have a supplementary exceptional indemnity. The exceptional indemnity shall be no less than six months of salary and shall not exceed the total compensation of the employee during the previous two years. The additional compensation is income tax exempt.

During the year that follows the merger, the merged entity shall be exempted from income tax due on part of its profits, provided that this part does not exceed the combined nominal value of the capital of the merged entities one year before the merger was finally approved. The exemption has to be added to the capital of the merged entity.

The merged entities will also be exempted from taxes occasioned by the application of Article 45 of the income tax law concerning re-evaluation of fixed assets, if invoked.

All stamp duties, transfer taxes, notary public fees and registration fees related to the procedures and formalities required for the merger are waived, including those for the issuance of new shares.

Employees

Employees of insurance companies must be Lebanese citizens, but insurance companies may hire up to three foreign experts following the approval of the Ministry of Labor, upon proposal by the Minister of Economy &Trade. Additionally, foreign insurance companies are authorized to have a foreign manager or general representative residing in Lebanon.

Experts

Only persons employed by insurance companies or registered as experts are empowered to assess claims and evaluate damages. Experts have to keep standardized records oftheir activities on special documents.

TRANSPARENCY

Insurance ratings provide an opinion on the strength of insurance companies and their ability to repay obligations. Ratings are based on a comprehensive analysis of relevant factors including:

1) the insurance company's liquidity,
2) operating performance,
3) financial flexibility,
4) capital strength,
5) management quality,
6) competitive positioning,
7) and long-term business viability.

Insurance firms can receive two types of ratings:

1) financial strength ratings (FSR)
2) and debt ratings.

FSRs measure the insurer's ability to meet its ongoing policy obligations, while debt ratings cover insurers that issue debt securities and assess the firm's creditworthiness regarding a specific debt issue.

Insurance firms can be rated either:

1) interactively
2) or non-interactively.

Interactive ratings involve in-depth meetings with senior management and could include confidential information and figures. Non-interactive ratings rely on publicly available information and financials. Interactive ratings are considered to be more comprehensive because they incorporate both qualitative and quantitative assessments.

Five major international rating firms issue ratings for insurance companies:

1) A.M. Best,
2) Fitch Ratings,
3) Moody's Investors Service.
4) Standard & Poor's,
5) and Weiss Ratings.

The first four are the largest agencies in the world. While A.M. Best rates insurers only and has covered the sector longer than any other agency.

The Arab world has little exposure to ratings by global agencies as the sector is dominated by privately held and family-owned businesses that are reluctant to disclose

information and find it unnecessary to have their firms rated. However, this trend is gradually changing as insurers are realizing the importance of independent ratings. Ratings have become a useful tool in more open markets for insurers, reinsurance firms, shareholders, brokers, risk managers, policyholders, investors, banks, auditors and regulators. Ratings result in the following:

- Provide transparency, credibility and a check on a firm's financial health.

- Help attract funds and reduce the cost of capital.

- Act as a marketing tool that can be used as a benchmark.

- Assist an insurer to compete for business.

- Encourage reinsurance firms to work with an insurer as they prefer to deal with highly rated insurance companies.

Rating Lebanese Insurers

The big four international rating agencies have not rated any of the Lebanese insurance firms.

Lebanese insurers have not issued debt securities, a factor that excludes debt ratings at this stage. But any future debt ratings are likely to be restricted by the sovereign ceiling.

Table 3.3

Foreign Currency Sovereign Debt Ratings for Lebanon

Agency	Long Term	Short Term	Outlook
Capital Intelligence	B	B	Negative
Fitch Ratings	B-	B	Stable
Moody's Investor Services	B2	n/a	Negative
Standard & Poor's	B-	C	Stable

ALICO is indirectly rated by being a subsidiary of the American International Group (AIG). The latter has publicly traded shares on the New York Stock Exchange and is rated by the international agencies.

AXA and the AGF Allianz Group, which own majority stakes in local insurers, are publicly traded firms on European exchanges and are rated by the international agencies. However, their local partners are companies incorporated in Lebanon as joint stock entities and, therefore, would be rated as local firms.

Listings

There are about 60 Arab insurers that are listed on equity markets, none of which are Lebanese firms. Further there are no insurance firms listed on the Beirut Stock Exchange.

SNA Holding (Bermuda), the holding company of Société Nationale d'Assurances sal planned to float about 6 million 'A' shares on the Beirut bourse in February 1999. SNA would have been the first insurance company to trade shares on the bourse, but it postponed indefinitely the listing due to prevailing market conditions.

Several problems have slowed the Beirut bourse in past years. The market remained hampered by a lack of interest from foreign institutional investors, political and economic uncertainties, fiscal imbalances, reluctance on the part of family-owned firms to list their shares, the small number of listed firms, poor marketing, absence of an independent supervisory body, and low liquidity.

Figures & Statistics

The sector suffers from a lack of detailed and up-to-date figures and statistics. This statistical weakness constitutes a serious impediment to the in-depth analysis of Lebanon's insurance sector, mainly due to the following reasons:

• ACAL used to issue figures on premiums by insurance category. But the data became unreliable because it was based on voluntary disclosure by individual firms and many of them did not provide figures.

• Currently there are no reliable or recent figures on premiums by category. Sector-wide figures on life and non-life premiums per company are compiled by one business magazine and published once a year.

• The Ministry of Economy & Trade used to issue in the 1990s figures on the consolidated balance sheet and income statement of the sector. The financials were unreliable, as insurers were not bound by any reporting or auditing standards.

• There is no proper financial disclosure framework for individual insurance companies. Insurers typically publish in the local press partial balance sheets that do not give a clear picture about the firm's financial health or performance. This is mainly done at the discretion of individual insurers and usually takes place several months into a new year. Generally, only the larger insurance firms operating in Lebanon publish any kind of financial information.

• There is a lack of reliable data on areas vital to life and medical insurance such as morbidity, mortality, and life expectancy rates in Lebanon.

• There is a lack of macroeconomic indicators that are necessary for a more accurate analysis of the sector such as population figures, as the last census was conducted in 1932 and existing figures on the number of inhabitants in Lebanon and population growth are estimates at best. Other needed indicators include updated GDP and national income figures.

On the positive side, several steps have been taken by various stakeholders to raise transparency and improve the quantity and quality of figures and statistics.

• ACAL and the regulatory authorities have established a joint committee entrusted with building up market statistics and figures.

• The Ministry of Economy & Trade contracted international auditing firms Ernst & Young and PricewaterhouseCoopers to establish regulatory accounting procedures. Under the supervision of the Insurance Control Commission the firms completed the first-ever comprehensive field audit of insurance companies. Further, the commission has imposed uniform accounting and reporting standards for the entire sector so that the inspection of insurance companies becomes detailed and transparent. The two auditing firms are also assisting in the development of the uniform reporting standards and procedures.

• On the macroeconomic front, the government issued in May 2003 national economic data covering the year 1997 that provide detailed official figures of gross domestic product, its structure and components, as well as figures on gross national income and gross national disposable income. The data is a first step towards forming a scientific statistical database of the Lebanese economy and will serve as the base year for computing the national accounts for the 1998-2004 period. It also provides details of real economic activity and is a tool to evaluate the government's economic and financial policies.

Some insurance figures have been compiled by the Ministry of Economy & Trade with the technical assistance of French research organization L'Institut National de la Statistique et des Etudes Economiques (INSEE). The accounting model adopted complies with basic international standards.

Anti-Money Laundering

Regulators around the world have historically focused their attention on money laundering within the banking system. However, the ease with which money can be transferred globally has increased regulators' attention to other fields within the financial sector such as the insurance industry.

Globally, some insurance transactions have been used to launder money since insurance companies have not been subject to the same rigorous reporting and monitoring requirements as banks. Life insurance policies have been an important vehicle to channel dirty money.

Lebanon possesses the necessary framework to cooperate in the international fight against money laundering.

• In April 2001, the Lebanese Parliament passed Law No. 318 on combating money

laundering. The law defines money-laundering operations and specifies the fines and imprisonment penalties imposed on such offenses.

• In May 2001, the Central Bank promulgated Decision No. 7818, which addresses issues relating to the verification of the client's identity and the obligation to report suspicious transactions.

The fight against money laundering in Lebanon is supervised by the Central Bank of Lebanon and is implemented by the Special Investigation Commission (SIC). Established by the Central Bank as an independent entity, the commission's mandate is to investigate suspected money-laundering operations and to monitor compliance with the rules and procedures of Law No.318.

The insurance sector is covered by Law No. 318 and is subject to the commission's supervision. In 2002, the SIC examined 44 insurance firms to ensure compliance with existing anti-money laundering laws and regulations.

In 2002, the Financial Action Task Force (FATF) decided to de-list Lebanon from the list of Non-Cooperative Countries or Territories (NCCT), based on the significant progress towards the full implementation of Law No.318.

FINANCIAL PERFORMANCE

The below information from consolidating the statements of most of the insurance companies in Lebanon which mainly represent around 90% of the market; though not all financial statements were available.

Figure 3.4

Key Figures & Ratios in 2004				
US$ Millions	Pre-reinsurance		Post-reinsurance	
Premiums	577.00	100.00%	485.00	100.00%
General (Non-Lfe)	397.00	68.80%	320.00	65.98%
Life	180.00	31.20%	165.00	34.02%
Claims	362.00	100.00%	248.00	100.00%
General (Non-Life)	325.00	89.78%	220.00	88.71%
Life	37.00	10.22%	28.00	11.29%
Loss ratio	62.74%		51.13%	
Acquisition cost ratio	18.20%		21.50%	
Expenses ratio	20.70%		26.00%	
Combined ratio	101.64%		98.63%	
Net Income		24.60		
Total Assets		865.50		
Shareholders Equity		270.80		
Return on Assets		2.84%		
Return on Equity		9.08%		

Notes:

a) Premium: Most insurance experts believe that insurance premiums generated from the Lebanese market could reach 1.5 times the above figures as figures of Insurance Mutual Funds that are tax exempted are not reported; moreover some companies tend to open offshore subsidiaries used to book part of the premium; in addition to misreporting by some firms.

b) The loss ratio is the ratio of claims to premiums, which means that for life and non-life 62.74% of the premium is paid back as claims. You will note that the life's loss ratio alone is far better than that of the non-life.

C) Acquisition cost ratio represents the ratio of commissions paid to brokers over premiums or in other words the cost of acquiring business. The acquisition cost ratio usually depends on the age of the company and its product range.

D) The expense ratio represents the ratio of operating expenses to premiums(it contains salaries, rent, maintenance...).

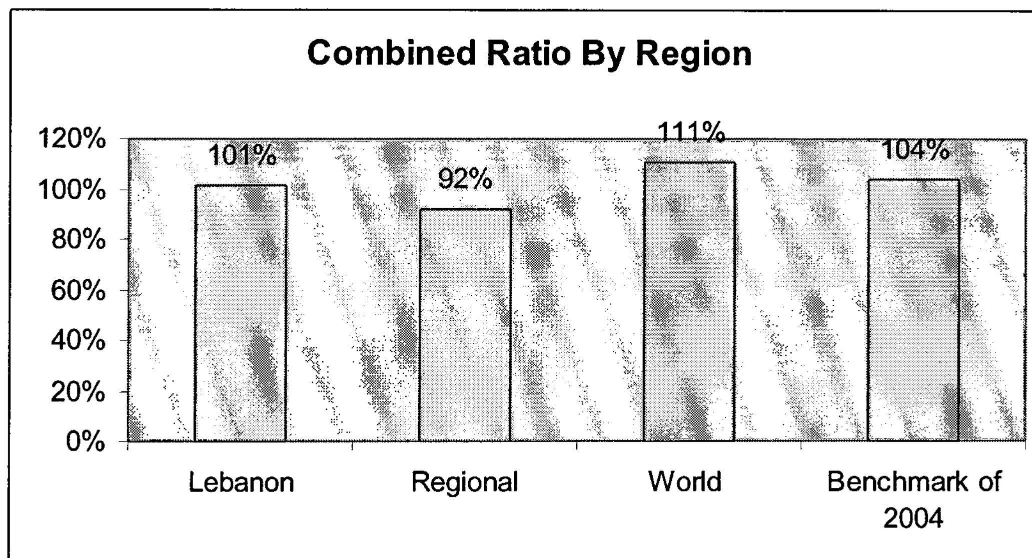
E) The combined ratio, or the underwriting result, is the sum of the loss ratio, acquisition cost ratio and expenses ratio. The combined ratio measures the company's overall underwriting profitability and does not reflect investment income or income taxes. A combined ratio of less than 100% indicates that the company has reported an underwriting profit. A combined ratio of 100% is a breakeven point, where claims and expenses equal premiums.

It is clear from the table above that the net income is not generated from underwriting activities, as the combined ratio is 101.64%. Most of the net income is generated from two sources:

1) Commissions gained by insurers from reinsurers as they are the business providers. The reinsurer usually gives a commission to the insurer, which varies from one line of business to another.

2) Investment Income as most of the top companies are owned by banks who in their turn invest the insurance premiums in the manner as bank's funds. We should note that most of the investments are in the Lebanese Treasury Bonds.

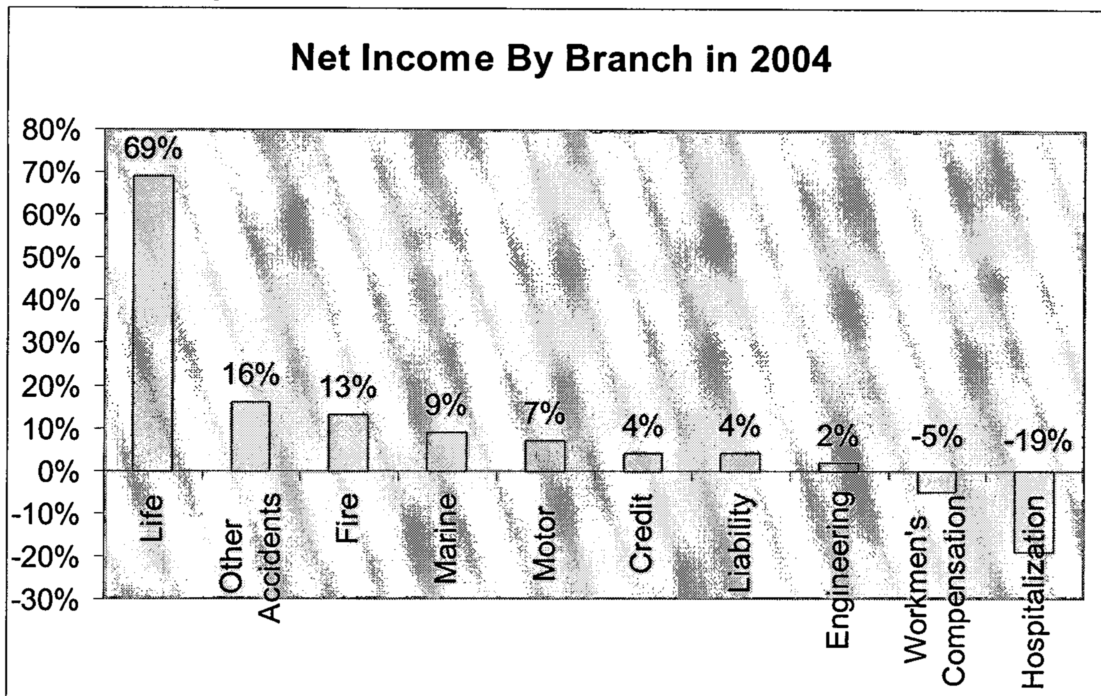
Figure 3.6 (Muhanna DAIR Magazine)



Profitability

Although life insurance accounted for around 31% of total premiums in 2004, it contributed to 69% of the sector's net income. On the other hand, hospitalization which accounted for 33.3% of total premiums, incurred losses and accounted for around -19%

Figure 3.7



Solvency Ratio

An insurance company is solvent if it is able to fulfill its obligations under all contracts under all reasonably foreseeable circumstances. The solvency margin is the extra capital that insurance companies are required to hold as a buffer against unforeseen events such as higher than expected claims levels or unfavorable investment results.

Under the Lebanese insurance law, the minimum solvency ratio of insurance companies for all branches is 10%. The solvency ratio is calculated as the ratio of shareholders' equity to premiums. This means that insurance companies may not write premiums exceeding ten times their equity. The solvency ratio of the Lebanese insurance sector is around 46.93% (including life insurance). Since the sector's shareholders' equity is reported on a consolidated basis and is not divided between life and non-life branches, the solvency ratio for life and non-life branches cannot be calculated separately. *(Ministry of Economy & Trade)*

ISLAMIC INSURANCE

Islamic insurance, also known as Takaful, is a growing trend in Arab and Islamic countries. There is no one standard Takaful system in use yet but it is believed to have potential among individuals and organizations that prefer to follow the Islamic precepts of finance. The market for Islamic insurance in the Arab world is estimated by various Gulf-based firms at about $500 million over the next four to five years.

Market Characteristics

Islamic scholars have argued that conventional insurance is regarded as taboo because it contains certain elements which are contradictory to the Islamic Shari'ah such as Gharar, Maisir and Riba.

Gharar signifies the element of uncertainty or the unknown.

Maisir is a form of gambling or speculation, which arises as a consequence of the presence of Gharar, mainly in the case of life insurance.

Riba is the act of giving or receiving interest, practiced by conventional insurance companies whereby the amounts received from policyholders are invested in interest-bearing securities.

The main difference between Takaful and conventional insurance is that Takaful is cooperative. Takaful, an Arabic word meaning joint guarantee is based on co-operative principles. Premiums are treated as donations to a fund for mutual benefit, and risks or rewards are shared on a collective basis. The company then compensates the participants should an accident occur. The contributory or donation basis of the payment of premiums eliminates the element of uncertainty. The insured, or participants in the fund, share in the fund's profits and, therefore, are expected to bear losses as well. Profits from insurance operations are returned to the policyholders on a predetermined basis. Another key principle of Takaful insurance is that the fund's investments must avoid all areas considered harmful or forbidden under the Shari'ah Law such as tobacco, alcohol, gambling and usury, among others.

MERGERS, AQUISITIONS & ALLIANCES

There are three major trends in terms of mergers, acquisitions and alliances in the Lebanese insurance sector. The first trend is mergers and acquisitions among local insurers due to various reasons. The second trend is cross-sector alliances between banks and insurance firms, while the third trend consists of the noticeable increase in the number of global insurers in the local market.

Surprisingly, the first trend, which is supposed to be the driving force among the three trends, is the one lagging behind. The second trend is the most significant while the third trend is likely to have the biggest impact in the long term.

Domestic Mergers & Acquisitions

Overall, there have been about a dozen mergers and acquisitions over the past 5 years in the sector. The insurance reform law of 1999 provided tax incentives for mergers by exempting the merged entities from corporate income tax during the year that follows the merger. Clearly, the sector needs further incentives to merge.

Several factors have prevented an accelerated consolidation:

• The reduction in the number of insurance companies in the late 1990s has been caused mainly by bankruptcies and the revocation of licenses by the Ministry of Economy & Trade.

• Insurers still depend largely on brokers to sell their products, with the smaller insurers even more dependent on this distribution channel due to the heavy capital investment required to establish branches and develop a sales force. This has discouraged bigger insurers from acquiring smaller ones in general due to the fact that they can attract a company's portfolio from the brokers without assuming the insurer's assets and liabilities.

• Many of the owners of medium- and small-size insurers were former insurance brokers who accumulated enough capital to obtain a company license at the time. Other owners are businessmen who are involved in other businesses such as trade, commerce and manufacturing.

• Increased competition, slow economic growth and the bankruptcy of several insurers led to an increase in client migration in the mid-1990s.

• Many medium- and small-size companies are tightly held family businesses and the origination of business is closely connected to one or two key persons at most. Until the mid-1990s, most business development was based primarily on personal relationships.

• Most of the smaller players seem to be content with their current market share and level of profitability.

• The family owned firms still lack a culture of institutions that is essential for understanding the benefits from merging with other players.

• Lack of transparency in the sector in general, both on the financial and operational levels.

The most significant transaction in the late 1990s involved a cross-border acquisition followed by a merger that created Lebanon's largest non-life insurer.

In 1997, the Bahrain-based insurer MEDGULF acquired the local firm Strikers Holding sal as the latter was facing serious difficulties and resulted in a new entity named MEDGULF Strikers sal. In 1998 the firm merged with Arab Universal Insurance sal, a member of Groupe Méditerranée. A capital increase led to a new shareholders base that included Méditerranée Investors Group, Saudi Oger Ltd and Al-Azizia Commercial Investment, an investment vehicle of Saudi Prince al-Waleed bin Talal. The latter holds a 25% stake in MEDGULF sal.

Table 4.1

Mergers & Acquisitions in Lebanon

Acquirer	*Acquired*	*Year*
ITI	Al-Fajr	2003
SNA	Credit General	2001
UFA	AMECO	2000
UFA	SOFRACE	2000
La Phenicienne	International	2000
Sonar	Centrale	2000
UCA	General Fire & Marine	2000
Bankers	Express	2000
Fidelity	Iskan	1999
Compass	Trust International Insurance	1999
MEDGULF Strikers	Arab Universal	1999
MEDGULF	Strikers	1997

Banks and Insurers

Cross-sector alliances between banks and insurance firms represent the second trend. It reflects the rise in the number of agreements between banks and insurers in order to use banking networks for the sale of insurance products. It also illustrates the banks' ongoing attempt to diversify their sources of revenue through the offering of bancassurance products.

The Lebanese market witnessed four distinct approaches to alliances between banks and insurers:

a) start-ups,
b) acquisitions
c) joint ventures,
d) and distribution arrangements.

The selection of an approach has depended on various factors intrinsic to the parties involved, as each type of alliance offers its own specificities and advantages, and provides a differing degree of integration.

a) Start-ups

This seems to be the most popular mode of entry of Lebanese banks into the insurance sector, as 8 banks have followed this approach. The banks chose this method of entry due mainly to the high control they have over the entire process, as they do not have to address the cultural differences of an insurance firm and deal with pre-existing management systems. They also get to keep the whole margin. This approach has the highest degree of integration.

Table 4.2

Bank	Insurer
BLOM	AROPE
Byblos	ADIR
Jammal Trust Bank	Trust Insurance
Banque Libano-Francaise	Bancasurance
Fransabank	Bancasurance
Credit Libanais	CLA
SGBL	SOGECAP

b) Acquisitions

Mergers and acquisitions are best suited when a bank is seeking a quick entry into the insurance sector and does not want to spend the time needed to build a new insurance affiliate from the ground up. There are six cases in Lebanon where a bank acquired a stake in an insurance firm, two of which consisted of controlling majorities.

The one exception to the trend of banks acquiring stakes in Lebanese insurers is the acquisition of the MEPA insurance group of a stake in the Lebanese-Canadian Bank in 2000. This approach is the more popular approach in mature markets where insurers have fully acquired banks, rather than the other way around, as part of the ongoing trend of convergence between insurance, banking and asset management. One such high visibility deal involved the acquisition of Citibank by the Travelers Group in the United States and the buyout of Dresdner Bank in Germany by pan-European insurance giant Allianz. The advantages of ownership of an insurer over an alliance are control, absence of risk that the insurer will be an unreliable partner and, very importantly, retention of the whole margin.

Table 4.3

Bank	Insurer	Stake
Audi	Libano-Arabe	99%
BBAC	Capital	80%
Al-Baraka Bank Lebanon	Amana Takaful	70%
Saradar	Assurex	23%
Audi	SNA	10%
Arab Bank	Arabia	7%

c) Joint Ventures

A joint venture is a cooperation agreement between two or more independent firms that set up a legally separate entity that is owned and controlled by the parent companies. In this case, the jointly owned legal entity underwrites insurance. The two insurance-related joint ventures in Lebanon involved local banks teaming up with insurance arms of global banks to establish specialized insurance joint ventures. The two common features to the insurance joint ventures in Lebanon is that the global banks had substantial equity in the local banks and that the insurance arm of the global bank held a minority stake in the venture. The joint venture model has a lower level of integration than start-ups and acquisitions.

• Bancassurance

In 2000, Fransabank sal and Banque Libano-Francaise sal, two of Lebanon's top 10 banks, formed a joint insurance company with Predica, the insurance arm of French bank Credit Agricole Indo-Suez. Named Bancassurance sal, the firm provides a range of life insurance and savings products. Fransabank and Libano-Francaise own 49% and 31% of the firm, respectively, while Predica holds a 20% stake.

• SOGECAP Liban

In 2000, Société Générale de Banque au Liban and SOGECAP SA, which is owned by French banking group Société Générale, teamed up to form SOGECAP Liban sal. The firm provides a range of life insurance and savings products. SOGECAP France owns 25% of SOGECAP Liban.

Table 4.4

Foreign	Local	Stake
Predica	Bancassurance	20%
SOGECAP France	Sogecap Liban	25%

d) Distribution Alliances

There are two models to this approach. The first model consists of the common shareholder base where a bank and an insurer are owned by the same group but operate as totally separate and independent entities, and each retains its own brand name. The common ownership makes it easier to reach marketing and distribution agreements.

One such example is Groupe Méditerranée, which owns MEDGULF as well as three banks operating in Lebanon that are Banque de la Méditerranée, Allied Bank and the Saudi-Lebanese Bank. As such, MEDGULF has launched a series of bancassurance products through the 50 branches of its three sister banks. Because distribution alliances are loose compared to other forms of bank entries, it gives the companies involved the highest degree of freedom and the level of integration is very low.

Another such example is the MEPA Group, which fully owns UFA Assurances and a minority stake in the Lebanese-Canadian Bank. As a result, UFA has been marketing its products through the bank.

The second model under this category is the pure distribution agreement where a bank acts as another distributor for an insurance company without any cross-shareholding between the two entities. This is the least used method in Lebanon due to its loose nature, the lack of control of the bank over the insurer, and where the level of integration is the lowest. Smaller banks like Federal Bank, Credit Bank, and Intercontinental Bank have usually adopted this approach. The size of the bank does not preclude such an alliance, as evidenced by some large and medium-size banks in Lebanon that also adopted this approach like the distribution arrangement between SNA and each of Bank of Beirut as well as Bank of Beirut & the Arab Countries.

Presence of Global Players

The low barriers to entry in the Lebanese insurance market have allowed global insurers to establish a local presence through the acquisition of minority or majority stakes in local players. The common features of international insurance firms in the Lebanese market have been to

1) acquire stakes in major players,
2) introduce new products in the market,
3) and potentially use Lebanon as a base to expand to other parts of the Arab world.

The other entry strategy for global insurers in Lebanon has been to establish a direct presence through branches or indirectly through representation.

Global insurers bring several benefits to the local market:

• They play a role in integrating Lebanon in the global economy through their capacity, capital and know how.

• They bring a company's global brand name recognition and trust. An insurance firm's reputation as a financially strong company is particularly important in life insurance given the long-term nature of the products in this category.

• They can assume risks that exceed the capacity of local insurers, especially in commercial lines.

• They bring expertise in designing, managing and marketing insurance products and introduce new products.

• They have better know how regarding products and risk management due to their extensive experience in various parts of the world.

• They transfer technology and managerial know how. More specifically, they introduce new operating systems, procedures and management tools. They also provide staff training, product development and market leads.

There are four main alliances between global insurers and local players:

1) Natexis Assurances & AIMR

In 2001, Assurances Banques Populaires, now operating as Natexis Assurances, acquired 34% of Adonis Insurance and Reinsurance Co. (ADIR). Natexis Assurances is the fifth largest bancassurance group in France, while ADIR is the insurance subsidiary of Byblos Bank sal. The venture's main objective is to develop bancassurance products in Lebanon and in selected Arab countries and to cooperate in areas where Natexis is active such as asset management, leasing and fund creation.

The Byblos-ADIR-Natexis alliance illustrates the convergence of banking, insurance and asset management. Natexis Assurances is an affiliate of Natexis Banques Populaires, which has around 33,000 employees and operates in 44 locations around the world.

2) Atradius & LCI

In 2001, Gerling NCM, the world's second largest credit insurance and receivables management firm, helped start the Lebanese Credit Insurer sal (LCI) and holds a 29% stake in the venture. LCI is a local insurer specializing in trade credit insurance. Gerling NCM, now named Atradius, has a 25% global market share in trade credit insurance, covers €350 billion in trade turnover, and operates through 80 offices in 42 countries. Atradius is also the technical partner of LCI, providing reinsurance support, staff training, product development, underwriting, international debt collection as well as leads through its global database. It is worth noting that Atradius' stake in LCI is through a joint holding firm with the International Finance Corporation, the private sector arm of the World Bank. Together, the two entities hold a 49% stake in the firm.

3) AGF/Allianz & SNA

In 1998, French insurance company Assurance Générale de France (AGF) acquired a 30% stake in SNA Holding (Bermuda) Ltd., the holding entity of Société Nationale d'Assurances (SNA). AGF raised its stake in its SNA Holding from 30% to 56%. Allianz, Europe's largest insurance group, owns 51% of AGF. The deal helps SNA keep up with technological advances and positions it to expand regionally and internationally.

4) AXA & Société Libano-Francaise

In 1999, the AXA Group acquired a 51% stake in Société Libano-Francaise d'Assurances et de Reassurances sal, one of Lebanon's top 10 insurers at the time. AXA is one of the world's largest insurance companies with a global presence in 50 countries. The new alliance is expected to cover Lebanon and the region. The resulting entity became AXA Middle East. The AXA Group is one of the largest insurance and asset management groups in the world.

Table 4.5

Global	Local	Year
Natexis Assurances	ADIR	2001
Atradius	LCI	2001
AGF/Allianz	SNA	1998 & 1999
AXA	SLF	1999

ALICO

In 1953, the American Life Insurance Company (ALICO), a member of the American International Group (AIG), established a direct presence in Lebanon. ALICO opened a branch in the country to sell life insurance products. AIG is one of the world's largest insurance groups and has a presence in more than 135 countries. It is considered to be the most global among insurance firms and the world's leader in life insurance.

Presence of Arab Insurers

Arab insurance firms have long been present in the Lebanese market through direct interests in local insurers. Some of them include:

• The Kuwait-based Gulf Insurance Co. and the Bahrain-based Saudi Pearl Insurance Co. are main shareholders in the local Al-Fajr Gulf insurer. Gulf Insurance is one of Kuwait's largest insurance firms. It is part of the Kuwait Projects Company (KIPCO), one of Kuwait's largest conglomerates.

• The Bahrain-based Arab Reinsurance Group (ARIG), the largest Arab reinsurance company, has stakes in ALIG and ALIG Life.

• The UAE-based Al-Habtour Group owns the Dubai National Insurance Company.

• The Saudi insurer Al-Nisr is present in Lebanon through its subsidiary Al-Nisr Insurance Company.

• The Arab Life Insurance Company is owned by the Kuwait-based Al-Ahleia Insurance Co. and by the Jordan-based Arab Life & Accident Insurance Co.

REGIONAL EXPANSION

Overview

The limited size of the Lebanese market, the 15-year war, the economic slowdown of the past few years, the ongoing liberalization of markets, and the low barriers to entry have encouraged local insurers to look for external markets to expand. Particular trends encouraging regional expansion include population growth, economic reforms, new compulsory insurance in several markets and an increase in consumer awareness about the benefits of insurance. Already, several large Lebanese insurers have a regional and international presence.

Arabia Insurance Company sal

Arabia Insurance was established in 1944 in Jerusalem and moved in 1949 to Beirut following the 1948 Arab-Israeli war. It is incorporated in Lebanon and offers life, motor, property, marine as well as general accidents insurance, and is launching medical insurance.

Arabia derives a small fraction of its premiums from the Lebanese market. Its life and non-life premiums generated in Lebanon totaled about 9% of the firm's aggregate premiums. The firm has long been a player in Arab insurance markets.

Arabia operates in Bahrain, Kuwait, Oman, Qatar, and the United Arab Emirates through branch offices and in partnership with a local sponsor in each country. It is also present in Saudi Arabia through its affiliate Arabia Insurance International E.C. and has 7 branches across the Kingdom.

Additionally, Arabia operates in Jordan through its subsidiary General Arabia Insurance Company Ltd. and in Tunisia through Le Groupe des Assurances de Tunisie.

Bankers Assurance sal

Established in Beirut in 1972, Bankers is part of the Nasco Karaoglan Group, a major player in insurance and reinsurance that operates in the Middle East and Europe. Bankers is the third largest insurer in Lebanon with total premiums about $46 million in 2004. The group operates in the United Arab Emirates through the Ras El-Khaima National Insurance Company and insurance broker Nasco Karaoglan Dubai. It has a presence in Europe through Nasco Karaoglan France, an insurance and reinsurance broker based in Paris.

MEDGULF sal

The Mediterranean and Gulf Insurance & Reinsurance Company sal is the largest non-life insurer in Lebanon. Its sister company MEDGULF E.C. operates in Saudi Arabia through

branches in Riyadh, Jeddah and Khobar and has become the second largest insurer in the Saudi market. The firm plans to expand its coverage to other Gulf markets.

The firm has in Saudi Arabia a third-party administrator named Medical Express that manages and services MEDGULF E.C.'s medical portfolio with more than 10 physicians, 15 medical delegates and 40 supporting staff.

Libano-Suisse sal

Established in 1959, Libano-Suisse is one the largest insurers in the Lebanese market. It generated $23.8 million in life and non-life premiums in 2004, ranking it as the 8th largest insurance provider in the country.

Libano-Suisse has a presence in many Arab and African markets as well as in Europe. It has been present in Arab Gulf markets since the 1960s and has traditionally been represented by local agents.

Currently, the parent company of Libano-Suisse is engaged in an insurance joint venture with the Saudi El-Seif Group to take advantage of a recent law in Saudi Arabia that has mandated health insurance for all expatriates working in the Kingdom. It also has a presence in Jordan and Cyprus through its own general agencies. Additionally, Libano-Suisse operates in the Ivory Coast since 1980.

Société Nationale d'Assurances sal

Established in 1963, SNA generated $39.78 million in life and non-life premiums in 2004 from the local market, ranking it as the fourth largest insurance provider in the country.

SNA embarked on a regional expansion in 1975 with the start of the Lebanese conflict, and operates today under various structures in several Arab countries. SNA is in partnership with local investors and institutions in insurers operating in Jordan (Al Nisr al-Arabi), Morocco (La Marocaine Vie), and Tunisia (Maghrebia Insurance).

The SNA Group also owns Axioma, a Cyprus-based company that markets insurance and retirement products to regional expatriates. SNA is currently cooperating with AGF in Egypt through the management of a recently privatized insurer. SNA has also entered the Saudi market through its role in the first bancassurance operation that took place in Saudi Arabia and was realized by AGF and the Saudi-French Bank. SNA generates more than 95% of its gross premiums in Lebanon.

UFA Assurances sal

Formed through the acquisition and merger of existing insurance firms, UFA is the 19th largest insurer in Lebanon with $9.23 million in total premiums for 2004. The company is part of the MEPA Group, a large insurance and reinsurance group established in 1976 and operating in Lebanon, the Arab Gulf, Europe and North America.

UFA Assurances-Lebanon has a sister company, UFA-Bahrain, that operates in Saudi Arabia and the UAE through tied agents and 5 offices across the Gulf. Through MEPA Gulf, the group also underwrites business in the UAE. The group also has insurance and reinsurance brokers in London, Lebanon and the UAE. More broadly, MEPA controls and runs underwriting management agencies, insurance and reinsurance brokers and service companies.

Regional Insurance Opportunities

There is a general consensus that the regional markets that offer the biggest potential for Lebanese insurers are Iraq, Saudi Arabia and Syria. The three countries are considered to be the largest 'natural' markets for Lebanese insurers. Other Arab Gulf markets may provide opportunities but are already saturated with foreign and local insurers amid fierce competition among market players. Further, Lebanese insurers need to take into consideration the fact that Saudi authorities have mandated insurance firms operating in the Kingdom to have a minimum capital of $30 million, while the other Gulf states have required insurers to have a minimum capital of $15 million. Finally, the North African and Arab Maghreb markets are an uncertain proposition at best, as European players are already entrenched along with large local insurers in addition to the need of adequate knowledge about the markets.

The sheer size of the capitalization of Gulf insurance firms as well as the scale and scope required to enter the Saudi and Iraqi markets tend to limit regional expansion to the large, well-capitalized Lebanese insurers that have alliances with Gulf or foreign players.

Iraq

Iraq's insurance sector was in the hands of the private sector and was regulated by the Insurance Law of 1921. Following the accession to power of the Baath Party, the sector was nationalized under the new Nationalization of Insurance Law of 1964. The regime also nationalized most other industries, including the oil sector. In 1997, Laws 21 and 22 authorized the establishment of local private insurers in the country and by 2000 there were four privately owned and operated insurance firms in Iraq. The regime also authorized local private banks in order to help offset the impact of sanctions imposed after the 1991 Gulf war. Due to military conflicts with Iran and Kuwait and 11 years of UN sanctions, there are no reliable figures on the Iraqi insurance market or on most other macroeconomic or sectoral indicators.
More than two decades of conflict resulted in the significant deterioration of Iraq's economy, society, and infrastructure. Consequently, there has been a sharp fall in GDP, resulting in a huge decrease in per-capita income and living standards.

The Economist Intelligence Unit (EIU) estimated the total Iraqi population at around 24 million in 2004 with a growth rate of about 2.8°/o per year. This rate places Iraq among the world's high population growth countries. Further, Iraqis a relatively young country with around 41% of the population under the age of 14.

The change of regime heralded massive reconstruction needs, the establishment of a market-base economy, and the likely privatization of most state-owned entities. The share of the private sector in GDP was relatively low as most of the large enterprises were state controlled, but it is expected to increase significantly in the coming years due to higher foreign investments in oil and infrastructure, privatization, the development of capital markets and an open economy. The costs of post war reconstruction have been estimated at around $100 billion.

The scale of the reconstruction and modernization efforts of the Iraqi economy, along with its rich natural resources and large population present a unique opportunity for Lebanese insurers. Even a small share of the potential insurance market linked to economic reconstruction would be a major boost for Lebanese insurers. But only the large, experienced and well prepared insurers have the means to enter the Iraqi market. Further, they are likely to face fierce competition from Arab and foreign insurers. Additionally, Lebanese industries have been exporting all kind of goods to Iraq under the oil-for-food program and demand currently has increased following the lifting of the sanctions. Insurers stand to benefit with the growth of Lebanese exports to Iraq.

Saudi Arabia

The Saudi insurance market is the largest in the Arab world. There are about 60 insurance companies operating in Saudi Arabia with the top 35 accounting for 85% of aggregate premiums. Total premiums are estimated at $1.2 billion for 2004. But penetration and density rates are still low relative to the size of the economy and to the country's population. The insurance density rate, or premiums as a percentage of GDP, was 0.48% in 2004, fourth lowest in the Arab world, while the penetration rate, or premium per capita was $51.4, eighth highest in the region in 2004 and coming behind all other GCC countries. Two factors have contributed to transform the Saudi market into one of the most promising in the region.

First, the government has required mandatory medical insurance coverage for all 7 million expatriate workers and their families living in Saudi Arabia. Although the decision was effective starting in September 2002, the Saudi Health Ministry has given employers a three-year transition period to implement the coverage under the Cooperative Health Insurance Law. The new regulations stipulate that expatriates working for companies with 500 workers and above have to be medically covered. The second stage will see the law applied to companies with more than 100 staff, and the last stage will cover all categories of expatriate employees, including domestic helpers and drivers.

The law has set a yearly insurance premium of $266.67 per person and a maximum coverage of $66,667 per insured annually. Industry sources estimate that medical premiums should rise to $1.8 billion a year once the last stage of the plan is implemented.

Second, the government made auto insurance compulsory for all motorists in the

Kingdom as of November 2003. The decision applies to all Saudis and expatriates alike. There are about 5 million cars registered in Saudi Arabia and demand for auto coverage has been on the rise due to the high rate of traffic accidents across the country. The government also mandated all cars entering or passing through Saudi territory to have motor coverage from a Saudi insurer. Motor insurance is the second largest insurance category, accounting for about 25% of written premiums. Saudi Arabia has a population of nearly 23 million and a GDP per capita of about $7,500.

In parallel, Saudi Arabia has been negotiating for membership in the World Trade Organization. Eventually, such membership would require the government to open up the insurance market and reduce barriers to entry for all foreign players. Saudi Arabia expects to become a full member in the coming few years.

Already, several Lebanese insurers have a presence in this market, including MEDGULF, Al-Mashrek, UFA Assurances, Cumberland, Saudi Arabia, Leaders, and Union Nationale.

Syria

The Syrian economy is considered to be one of the most underinsured economies in the Arab world. The insurance density rate, or premiums as a percentage of GDP, was 0.4% in 2004, second lowest only to Yemen, while the penetration rate, or premium per capita was $5.1, third lowest in the region in 2004.

Before the 1960s, private insurers were allowed to operate in the country and the only state-owned firm was the Syrian Insurance Company (SIC), which was established in 1953 with help from Munich Re and Swiss Re. But the Syrian insurance sector was nationalized in 1961 and the assets and liabilities, branches and agencies of the existing private firms at the time were transferred to SIC. Today, the sector is underdeveloped and will allow private insurers, as the state-owned SIC continues to monopolize the provision of insurance. Further, there are no indications that the government is willing to privatize SIC. Various estimates put total premiums at between $88 million and $95 million for 2004.

According to the SIC, motor insurance accounted for nearly 62% of total premiums in 2004 followed distantly by transportation with 21%, while life insurance came in last place with a mere 0.04% of aggregate premiums.
However, the country has a huge upside potential with a GDP estimated at $20 billion and a population of 18 million for 2004. Additionally, and more importantly, Syrian authorities have become aware of the need to reform and liberalize the state-dominated economy in general and the financial sector in particular. The banking reforms that are taking place and that have authorized private banks in the country are a first step towards further financial reforms in general and of the insurance sector in particular. Syria has a large manufacturing base and an active private sector, but it needs to modernize its legal system and open up the country for private insurers in order for the sector to realize its potential.

Lebanese insurers have a decisive first mover advantage in the Syrian market. Geographic proximity, long established commercial and banking relationships, the entry of Lebanese banks into the market, and the numerous Syrians already insured in Lebanon or utilizing the services of Lebanese insurers as an off-shore insurance market position Lebanese insurance companies in a very advantageous situation. Also, several Syrian private firms are said to be insured in Lebanon, but the risk for Lebanese insurers is that the courts are unlikely to recognize the policy in the case of a dispute and the policy would not be legally binding. The Syrian free zones already allow the presence of Lebanese insurers, but this represents a very limited market outlet compared to the potential of the onshore market.

However, the Syrian insurance market needs proper legislation, clear rules and regulations, independent supervisory bodies, and the authorization of private players, along with the liberalization of other sectors to start realizing its true potential. Judging from the pace of banking reforms, the Syrian insurance market would represent a real opportunity in the medium-term, or in about 3 to 4 years, when the legal infrastructure is in place.

REINSURANCE

A reinsurance company is an insurance company that assumes all or part of an insurance policy written by a primary insurance firm. The purpose of reinsurance is to relieve the primary insurer from heavy liabilities. i.e Diluting the risk of underwriting.

"Reinsurance is insurance for insurance companies"

More precisely, Reinsurance is the transfer of part of the hazards or risks that a direct insurer assumes by way of insurance contract or legal provision on behalf of an insured, to a second insurance carrier, the reinsurer, who has no direct contractual relationship with the insured.

Why is there a need for reinsurance?

Mainly, a direct insurer needs reinsurance:

1) to limit (as much as possible) annual fluctuations in the losses that the company must bear on its own account; and
2) to be protected in case of catastrophe.

How reinsurance affects the direct insurer

The reinsurer adds value in many ways to the services that a direct insurer provides to his clients:

1) The reinsurer reduces the probability of the direct insurer's ruin by assuming the company's catastrophe risks.
2) The reinsurer stabilizes the direct insurer's balance sheet by taking on a part of the company's risk of random fluctuation, risk of change, and risk of error.
3) The reinsurer improves the balance of the direct insurer's portfolio by covering large sums insured and highly exposed risks.
4) The reinsurer enlarges the direct insurer's underwriting capacity' by accepting a proportional share of the risks and by providing part of the necessary reserves.
5) The reinsurer increases the amount of capital effectively available to the direct insurer by freeing equity that was tied up to cover risks.
6) The reinsurer enhances the effectiveness of the direct insurer's operations by providing many kinds of services: for example, by:
   a. compiling and presenting underwriting data from sources around the world;
   b. assessing and evaluating special risks;
   c. offering consultation in loss prevention;
   d. providing loss adjustment support;
   e. performing actuarial work;
   f. training members of the cedent's staff; and
   g. helping ceding companies to invest their capital, to recruit managerial staff, find cooperation partners, arrange mergers, etc.

Who offers reinsurance?

The top four reinsurers have a market share amounting to 35% of reinsurance business. The syndicates that have banded together in London's Corporation of Lloyd's, with its more than three centuries of history, operate both in the direct insurance and reinsurance markets. Here, reinsurance covers are bought on an exchange system similar to a stock market.

Lloyd's has established a particular reputation for marine insurance and the coverage of unusual risks. For special types of risk, such as aviation or nuclear energy, insurance pools have been created. These are mainly designed to balance risks as well as possible at the national level, while attempting to secure further international cover with reinsurers or foreign pools.

In addition to the professional reinsurers, a number of large direct insurance companies write reinsurance business, either through their own reinsurance departments or through reinsurance subsidiaries.

Reinsurance brokers act as intermediaries in providing direct insurers with reinsurance cover. They play a significant role in the worlds English-speaking markets.

There are two basic forms of reinsurance, namely treaty and facultative.

1) Treaty Reinsurance

Treaty reinsurance is when a primary insurer and reinsurer agree in advance that the primary insurer will transfer (cede) risks to the reinsurer in accordance with the terms and conditions of the reinsurance treaty. The duration of the treaty is usually one year or longer. Different treaties may be drawn between insurance companies and reinsurers such as excess of loss, quotas share, stop loss or aggregate excess of loss, surplus, and total cover treaties.

2) Facultative Reinsurance

Unlike treaty reinsurance, facultative reinsurance is non-obligatory. The primary insurer in not obliged to cede the business and the reinsurer is not obliged to accept the risk. Facultative reinsurance agreements are individually underwritten and are common for large limit risks.

Basic types of reinsurance: proportional and non-proportional

Both forms of reinsurance (facultative and obligatory) may be either proportional or non-proportional in type.

1) Proportional reinsurance

In all varieties of proportional reinsurance, the direct insurer and the reinsurer divide premiums and losses between them at a contractually defined ratio. According to the type of treaty, this ratio may be the same for all risks covered by the contract (quota share reinsurance), or it may vary from risk to risk (all other proportional reinsurance types). In all cases, however, the reinsurer's share of the premiums is directly proportional to his obligation to pay any losses. For instance, if the reinsurer accepts 90% of a particular risk and the direct insurer retains 10%, the premium is apportioned at a ratio of 90:10.

a- Quota share reinsurance

The simplest form is quota share reinsurance, in which the reinsurer assumes an agreed-upon, fixed quota (percentage) of all the insurance policies written by a direct insurer within the particular branch or branches defined in the treaty. This quota determines how liability, premiums and losses are distributed between the direct insurer and the reinsurer.

The quota share arrangement is simple as well as cost-effective. Its disadvantage lies in the fact that it does not sufficiently address the direct insurer's various reinsurance requirements, since it measures everything by the same yardstick. In particular, quota share reinsurance treaties do not help to balance a portfolio: that is, they do not limit the exposure posed by peak risks (for example, those with very high sums insured).

b- Surplus reinsurance

Surplus reinsurance is a more sophisticated form of proportional reinsurance. With this kind of treaty, the reinsurer does not participate in all risks as in the quota share treaty: instead, the direct insurer himself retains all risks up to a certain amount of liability (his retention). This retention may be defined differently for each type (class) of risk. The reinsurer, for his part, will accept, in fact, is obliged to accept, the surplus; the amount that exceeds the direct insurer's retention.

Of course, there must also be an upper limit to the reinsurer's obligation to accept risk. This limit is usually defined as a certain multiple of the direct insurer's retention, known as lines. For each reinsured risk, the ratio that results between the risk retained and the risk ceded is the criterion for distributing liability, premiums and losses between the direct insurer and the reinsurer.

2) Non-proportional reinsurance

With non-proportional reinsurance there is no set, pre-determined ratio for dividing premiums and losses between the direct insurer and the reinsurer; the share of losses that each pays will vary depending on the actual amount of loss incurred.

The treaty defines an amount up to which the direct insurer will pay all losses; this is the deductible (other terms used include net retention, excess point and priority). For his part, the reinsurer obliges himself to pay all losses above the deductible amount, up to a contractually defined cover limit.

As the price for this cover, the reinsurer demands a suitable portion of the original premium. In defining (rating) this price, the reinsurer considers the loss experience of past years (experience rating) as well as the losses to be expected from that type and composition of risk (exposure rating).

Thus, the reinsurance agreement only obliges the reinsurer to pay when the reinsured portfolio or risk incurs an actual loss which exceeds the deductible amount.

a- Deductible, cover limit

Excess of loss (or XL) reinsurance is structured quite differently from the proportional types of treaty discussed above. With proportional treaties, cessions are linked to the sums insured; with excess of loss reinsurance, in contrast, it is the loss that is important. Here, no matter what the sum insured, the direct insurer carries for his own account all losses incurred in the line of business named in the treaty — up to a certain limit known as the deductible. (As mentioned above, other terms such as net retention, excess point or priority may also be used.) The reinsurer pays the entire loss in excess of this amount, up to the agreed cover limit.

Thus, in contrast to proportional treaties (in which the reinsurer pays his defined share of all losses falling under his obligation to reinsure), with excess of loss treaties the reinsurer pays only when the loss exceeds the deductible. When this happens, he will pay that part of the loss in excess of the deductible (up to the agreed cover limit).

b- WXL/R and CatXL covers

Excess of loss insurance can be broadly divided into covers per risk (WXVR) and covers per catastrophic event (CatXL). Such treaties meet the needs of those direct insurers who want reinsurance protection (at least against large losses) while retaining as much of their gross premium as possible. However, these insurers are also buying a risk that is greater than with proportional insurance, for the reinsurer provides no relief from losses below the deductible amount. Thus non-proportional insurance covers greatly increase the danger that the direct insurer will actually have to pay in full, and for his own account, any losses near or at the agreed deductible amount.

XL reinsurance has a much shorter history than proportional insurance, and did not become established until the 70s. One main reason may be that in contrast to proportional reinsurance treaty wordings do not explicitly define the way premiums are to be shared by the direct insurance company and the reinsurer. Rather, from the very beginning, the reinsurer must estimate what future loss burden it can expect to pay under such a treaty.

c- Stop-loss (SI) reinsurance

The stop-loss treaty is designed for direct insurers who are seeking comprehensive protection against fluctuations in their annual loss experience in a given class of business. In this somewhat rare form of reinsurance, the reinsurer is obliged to cover any part of the total annual loss burden that exceeds the agreed deductible: usually, this deductible is defined as a percentage of annual premium income, but it may also be a fixed sum. It is irrelevant whether the deductible is exceeded by one single large loss or an accumulation of small and medium-sized losses.

As it is not the purpose of the stop-loss treaty to relieve the direct insurer of all entrepreneurial risk, the reinsurer understandably requires the direct insurer to incur a technical loss (ie losses + costs> premiums) before his duty to pay is triggered.

The stop-loss treaty is actually the most comprehensive form of reinsurance protection. However, reinsurers have reservations towards this type of treaty, which is the reason it is not more widely used.

There are several reasons for their restraint:

1- a large amount of risk is transferred to the reinsurer while means of influencing the exposure remain limited;
2- the reinsurer loses premium volume, and hence influence;
3- the reinsurer needs an enormous amount of information;
4- there is a danger of manipulation by the cedent;
5- and the composition of most portfolios is becoming less transparent as the insurance business becomes increasingly internationalized.

Overview on Reinsurance in Lebanon

Lebanon used to be the reinsurance center of the Arab world in the 1960s and 1970s.

The Lebanese insurance sector has been, and continues to be, actively working with global reinsurance companies to transfer most of the risks that local insurers underwrite.

Reinsurance companies are rated by international rating agencies. As per the amended law of 1999, insurance companies operating in Lebanon are obliged to conduct their reinsurance business with reinsurance firms that have a minimum ‘B’ rating. Further, the large losses suffered by insurers that did not have adequate reinsurance coverage led the

government to require the Ministry of Economy & Trade to approve all reinsurers as a prerequisite for them to do business in Lebanon.

There are four foreign reinsurance companies that have offices in Lebanon. They are Cologne Re and Gen Re (Germany), GE Frankona Re (United States), and Caisse Centrale de Reassurance CCR (France). Further, Arab Re and B .E. S.T. Re (Tunisia) are physically present locally.

Gen Re established its offshore regional office in Beirut in the late 1990s to cover the Arab markets.

B.E.S.T. Re's full name is (Beit Iaadat El-Ta'amin Al-Saoudi Al-Tunisi), or the Saudi-Tunisian Reinsurance House. The firm operates in more than 45 countries in Africa, Asia, the Middle East and the Mediterranean. It has its base in Beirut to cover the Gulf and Mediterranean markets. B.E.S.T. Re operates on the principles of Re-Takaful, or Islamic reinsurance, which are based on Shari'ah Law.

Arab Re is a pan-Arab reinsurance company that is owned by about 56 Arab insurers and financial institutions representing 16 Arab countries.

ALTERNATIVE RISK TRANFER (ART)

Innovative products, such as ART (Alternate Risk Transfer) or ARF (Alternate Risk Financing) are simply a link between finance and insurance. The core issue is whether the regulator and the fiscal authorities view them as being Reinsurance Contracts or just Banking Arrangements.

Unfortunately, the definitions available to help decide this issue are not specific but rely on subjective words such as significant, reasonable and possible. The main questions that help decide are:

1) Is it reasonably possible that the reinsurer may realize a significant loss from the contract?

2) Is there is a reasonable possibility of a significant range of outcomes under the contract?

3) Is there a significant degree of uncertainty in respect of the timing of claim payments?

Significant must be assessed in the context of the commercial substance of the contract being evaluated as a whole.

There is a wide range of products under various names the most important are:

1. Contingent Capital
2. Swaps
3. Finite Risks
4. Catastrophe Bonds

1. Contingent Capital

It is securing access to funds in advance which are available after the happening of a pre-agreed significant event when refinancing might be very costly.
Paying a premium to have the right to raise equity or loan capital subject to certain conditions:

- Via a "CSN" (Contingent Surplus Note)
- Terms agreed in advance
- Triggered if a contractually defined event occurs.

The reinsured has the option to issue capital within predetermined limits after a pre-specified event or combination of events occurs, e.g. Earthquake above X.X on Richter Scale, or Stock market drops by X points.

Example:

Insurer purchases the right to issue in the future to investors pre-agreed paper at pre-set terms, e.g Sept 2002 Horace Mann (US) - 3 year deal - if major US Catastrophe as defined happens they have the right to issue up to $75m of Convertible Securities which must be taken up.
The deal can be based on any style of capital, in many cases preference shares or subordinate debt. The aim of the product, if designed correctly, is to achieve access to capital without diluting shareholders' interests.

It is highly recommended by the specialists in this area that such a product be discussed with regulators, rating agencies, etc.

Why this path might be considered:

- Cheaper and more efficient than buying conventional forms of Reinsurance
- Requires less detailed information regarding specific business
- Can be put in place quicker than placing Cat X/L
- Does not require proof of specific loss amount i.e. not indemnity

2. Swaps
Are privately negotiated financial contracts in which two parties agree to exchange or swap specific price risk exposures over a pre-determined period of time.

There is no cost for a swap. Most deals involve the payment of periodic payments between the parties, one side paying a fixed price and the other a variable price.

The concept in Reinsurance is basically two parties agreeing to pass to the other a pre-agreed monetary amount of exposure for specific perils in a pre-determined area thus reducing down the need for Cat X/L and diversifying the portfolios of both parties.

Example:

In June 2003 Swiss Re and Mitsui agreed to swaps:
Swiss Re swapping $50m of exposure to loss from North Atlantic Storm for $50m of exposure to loss from Japanese Typhoon.

and under a separate contract

Swiss Re swapping $50m of exposure to loss from European Storm for $50m of exposure to loss from Japanese Typhoon.

Both parties have passed out peak exposures for them and taken in exposures from other areas with which they feel more comfortable.
The swap has basically only become possible because of the major advances in Weather

and Catastrophe simulation proving that the chance of loss in a given scenario is similar for both sides.

3. Finite risk:

A very complex issue of risk transfer based on a long-term strategy of risk sharing between the reinsured and the reinsurer, which is generally a multi year arrangement with an overall aggregate limit.

Losses or expenses or profits are spread over a number of years, with the maximum profit/loss for both parties reasonably clear.

The overall basis of the "premium" formula is likely to create similar income and outgo on both sides over the period of the contract.

Finite Risk does not deal with specific perils and is more likely to be concerned with the impact on the overall financial position.

Example:

A new life insurer with a very poor cash flow in the early years (very high expenses) might place a Finite Risk Quota Share Treaty. The reinsurer would agree to "fund" the Treaty commission to the reinsured in advance at the start of the contract (subject to an agreed formula for interest). The commission (and interest) would be being paid back out of any profits from Q/S.

Usually the reinsurer would agree to accept a finite risk if:

1) Strategic alliance in a market with high potential,
2) Or, the interest paid by the insurer is adequate

The insurer on the other hand, will seek a finite risk if he has a potential insurance line that needs financing.

The arrangement would be subject to a maximum limit of loss or profit with one party or the other having to "top up" the overall fund if it ends up too far into deficit or profit.

In summary: finite risk deals in many cases are "smoothing covers" the purpose of which is not necessarily to transfer risk as such.

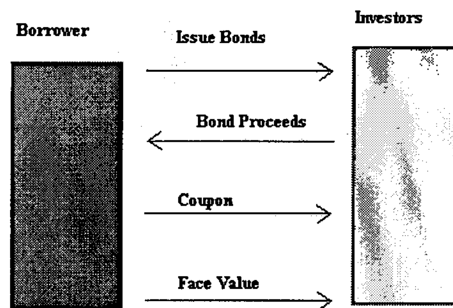
4. Catastrophe Bonds

Funds are provided in advance to pay for a Catastrophe if it occurs.

This is different from contingent capital as the funds are received in advance.

If the event happens (the trigger) bondholders "forgive" or defer: coupon and/or Face Value and/or a combination of both.

Figure 6.1



Example:

Tokio Marine wanted a further $100,000,000 of Catastrophe to augment their existing X/L program particularly with regard to the Kanto region in Japan

What is the process?
1) Want "Reinsurance" for $100,000,000.
2) Issues a Bond to borrow $100,000,000.
3) Investors lend $100,000,000 subject to:
- pre-agreed interest
- repayment at a fixed date

If loss occurs funds from the bond are used to pay the claims.

At this point it seems just like any other Bond with no particular relationship to Reinsurance. The money lend under the bond will have to be repaid. So how does it become reinsurance?

If "trigger" occurs (e.g earthquake above 7.1 on the Japanese Scale) there will be loss of principle for the investors in the bond (or, in the Tokio Marine example, partial loss of principal).

Now the product is in basic terms operating like Catastrophe Reinsurance. Premium has been paid for cover by the insured. Funds (which do not have to be repaid) are used to pay losses following a pre-specified catastrophe.

Although supposedly "Non-traditional", there is a standard way of putting these products together using a SPV (Special Purpose Vehicle) Reinsured buys "R/I protection" from a SPV (Special Purpose Vehicle) SPV issues a "Cat Bond" to Investors.

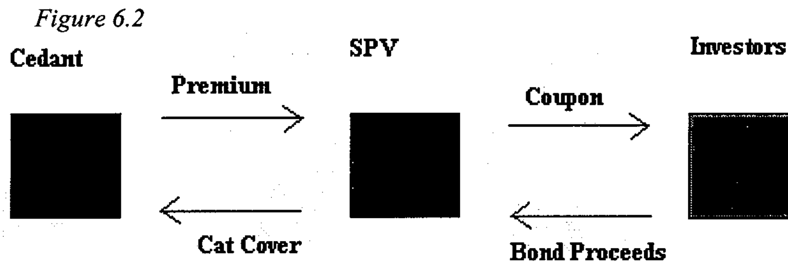
Why the SPV?
To convert Reinsurance risk into a "securitisable asset" by converting the Reinsurance risk into a form the Capital Market can understand and legally accept.

What are the specifics of an SPV?
- Probably very low Capital
- Normally registered "offshore"

How does it all work?
a) the SPV issues traditional cover to the Reinsured;
b) the SPV issues a bond(s) to the traditional bond market to obtain the Capital to cover their liabilities under the "Reinsurance";
c) the bond as with any other bond will be fully rated by the major Rating Agencies

Giving an overall picture it looks something like this:

Figure 6.2



These products should be seen as an important adjunct to traditional reinsurance.

Although the actual volume in terms of numbers of contracts purchased is still low perhaps 5 per year, total protection being bought is in the vicinity of $ 1 bn to $ 1.5 bn per year with particular interest being shown by major reinsurers, e.g., Swiss Re June 2004 issuing 6 covering a range of differing perils and areas.

In the opinion of Standard & Poor's, for financial strength rating purposes a properly structured catastrophe bond serves the same function as a program of reinsurance even if it is not structured as such.

HISTORY OF NATURAL CATASTROPHES IN THE MEDITERRANEAN REGION THAT AFFECTED LEBANON

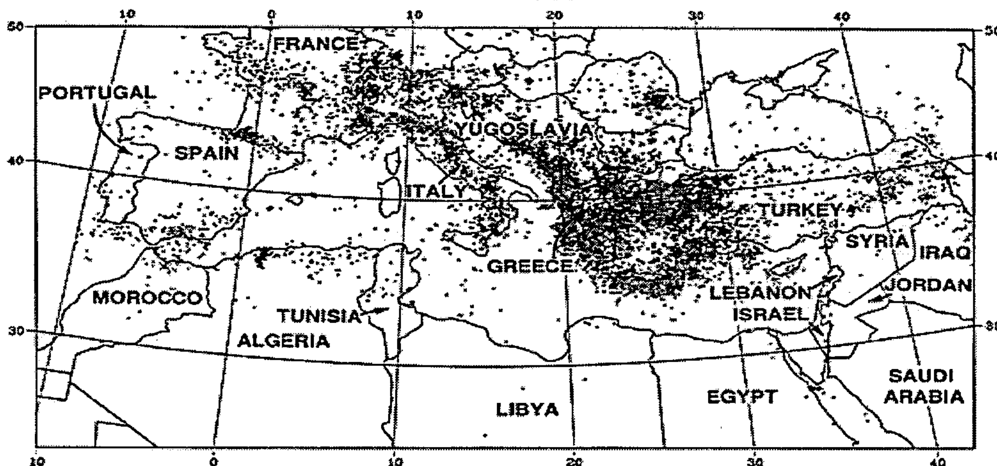
The seismicity in the Mediterranean has been documented for over 2000 years, many important cities in the middle east have been destroyed by earthquakes.

The next disaster is not a question of "If," but "When"

The below figure indicates where earthquakes took place in the Mediterranean between 1960 and 1968.

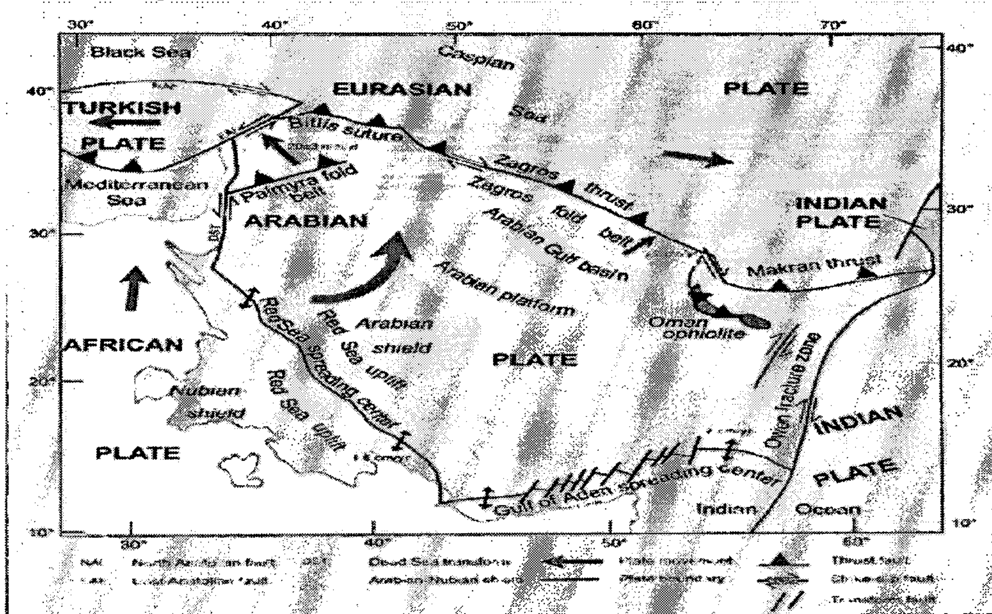
Figure 6.3

SEISMICITY OF THE MEDITERRANEAN SEA AREA, 1960-1986



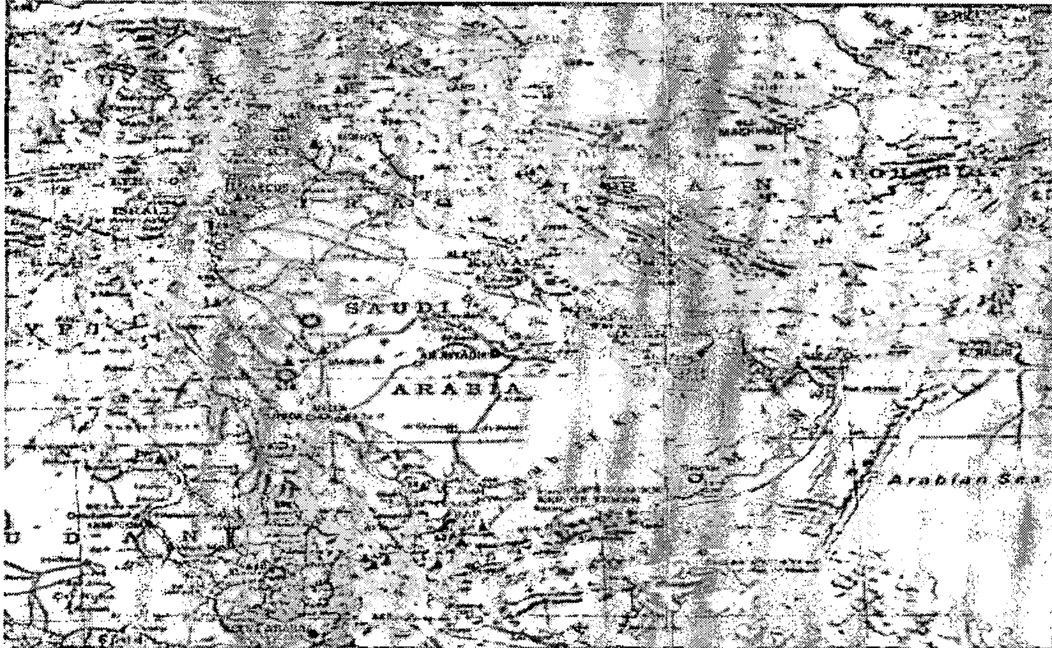
The below figure shows the plates' movements, you can notice that Lebanon falls between the Arabian and African Plates.

Figure 6.4



The below picture shows the plate tectonics in the last 2,000 years.

Figure 6.5



2150 BC EARTHQUAKE:
Sodom and Gomorrah destroyed.

525 BC EARTHQUAKE AND TSUNAMI:
Tyre destroyed by tsunami

140 BC EARTHQUAKE:
Tsunami strikes again Tyre

31 BC EARTHQUAKE:
One of the largest shocks in 2000 years, an earthquake of at least magnitude 7 on Richter Scale hit Jordan Valley

DECEMBER 3, 115 AD EARTHQUAKE:
Levantine coast, Antioch devastated

April 2, 303 AD EARTHQUAKE:
A severe earthquake shook Sidon and Tyre, and Caesarea, where it seems to have caused a sea-wave, but no damage. It also may have affected Byblus. Many buildings collapsed, which killed thousands of people.

349 AD EARTHQUAKE:
Coastal Lebanon, most of Beirut destroyed

SEPTEMBER 455 AD:
A violent earthquake in Tripolis on the Lebanese coast. The city was very badly damaged and may even have been destroyed. In particular all public buildings of the city together with the aqueduct fell down, but were all rebuilt by the Emperor Marcian. This earthquake may have caused destruction over a much wider area of the Lebanese littoral.

SEPTEMBER 476 AD:
A violent earthquake destroyed the town of Gabala (m.Jablah). The emperor gave gold for reconstruction.

AUGUST 21-22, 502 AD EARTHQUAKES:
Damage from Tyre to Aleppo

JULY 9, 551 EARTHQUAKE AND TSUNAMI:
A large earthquake along the Dead Sea Fault zone was felt as far north as Laodicea and Antioch, where it caused slight damage, and as far south as Alexandria where it caused panic, and reportedly eastward as far as Mesopotamia. It generated a seismic sea-wave off the Lebanese coast: the sea first retreated for about a mile (1.6 km) before returning as a colossal wave which flooded and partly flattened Tyre, Sidon, Berytus, Tripolis, Botrys and Byblus (Jubail), Entaradus (Arwad), Sarepta, and Trieris.

Beirut seems to have been the worst hit: it was badly-damaged by the earthquake and sea-wave, but most of the destruction seems to have resulted from the ensuing fire which apparently raged for two months. Beautiful buildings and works of art were lost. The famous Law School, one of only three in the Roman Empire, was destroyed and had to be temporarily transferred to Sidon (which cannot therefore have been badly damaged) during reconstruction. 30,000 people were known to have been killed in Beirut: the high death toll is not surprising, as there were many students at the Law School, and also many people were drowned by the sea wave, as when the sea had retreated they had gone down to the sea-bed to plunder sunken wrecks. At the coastal town of Botrys, just north of Byblus, part of the Libanus Mountain, known as the Lithoprosopon or "Face of Stone", broke off and fell into the sea. This was actually a great benefit to Botrys, because it thereby acquired a sheltered harbour in which large ships could dock. Further up the coast Trieris, the exact location of which is not certain, was also destroyed.

JUNE 658 AD EARTHQUAKE:
Syria-Palestine, devastation everywhere

JANUARY 18, 746 AD EARTHQUAKE AND TSUNAMI:
Jordan Valley, intense damages in valley

NOVEMBER 24, 847
A violent earthquake at dawn destroyed many houses and bridges in Damascus, including the el-Aamer mosque throwing down a quarter of it with its minaret. The earthquake was at least felt in al-Ghutah, it destroyed Darayyah, al-Mazza, Beit Lthyah and other places, and was felt as far away as Antioch. The earthquake continued until at least midday, and caused great fear.

OCTOBER 881 AD EARTHQUAKE AND TSUNAMI:
Levantine Coast, tsunami at Acre

APRIL 5, 991 EARTHQUAKE:
A strong earthquake during the night in Damascus and the surrounding region caused 1000 houses to collapse on their inhabitants in the city and in the region as far as Baalbek (Heliopolis), resulting in great loss of life. The village of Duma sunk into the ground, indicating either faulting or a landslide. Aftershocks followed for almost a month, one being recorded for May 2nd, and another for May 5th, and caused additional damage.

Dec 5, 1033 EARTHQUAKE:
A violent earthqualce occurred in Palestine just before sunset, and was felt in Egypt and Syria. The epicentre seems to have been around Ramla: a third of its houses were destroyed together with half of its wall, and although many of the people who were in the town at the time were killed, most of the male population at least were spared, because they were working out in the fields. The earthquake caused panic, and the survivors evacuated the town, joining the farm workers outside the city for eight days during the destructive aftershocks, one of which may have brought the mosque down. In Jerusalem there was widespread damage: parts of the Dome of the Rock, the mosque of David, and the mosque of Abraham in Hebron, collapsed, shocks continuing to be felt for two days. Nearby Jericho and Arriha were heavily damaged. At Nablus (Neapolis/Shechem) on the coast, 300 people died when the houses collapsed, and the nearby village of Badan was swallowed up in the ground with many others. Acre (Ptolemais) also collapsed. At least half of Banyas (Caesarea Philippi) fell down, and around Lake Tiberias the mountains were seen to move, trees were uprooted and wells overflowed. The earthquake was less strongly felt further south, although it still caused damage: the minaret of the great mosque in Ashqelon fell down, as did the pinnacle of the minaret of the mosque at Gaza. The earthquake was followed by a tsunami, probably off the coast of Acre. The sea flowed out several kilometres before flowing back as a tidal wave an hour later. Although it killed those who were foraging on the seabed, there is no evidence that it caused destruction inland.

1042 AD EARTHQUAKE:
An earthquake occurred in Syria, affecting Ba'albek and Tadmur - the latter was heavily damaged, many of the inhabitants dying when their houses collapsed.

MAY 1053 AD EARTHQUAKE:
Coastal Lebanon Arqa destroyed and abandoned

AUGUST 1063 AD EARTHQUAKE:
A destructive earthquake on the Syrian littoral. The walls of Tripoli fell down, and there was widespread destruction in Antioch (Antakia) Laodicea (Al-Ladhiqyyah), Tyre (Sur), Acre (Akko) and in many other cities in both Byzantine and Arab territory

AUGUST 12, 1157 EARTHQUAKE:
Bekaa Valley, Magnitude 7 plus, Dead Sea rift zone, Damascus destroyed
The culmination of over a year of foreshocks, a violent earthquake occurred in Syria and along the northern section of the Dead Sea Fault: it was felt over an area of 3 million sq. km and killed many thousands of people. Because of the numerous fore- and aftershocks, it is difficult to date the event precisely, but it seems that the most violent shock was on Aug.12.

JUNE 29, 1170 EARTHQUAKE:
Bekaa Valley, Magnitude 7 plus, Dead Sea rift zone
Preceded by foreshocks, an earthquake occurred early in the morning, continuing for some hours, on the northern part of the Dead Sea Fault. It was as destructive as that of 1157 Aug.12, but the epicentral area on this occasion was Aleppo, which was very heavily damaged: many public buildings, houses and the city walls collapsed, leaving it defenseless. The death count was very high, estimates ranging from 5000 to 80 000.

JUNE-JULY 1201 EARTHQUAKES AND TSUNAMIS:
Levantine Coast seismic swarm, destruction in Cyprus, Syria, Palestine

MAY 20, 1202 EARTHQUAKE:
Bekaa Valley, Dead Sea rift zone Tripoli, Homs, and Baalbek destroyed

AUGUST 8, 1303 EARTHQUAKE:
Egypt, damage in Cairo and Alexandria

OCTOBER 28, 1354 EARTHQUAKE:
Hums, Hamah and Ba'albek were shaken by an earthquake, which brought a number of walls down. The worst casualties were in Hamah, Hums and Ba'albek where people were killed.

DECEMBER 1403 - JANUARY 1404 EARTHQUAKES AND TSUNAMIS:
Levantine Coast

DECEMBER 29, 1408
The earthquake sequence which began in 1403 culminated in a destructive event which affected the northern part of the Dead Sea Fault as far as its junction with the southeast Anatolian fault. The worst destruction appears to have been at Shughr, 50 km south of Antioch, which was razed with its castle and district, and apparently there were only 50 survivors. There was heavy damage in Aleppo, Tripoli, Latakia, Jibla, where 15 people reportedly died.

SEPTEMBER 19, 1509 EARTHQUAKES:
Marmara Sea, Istanbul destroyed

JULY 21, 1752 EARTHQUAKE AND TSUNAMI:
Levantine Coast

NOVEMBER 25, 1759 BEKAA VALLEY EARTHQUAKE:
Bekaa Valley magnitude 7.4, Dead Sea rift zone, Beirut and Damascus devastated, 30,000 dead

April 26, 1796
A destructive earthquake in the Sahel district of Lattakiya on the Syrian littoral. The shock almost totally destroyed the coastal plain between Jeble and Bucak where most of the houses collapsed. Destruction extended to villages in the Nahr al-Kebir plain an area about 40 km long and 15 km wide. In Lattakiya, 1500 out of a population of 5,000 were killed and one third of the town collapsed. The shock was felt at Saida, 230 km away.

JANUARY 1, 1837 EARTHQUAKE:
Tibnin, Jordan, 4,000 killed
Destruction or heavy damage was done along a relatively narrow zone which extended from the coastal area of Saida (Sidon) through the inland iklimi (regions) of al-Touffa, Marjuyum, Bshara to Lake Tiberias, for a total length of about 120 km.

DECEMBER 12, 1856 EARTHQUAKE AND TSUNAMI:
Jordan Valley, Tiberias destroyed

AUGUST 13, 1882 EARTHQUAKE:
Aleppo, Syria, 20,000 killed, 17,000 houses destroyed

JULY 11, 1927 EARTHQUAKE:
Jordan Valley, magnitude 7.2, Jerusalem and Amman damaged, 340 dead, many houses damaged

DECEMBER 26, 1939 ERZINCAN-REFAHIYE EARTHQUAKE:
Erzincan-Refahiye, Turkey, magnitude 8, many aftershocks, north Anatolian fault zone, 43,000 killed, 76,000 injured, 200,000 houses destroyed

MARCH 6, 1952 EARTHQUAKE:
Coastal Lebanon, 50 km south of Beirut, magnitude 6, 136 dead, 6,000 houses destroyed

March 16, 1956 EARTHQUAKE:
An earthquake in the southwestern part of the Lebanon range. Its epicentral region is located on the west facing slopes of the range which extends between the Mediterranean coast in the west and the Burak river on the east. In the north-south direction the area is confined by the al-Dammour and Zahrani rivers. Damage was widespread centering in the lower reaches of the Bisri river, 70 km south of Beirut, and it was confined between the villages of Ghaziye, Katermaya, Shihim, Mukhtara, Beter, Kfar Hune and Kfar Bait, within a radius of about 12 km.

OCTOBER 10, 1980 EL ASNAM EARTHQUAQKE:
El Asnam, Algeria, 300,000 homeless, more than USD 4 billion in losses (10% of Algeria's GDP)

DECEMBER 13, 1982 DAHMAR EARTHQUAKE:
Dahmar, Yemen, magnitude 6, 15,000 killed or injured, 500,000 homeless

MARCH 13, 1992 ERZINCAN EARTHQUAKE:
Erzincan, Turkey, magnitude 7.1, north Anatolian fault zone, 653 dead, 3,850 injured, 50,000 homeless

OCTOBER 12, 1992 DAHSHOUR EARTHQUAKE:
Dahshour, Egypt, magnitude 5.9, 7,000 killed or injured, 1,000 schools damaged

NOVEMBER 23, 1995 GULF OF AQABA EVENT:
Gulf of Aqaba, magnitude 7.5, damage to buildings in border regions of Jordan, Egypt, Israel, and Saudi Arabia considered a "wake up call"

AUGUST 17, 1999 KOCAELI EARTHQUAKE:
Kocaeli, Turkey, magnitude 7.4, industrial heartland and 12,500 square km impacted, north Anatolian fault zone, 17,127 killed, 43,953 injured, 250,000 homeless, economic losses in billions

NOVEMBER 12, 1999 DUZCE EARTHQUAKE:
Duzce, Turkey, 185 km east of Istanbul, magnitude 7.2, north Anatolian fault zone, 500 dead, 3,000 injured, Trans-European motorway damaged

DECEMBER 3, 1999 EARTHQUAKE:
Saudi Arabia, Damages

DECEMBER 25, 2000 EARTHQUAKE:
Dead Sea, Damages

SEPTEMBER 2, 2001 EARTHQUAKE:
Cyprus, Damages

SEPTEMBER 2, 2001 EARTHQUAKE:
Cyprus, Damages

FEBRUARY 11, 2004 EARTHQUAKE:
Dead Sea, Damages

JULY 7, 2004 EARTHQUAKE:
Jordan Valley, Damages

FEBRUARY 7, 2005 EARTHQUAKE:
Dead Sea, Damages

OCTOBER 10, 2005 EARTHQUAKE:
Jordan Valley, Damages

EARTHQUAKE MAGNITUDE RECURRENCE IN LEBANON

Analyzing the above data, we can notice that the major earthquakes that affected the Middle East, with a magnitude above 7 on Richter Scale in the last millennium are the following:

Table 6.1

Year of Occurrence	Magnitude Richter Scale
1033	7.1
1157	7.4
1170	7.3
1202	7.3
1408	7.2
1759	7.4
1837	7.1
1995	7.5

We can at least combine some of this historical knowledge with our understanding of present-day overall and earthquake mechanics to obtain some idea of how frequently the large earthquakes are to be expected.

Historical data suggest that both the 1202 and 1759 earthquakes ruptured the Yammouneh fault over a distance of about 100 km, which is most of its length. In most large inter-plate earthquakes, the ratio between average displacement and fault length is between 2 and 5 m, so we would expect these earthquakes to have produced slip of 2 to 5 m in each event. Slip of this amount on a fault rupture 100 km long extending to 15 km depth yields an estimated seismic moment of between 0.9 and 2.3 x 10^{27} d.cm, equivalent to a magnitude of 7.1 to 7.5. We would expect the average recurrence time of such earthquakes to be 130 years. *(Earthquake Hazard in Lebanon).*

The question now arises of how complete is the 20th century record for the Levantine zone and for Lebanon. This zone has been inactive in recent years as compared to earlier periods and because of this any analyses must be necessarily rather approximate, and do not warrant great sophistication. Indeed too sophisticated a method carries with it the danger that its weaknesses and assumptions may not be appreciated. Conversely, a simple method may be discredited just because it exposes the underlying problems too clearly.

CATASTROPHE (CAT) BONDS FOR LEBANON

Based on the above facts, and the high probability that a Natural Catastrophe (Earthquake and/or Tsunami) could strike Lebanon; taking into consideration that insurance covers that could respond to reduce such Catastrophic financial losses are insufficient, an attempt was made to create Cat Bonds tailored for the Lebanese market.

Could you imagine if a catastrophic event strikes Lebanon, what would be its affect?

Apart from human losses, the financial losses could drive the whole economy to collapse. In this regard, appropriate reinsurance covers and financial instruments (i.e. Cat Bonds) could minimize the impact of such disaster.

The effect of an earthquake striking Beirut for example, will cause building to collapse roads to bend etc., the human losses and structural damages will cause huge financial losses which in tern will lead many companies and institution to discontinue their operations. This will deeply affect the economic cycle, by increasing the unemployment rate, decreasing the GDP…

The below study is conducted on Libano-Arabe's portfolio, one of the top five insurance companies in Lebanon.

Libano-Arabe enjoys a well-diversified portfolio (by region and line of business) and is backed up by Audi Bank, which will facilitate such a project to take place if it were to happen.

First, we will start by studying the accumulation limits of Libano-Arabe in different Cresta Zones in Lebanon.

This is revealed in the below table:

Table 6.2

Natural Catastrophe Exposure
As at 31.12.2005
Underwriting Year 2005

Currency Units: US$

Zone		Retention	Quota-Share	Surplus	A.F.T.	Facultative	Total
[illegible]	Construction	26,733,684	40,100,540	61,506,857	27,110	80,391,570	208,759,762
	Contents	16,754,171	25,131,256	91,768,917	115,583	78,458,412	212,228,339
	L.O.P.	16,317	24,476	557,956	0	3,528,750	4,127,500
	TOTAL	**43,504,173**	**65,256,273**	**153,833,730**	**142,693**	**162,378,732**	**425,115,601**
Tripoli (2)	Construction	1,500,778	2,251,167	1,035,141	0	0	4,787,086
	Contents	446,209	669,312	5,205,332	0	0	6,320,853
	L.O.P.	0	0	0	0	0	0
	TOTAL	**1,946,987**	**2,920,479**	**6,240,473**	**0**	**0**	**11,107,939**
North (3)	Construction	4,741,871	7,112,805	2,038,004	0	0	13,892,679
	Contents	2,679,668	4,019,504	7,310,725	0	0	14,009,897
	L.O.P.	0	0	0	0	0	0
	TOTAL	**7,421,539**	**11,132,308**	**9,348,729**	**0**	**0**	**27,902,577**
Mount Lebanon (4)	Construction	89,357,658	134,036,506	91,809,304	570,836	39,924,265	355,698,570
	Contents	36,412,887	54,619,326	99,181,459	361,858	43,362,924	233,938,454
	L.O.P.	56,577	84,866	2,604,687	41,870	19,602,000	22,390,000
	TOTAL	**125,827,122**	**188,740,698**	**193,595,450**	**974,564**	**102,889,189**	**612,027,023**
South (5)	Construction	6,629,079	9,943,619	8,411,499	0	968,000	25,952,197
	Contents	3,803,938	5,705,910	16,342,446	0	878,000	26,730,294
	L.O.P.	0	0	0	0	0	0
	TOTAL	**10,433,017**	**15,649,529**	**24,753,944**	**0**	**1,846,000**	**52,682,491**
Al Bekaa (6)	Construction	2,429,463	3,644,192	5,424,773	0	11,089,422	22,587,850
	Contents	1,277,933	1,916,900	9,118,027	0	31,579,165	43,892,025
	L.O.P.	8,000	0	230,000	0	1,750,000	1,988,000
	TOTAL	**3,715,396**	**5,561,092**	**14,772,800**	**0**	**44,418,587**	**68,467,875**
TOTAL	Construction	**131,392,533**	**197,088,830**	**170,225,577**	**597,946**	**132,373,257**	**631,678,144**
	Contents	**61,374,807**	**92,062,207**	**228,926,906**	**477,441**	**154,278,501**	**537,119,862**
	L.O.P.	**80,895**	**109,342**	**3,392,643**	**41,870**	**24,880,750**	**28,505,500**
GRAND TOTAL		**192,848,235**	**289,260,379**	**402,545,127**	**1,117,257**	**311,532,508**	**1,197,303,506**

Explanation of the above table:

- The exposure for Natural Catastrophes is divided over the main six Cresta Zones in Lebanon.

- Each Cresta Zones, contains the aggregate results of all policies issued and are in force as at 31.12.2005, split by:
    - Value of construction insured
    - Value of contents insured
    - Loss of profit due to business interruption insured

- Retention: stands for the amount of exposure retained by Libano-Arabe, which will be our main concern for the Cat Bonds.

- Quota-Share Treaty: Is a type of proportional treaty reinsurance agreement that divides risks between Libano-Arabe and reinsurers (example: Swiss Re, Munich Re) based on fixed pre-agreed percentages. *(Discussed in Chapter 5)*

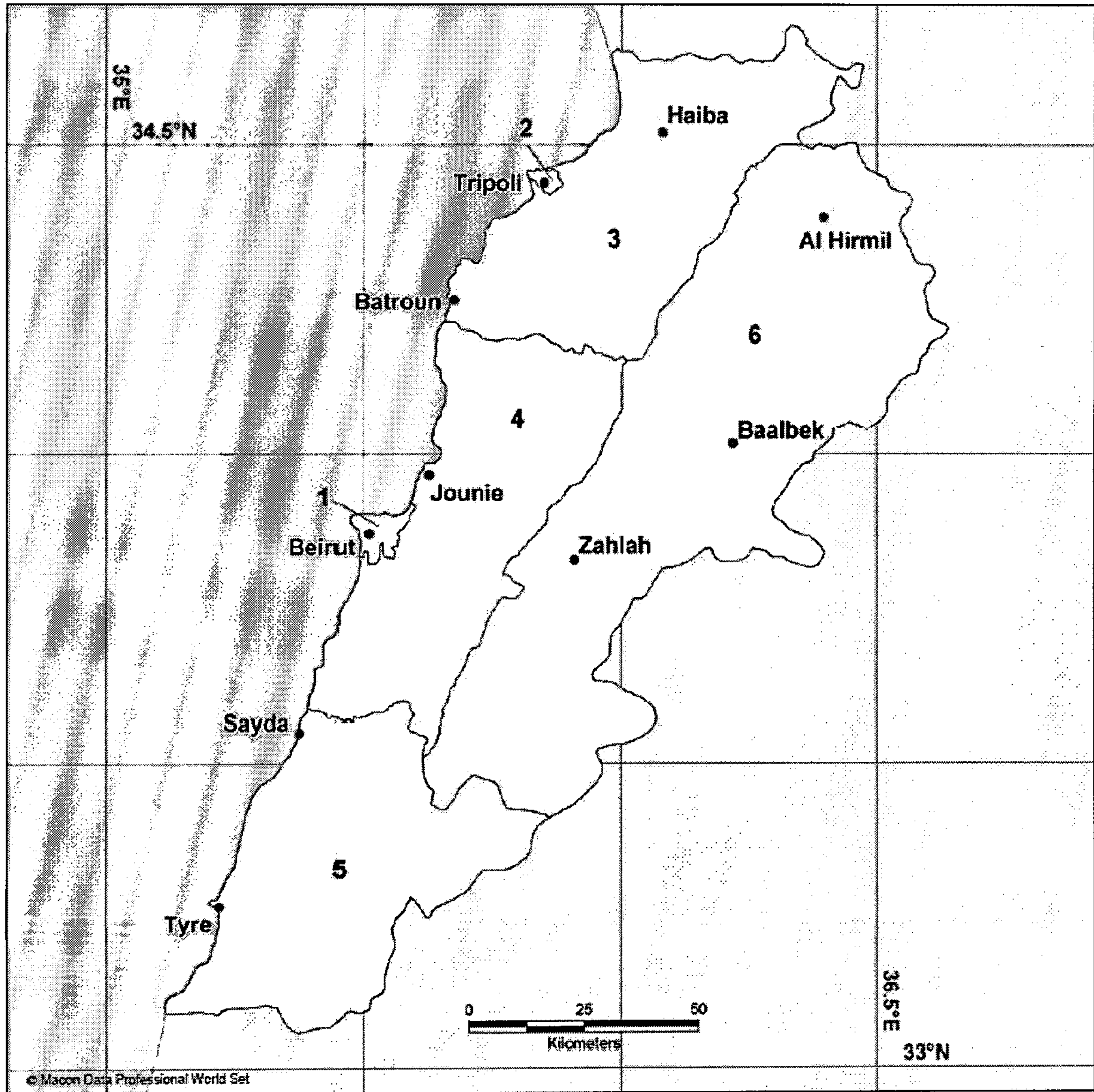
- Surplus Treaty: Is an other type of proportional treaty reinsurance agreement which provides reinsurers' participation on risks exceeding certain pre-agreed amount. The percentages split between Libano-Arabe and the reinsurers will be different from one risk to an other. *(Discussed in Chapter 5)*

- A.F.T: Is an Automatic Facultative Treaty, Libano-Arabe can chose to cede on it or not.

- Facultative: Is a type of reinsurance agreements were the insurer has the right to offer it to reinsurers or not and reinsurers have the right to accept it or not. Usually risks are placed facultatively if they exceed the treaty capacity or their coverage is excluded from the treaty. *(Discussed in Chapter 5)*

Below you can find Lebanon's map divided by Cresta Zones:

Figure 6.6
Accumulation Assessment Zones Earthquake / Flood



The concern of the study is the accumulation under the Retention as it is assumed that the remaining exposure is properly covered under their reinsurance programs.

Relying on a research done by Swiss Re, which identifies in terms of percentages of Sum Insured the destruction rate in most countries following an earthquake event; Lebanon rate stands at 8%. This research takes into consideration the average age of constructions along with the deformation tolerance of the material used in those constructions, an advanced simulation software conducts many scenarios to reach an average conclusion.

To be on the safe side, the study applies 8% on Al Bekaa accumulation and 9% (the additional 1% are for Tsunami exposure) for Beirut and Tripoli and for the remaining regions an average rate of 8.5%. This will result in the following:

Table 6.3

Natural Catastrophes
As at 31.12.2005
Underwriting Year 2005

Currency Units: US$

		Retention	Rate of Destruction	Expected Amount of Destruction
Beirut (1)	Construction	26,733,684		
	Contents	16,754,171		
	L.O.P.	16,317		
	TOTAL	43,504,173	9.00%	3,915,376
Tripoli (2)	Construction	1,500,778		
	Contents	446,209		
	L.O.P.	0		
	TOTAL	1,946,987	9.00%	175,229
North (3)	Construction	4,741,871		
	Contents	2,679,668		
	L.O.P.	0		
	TOTAL	7,421,539	8.50%	630,831
Mount Lebanon (4)	Construction	89,357,658		
	Contents	36,412,887		
	L.O.P.	56,577		
	TOTAL	125,827,122	8.50%	10,695,305
South (5)	Construction	6,629,079		
	Contents	3,803,938		
	L.O.P.	0		
	TOTAL	10,433,017	8.50%	886,806
Al Bekaa (6)	Construction	2,429,463		
	Contents	1,277,933		
	L.O.P.	8,000		
	TOTAL	3,715,396	8.00%	297,232
GRAND TOTAL		192,848,235		16,600,779

Libano-Arabe do have a reinsurance protection for Catastrophic events, covering a limit USD 9M over a priority (net retention of Libano-Arabe) of USD 1M. In other words the first USD 10M of a Natural Disaster are accounted for. So the remaining exposure should be covered.

Based on the calculation in the table, it is clear that the reinsurance cover of USD 10M is not sufficient if such disaster is to happen. An additional cover of USD 6,600,779 (i.e USD 16,600,779 less USD 10,000,000) is still needed. For ease of calculation a gap of USD 6,600,000 is considered.

To cover this gap, 10 years Cat Bond will be issued. The trigger for such Cat Bonds will be the occurrence of an earthquake affecting Lebanon with a magnitude exceeding 7.0 on Richter scale.

This Cat Bond is like any other bond; it pays high coupon (assume 10% annual) in order to be attractive to investors, but on the other hand if it is triggered the face value will not be returned to investors and the coupon payments will stop.

7,000 bonds will be issued which will be sold initially at a face value of USD 1,000. The total generated from this issue will be USD 7,000,000 which exceeds the USD 6,600,000 gap; the difference of USD 400,000 could be used if bonds are triggered, to minimize the liability of Libano-Arabe in the underlying net retention of USD 1,000,000.

WHY ISSUE CAT BONDS AND NOT BUYING AN ADDITIONAL REINSURANCE COVER:

1) Before the catastrophes that took place in the last two years in different areas of the world, buying an additional reinsurance cover (i.e. USD 6,600,000 XS USD 10,000,000) would have been less expensive, but nowadays as reinsurers are being more keen in selecting prestigious risks and applying stiff underwriting guidelines this is no longer the case. To issue bonds will be more cost effective to the company than buying a reinsurance cover. (knowing that funds collected could be used in investment opportunities and generate return to the insurance company)

2) Reinsurance companies that accept such CAT covers are limited. The insurance company may not have good relationships with such providers, which might lead to a weak position throughout the negotiations.

3) If Libano-Arabe has good relationship with providers of such CAT cover this does not mean that for sure they will obtain this cover; as the reinsurer is bound to a certain exposure per country that might have been already allocated to other firms (Bankers, Assurex...)

4) The CAT cover proposed by reinsurers is usually restricted by exclusions and limitations.

5) Why pay money when you can receive funds in advance.

6) The reinsurer who was unable to grant such a cover due to limited exposure, can subscribe to the bond as any other investor which is viewed as an investment from the reinsurer point of view and not as underwriting.

The reinsurer might end up paying the insurance company the face value and receiving back the coupon which is less than what he would have charged the company for a CAT cover while abstaining from paying any amount to the insurance company till the date of such catastrophe. This is mainly due to the fact that the trigger of the Cat Bond is very specific; losses might occur without triggering the bound (i.e earthquake with magnitude less than 7), this way the insurance company will remain liable to pay the coupon and the face value at maturity in additional to the losses at hand.

7) Usually under a reinsurance agreement the Net Retention of the insurance company can not be cover by another cover. While; if the CAT bound is triggered funds can be allocated at the company's discretion.

8) Many argue that the 8% destruction rate suggested by Swiss is rather pessimistic and suggest that a more accurate approach will result in a figure approximate to 6.5%. As per the above calculation worst case scenario is considered, it might be expect that if the bond in question is triggered Libano-Arabe could end up with funds exceeding the aggregate amount of losses. (i.e. USD 5,535,135 = 7,000,000 - 6.5% X 192,848,235)

PROBLEMS TO FACE:

The issue of such bond may be complicated though Libano-Arabe is backed up by Bank Audi which will facilitated such an issue. Problems to face:

1) Valuation of such a bond:

a) to be sold at premium or discount,
b) deciding on a coupon rate which for sure should be above the market return,
c) computing the payback period of constant issuance of such a bond which we took to be 130 years occurrence period;
d) what if this period is getting shorter and the risk bared by the bond is getting more probable?

All the above questions should be considered while valuing such a bond and most of the answers will be at best an expectation.

2) The ability of an investment bank to complete subscription. The number of CAT reinsurance bonds issued till now is still small and most of the subscribers are other reinsurance companies that are initially aware of the nature and exposure of the underlying risk. Creating awareness of such rather complicated financial instruments in the market will be quite difficult.

3) Creating secondary market for the bond. This point is linked to the previous one as once we achieve investors' awareness we would be moving towards creating an active secondary market for the Cat Bond.

WIDENING THE SCOPE:

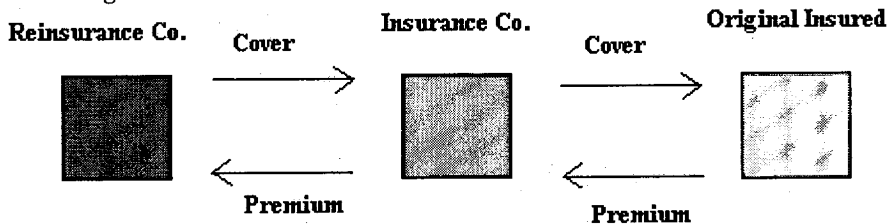
The concept discussed above of shifting insurance risks to the capital market may be applied broader than covering the Net Retention of an insurance company from Natural Catastrophes.

This shift can be applied to all risks that are written by an insurance company, by securitizing specific risks (ex: Damages caused by fire to Grand Hills Hotel) or securitizing the whole fire portfolio of an insurance company.

If investors in the coming decade prove to be interested in such securitized insurance products, this trend will lead eventually to the annihilation of the reinsurance market or a shift in their role to be quite similar to investment banks.

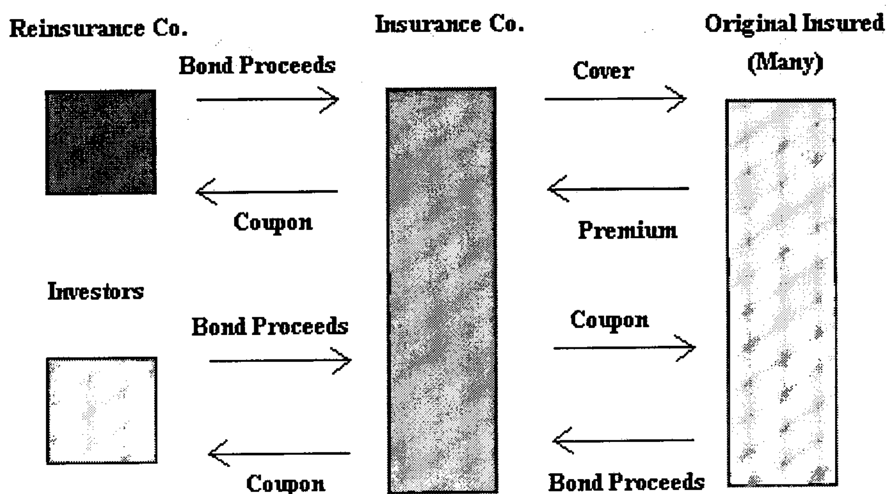
In graphical representation, the reinsurance market will shift from:

Figure 6.7



To:

Figure 6.8



CONCLUSION AND RECOMENDATIONS

I. By Line of Business for the Lebanese Market

Medical Insurance

There are several trends that are shaping the market for medical insurance in Lebanon that include population growth, ageing, economic stagnation, competition, over-equipment of hospitals, increased expectations of patients for the quality of medical care, the rise in health care cost, reliance on managed care, and pressure from the public sector.

The health insurance requires infrastructure such as claims-handling technology, and sufficient membership to generate negotiating clout with providers. The smaller players, as well as potential newcomers, will find their ambitions hindered by these conditions and will find competition to be increasingly tough, while established large players have solidified their dominance.

The existence of Third Party Administrator TPAs to service the smaller providers of medical insurance and reduce costs will not alleviate the overall pressure on the lower segment of the market. Margins will inevitably be squeezed at some point and the smaller players will feel the pincher effect and get caught between downward pressures from large insurers that have scale advantages, and upward pressure from cost and increasingly demanding clients. This, in turn, will eventually force players to exit the health insurance line and usher a new and necessary wave of consolidation in the sector.

Generally, medical insurers will face difficult days in the near term. In addition to pressure from market forces and economic stagnation, the ongoing and increasing reliance of the public sector on private insurers and the rising number of retirees will add to this pressure in the coming two to three years, especially on the smaller players. The wave of consolidation, sustained economic growth, continued cost control, and the significant barriers to entry will improve the medium- and long-term prospects of the larger players.

Meanwhile, the market is nearly saturated and, with low margins, the opportunity lies in cross selling from medical insurance.

The government can help in financing the NSSF by imposing Sin Taxes (on cigarettes, alcohol...) as applicable in most foreign countries. At the same time, using the funds in investment opportunities will also generate additional return.

Auto Insurance

It is questionable whether the auto insurance market in Lebanon will reach a position of strong underwriting profitability in the next few years due to the business' highly competitive nature and the uncertainty of regulatory and legal factors. Furthermore, one

of the expected results of the new law is that, increasingly, claims paid for auto policies will be for liability coverage. Therefore, it is not inconceivable that the line will become unprofitable with the accumulation of high third-party claims, leading many of the smaller insurers to eventually flee the line altogether.

For the line to remain profitable, the mandatory third-party liability law needs to be refined to reinstate some of the past exclusions and reduce the ceiling on medical liabilities coverage. This will help insurers' profitability and maintain their financial soundness, while containing the expected high amount of claims and fraud. In turn, this will encourage insurers to lobby for the introduction of compulsory third-party property liability insurance.

Moreover, technology can play a very important role in this specific line of insurance by creating a database for the Lebanese drivers containing claims produced by each driver; in order to know the probability of a certain client to be involved in a claim. Even more the claims experience by cars could be entered; in order to asses, how much a certain car last before a certain claim could arise. Accordingly, some rates could be adjusted based on past experience.

Fire Insurance

The situation may change in the next few years following an increase in the Lebanese Standards Institution's (LIBNOR) budget and the establishment of 30 technical committees charged with bringing the country's standards specifications up to international levels. Lebanese standards are voluntary in principle, but for reasons of public health or safety, or national interest, the government can decide to make them mandatory.

There is extremely low penetration of household insurance in Lebanon. Industry observers estimate that only between 2% and 5% of insurable households have any cover, although the increasing availability of homeowners' products through banks may lead to increased penetration.

Insurance awareness is said to be quite high but policies are rarely bought, partly as a result of social attitudes, and partly because people attach a higher priority to motor and medical expenses cover. When banks grant loans for house purchase, however, the interest rate charged will frequently include property insurance.

Insurance arrangements for apartment blocks are left to residents' committees which rarely agree on any course of collective action.

Workmen's Compensation

The new compulsory scheme is likely to be opposed by small businesses and traders as a

new form of expenses amid a slow economy. Another challenge to the new decision is its implementation, as the public departments in charge of implementing it, most likely the Labor Ministry, do not have the required resources to cover the entire country.

Recruitment of qualified personnel should be done by the Labor Ministry or joint teams in collaboration with ACAL (being the beneficiary of the regulation) should organize regional surveys to assure the implementation of such legislation.

Credit Insurance

Consumer credit insurance in Lebanon reached its peak in the mid 1990s but turned out to be a loss making business. Insurance companies moved away from acquiring a license when the business became a separate insurance category not only due to the shrinking market, but also mostly because of the difficulties and complex administrative requirements of this particular line. The relatively high capital requirement, along with the large losses incurred from consumer credit insurance, led many of the Lebanese insurers to pull out of this category.

Trade credit insurance is at a very early stage in the Lebanese market. It has yet to penetrate the corporate culture in Lebanon and there is little awareness about the value it adds to businesses. This category has an estimated market potential of $ 6 billion between domestic and export trade receivables.

A decision should be taken by the Banks' Control Commission BCC to make credit insurance mandatory. Thus limiting banks' exposure.

Marine Insurance

As a general rule all Lebanese owned vessels are very old and generally sub-standard. In 1998 the ISM Code became mandatory under the International Convention for the Safety of Life at Sea (SOLAS). The code addresses the responsibility of those who manage and operate ships and also provides international standards for the safe management and operation of ships, including aspects such as pollution prevention.

The code originally applied to passenger ships, oil, chemical, gas and bulk carriers and cargo high-speed craft of 500 dwt and above. As from 1 July 2002 other ships, including general cargo and container vessels, have been obliged to comply with the code, which now effectively applies to all commercial ships of 500 dwt and above on international voyages.

The introduction of the code has led to marine insurers requiring vessels to be compliant, and in the case of Lebanese vessels it appears that this is rarely the case. Allied with the fact that many vessels are over 30 years, and a number have wooden hulls, the availability of insurance has become severely limited.

Engineering Insurance

Construction insurance is a new separate category of general insurance. Following the collapse of several buildings in the country, Lebanese authorities have decided to raise the safety standards of new buildings, starting at the design phase. Part of the measures include the requirement of construction insurance on all new buildings. The requirement is stipulated in clause 18 of the new construction law. This insurance category offers various insurance policies for different stages of the construction process, including a 10-year insurance policy following the completion of construction as leverage against potential structural defects. As a separate insurance category, construction insurance will have its own reserve requirements.

The recommendations for the law on mandatory construction insurance have been jointly drafted by ACAL and an official committee. Currently, a parliamentary committee is reviewing the recommendations ahead of the law's ratification.

Life Insurance

Providers of life insurance in Lebanon are deploying their new individual and group variable universal and unit-linked plans due in part to increasing demand by Lebanese individuals and companies for stand-alone voluntary retirement plans with global investment choices. Their strategic decision to enter the Lebanese variable universal and unit-linked life market is based on their identification of a niche market of consumers looking for a broader choice of investment-based plans with flexibility and transparency while providing low cost access to world-class global funds and high-yield fixed-income investments.

Individual and group savings and retirement plans are the segments that offer the biggest growth potential in the life category. But several factors need to be realized to achieve this potential.

a) Reform of the Social Security System

Due to the increasing financial strains of the Lebanese government as well as of the NSSF, authorities need to change the current system to allow the participation of private operators in the provision and management of retirement benefits. The public sector would provide a basic minimum pension, while, simultaneously, the government would mandate compulsory employee retirement saving plans with privately operated funds on a mutual basis. The next step would include the offering of optional group savings, followed by individual voluntary savings.

This would alleviate the pressure on private employers to contribute to the NSSF, as well as reduce the fund's financial burden in the provision of end-of-service and retirement benefits.

b) Introduction of Tax Deferrals

Individual and group retirement plans enjoy tax deferral status in advanced markets. Currently, there are no tax deferral incentives in Lebanon. The modification of Lebanese tax laws to encourage pre income-tax contributions to group and individual retirement accounts would provide a strong incentive for employees to participate in such plans. In the case of individual retirement accounts, employees would inject pre-tax contributions into the account with a specified ceiling per year. Further, the employee would withdraw the sum only at retirement age or after he or she reaches a minimum age as pre-determined by the law. The lump sum would be taxable at a lower than regular income tax rates or at a flat tax rate.

In the case of group pension plans, employees would inject contributions from their pre-tax income, through payroll deductions, into their individually managed account but within a specified ceiling. The employer may, but is not obliged to, match the employee's contributions. At retirement, employees receive a lump sum or an annuity payment for a pre-determined period that would be taxed at a favorable rate compared to regular income tax rates.

In parallel, authorities should remove the end-of-service indemnity calculations in case employers want to match employees' contributions. The existing system discourages firms from matching and imposes on them additional taxes, as the matching is treated as additional income and is taxed accordingly.

c) Removal of the Ceiling on Mathematical Reserves

Life insurance contracts in Lebanon are denominated in US dollars, leading insurers to invest up to 50% of their mathematical reserves in foreign bonds and stocks to match their dollar liabilities. That is because insurance regulations require a minimum of 50% of life premiums to be invested locally with certain allocations.

However, insurers are having a hard time investing the domestic component of their mathematical reserves. The lack of depth in the local markets as well as the limited investment opportunities and low liquidity constitute an obstacle to adequate returns. The removal of the 50% ceiling on investments in foreign stocks and bonds would boost the prospects of better returns for the insurers and, by extension, of the policyholders.

d) Economic Factors

Two additional macroeconomic factors would help increase demand for group and individual life insurance. The reduction of corporate debt would encourage employers to set-up group plans and match employees' contributions. Second, economic growth would help increase disposable income, which would encourage individuals to invest in individual and group retirement plans.

II. Business Operations:

Insurance Operations

• Global players are expected to play an important role in improving the operational efficiency of the Lebanese insurance market through the introduction of new management techniques and the installation of operating systems, procedures and management tools. They will also contribute to the expansion of technology usage and know how, which is increasingly becoming an essential component in insurance operations. Further, they bring marketing and sales know how to the market, and have the ability to attract and retain talent as well as the scale to invest in human resources.

• It is in the best interest of insurers in the middle and lower market segments to focus on operational efficiency, as they will gain a much-needed competitive advantage in their attempt to retain clients and maintain their market share. This is particularly significant in the case of specialization, where niche players will have to increasingly focus on this aspect.

• Consolidation would bring about improved operational efficiency. The reduced number of firms will inevitably result in a smaller workforce, leading to higher premiums per employees.

Insurance Marketing

• Insurers are using advertising to raise their visibility in the market, to build corporate image and to introduce new products. Advertising and marketing campaigns have generally tried to communicate the 'safety', 'security' and 'protection' aspects of buying policies. Also, global players are keen on maintaining their brand image and name recognition through advertising and marketing.

• Insurance ads are present in the print and audio-visual media, particularly on television and billboards. But only big institutions are advertising, as they can afford sustained advertising campaigns. Other marketing tools include interactive websites, multimedia presentations on CD-ROMs, elaborate brochures and, in rare cases, detailed annual reports, as well as the sponsorship of civic, cultural and sports events. Again, only big insurers are investing in such marketing vehicles, while most of the smaller ones are shying away from marketing expenditures due to cost considerations.

• Advertising is not widely used to attract clients, to create awareness or to raise the trust level.

• The exposure of a large segment of the Lebanese population to foreign cultures through studies or work abroad helped introduce a certain level of awareness about the value of insurance among returnees, but this segment remains small.

• Half of the respondents in the poll indicated that they would feel safer if they purchase an insurance policy from a foreign company.

• Global insurers benefit from the trust factor, as buyers of insurance policies feel more comfortable with a player that has global brand name recognition, a reputation of reliability and success as well as high capitalization. An insurance firms reputation as a financially strong company is particularly important in life insurance given the long-term nature of the products in this category.

• Global insurers can utilize their marketing know how to introduce new marketing techniques in the Lebanese market.

• Despite some progress on medical and life insurance awareness, the industry as a whole needs to work on raising awareness, as well as on the shaping of usage and attitudes. There are no sector-wide campaigns or attempts by ACAL, the Ministry of Economy &Trade or other stakeholders to raise awareness or trust.

• The Lebanese Insurance Brokers Syndicate (LIB 5) is embarking on a campaign to improve its image.

• There is a need to educate and inform the public on the concept of recovering financial losses and its economic importance. People need to be aware of the indirect benefits that insurance plans represent such as encouraging businesses to take risk, be innovative as well as encouraging individual consumers to plan for the future.

Insurance Distribution

Brokers still dominate the distribution of insurance products in Lebanon, generating about 50% of total non-life premiums. Banks have become in a relatively short period of time a viable insurance distribution channel, chipping at the brokers' dominance of the market. They have entered into individual lines of insurance rather successfully mainly because the product base is largely standardized and due to the lower incremental cost of selling insurance products over a bank counter.

Many brokers consider the marketing and sale of insurance products by commercial banks as direct competition to their business. They also cite the accelerating trend in bancassurance as limiting the choice of consumers in their selection of insurance firms. Banks will remain an important distribution outlet for insurance products but this channel has its limitations, which represent an opportunity for brokers. The large brokers are not concerned about the push of banks into their territory precisely because they see the limitation of simple bancassurance products, which are the following:

a) Financial Planning & Advisory

First, commercial lines constitute a more specialized segment, making entry for banks more difficult. It is highly unlikely that banks will seek to acquire this expertise, which leaves brokers well positioned to retain the corporate segments within their domain.

Second, the commodity model is well advanced at banks but when moving beyond the standardized products, more specialization and a different set of skills are needed. In the case of bancassurance products, bank employees are trained as salespeople of simple products rather than as financial advisors for sophisticated products. A full 80% of their training is focused on selling techniques, 10% is focused on technology and 10% on product knowledge. Financial advisory for more complex products requires an entirely different set of skills, making it difficult for branch staff to make the transition to financial advisors. This segment will remain out of the reach of banks in the foreseeable future given that they will not post specialized advisors in branches or build a dedicated sales force of financial planners at the branch level.

Third, very few brokers sell life insurance products, as insurance firms prefer to sell such products through their own sales force or exclusive agents. The new wave of life and retirement products being introduced in the market forms part of overall financial planning where the client will require financial advice in relation to the level of risk to accept, long-term savings, and how much to invest to generate a required return.

The financial advisory channel is relatively under-developed in Lebanon. As the emphasis moves to the need to convince customers to buy products for long-term savings requirements, the personal relationship between a financial advisor and an individual customer will become increasingly important. Further, insurers are likely to face difficulties in transforming a significant proportion of their sales force into financial consultants, given the need for more specialized skills. Some insurers have already tried it with limited success.

As a result, insurance companies will need to recruit fresh blood for financial advisory distribution, given that the majority of tied agents and direct sales forces are not well equipped to sell financial advice. Otherwise, they risk being left with a direct sales force that cannot adapt to the new selling environment.

Fourth, bancanssurance is product-focused, while brokers are supposed to be client-focused. The professional brokers already play an advisory role to their individual and corporate clients. They provide guidance on best insurance plans, tailor insurance products to meet the client's specific needs, negotiate best terms with insurers, and offer after-sales service. Therefore, they are already prepared to handle complex products. The opportunity for brokers is to adopt the role of financial advisors and convince insurance firms that are issuing asset management products of the viability of working through them.

b) Assurfinance

Along the lines of financial advisory, brokers that look to endorse this strategy can take the next step and engage in assurfinance. This approach will be made easier for brokers that get into financial advisory due to the specialized skills required. They will be able to cross-sell simple banking products, and focus more on advice and service-oriented types of products.

c) Specialization

Another avenue for brokers is to focus on niche markets (example: Motor Insurance) rather than cover many lines of products simultaneously, which would stretch their resources given the relatively small size of individual brokers. Niche markets cover the spectrum from personal and family risk management in the retail market to integrated risk management and flexible employee benefits in the commercial and corporate segment.

d) Institutionalization

Brokers will retain distinct competitive advantages over other distribution channels and need not fear bancassurance as a long-term replacement to their services. Institutional brokers in particular, the ones that are run like a company rather than like an individual business or a one-man show, will have the biggest advantages in terms of professionalism and credibility. Therefore, there is a clear need to institutionalize and corporatize brokers' operations through the partial or full separation of ownership and management as well as through recruiting and retaining qualified staff.

e) Scale through Mergers

The market is in need of a number of national brokers that cover all or most of the Lebanese territory and that compete on the basis of service, value-added consulting, as well as product offering. But to gain size and scale, consolidation is a must. Some of the large brokers understand the need and benefits of pooling resources and expanding through mergers or acquisitions. But obstacles such as agreeing on how to value a portfolio, management control, and post-merger division of responsibilities have so far prevented the birth of any sizeable merger among brokers. The Ministry of Economy & Trade could play a role to stimulate mergers by following the same path as with insurers. It can increase the current guarantees, impose higher capital and provide tax incentives.

f) Image Polishing

Brokers need to engage in a major campaign to raise awareness about their actual role and to shed the lingering image. They can help their cause by increasing their visibility through seminars, participating in insurance conferences and becoming an effective lobbying force by setting clear objectives and focusing on implementing them.

g) Foreign Alliances

Just like insurance firms have entered into strategic alliances with foreign players, local brokers need to strike alliances with global brokerage firms. Such alliances help the local player leverage the network of its foreign partner to generate business through the local servicing of multinational accounts. It would also help raise the visibility and improve the image of the local player.

Regulations

Revision of Decree 1205

Decree 1205, which dates back to 1978, regulates the investments of technical provisions of insurance companies. The decree puts limits on the investments of such provisions.

The decree has been revised and updated to take into consideration recent developments and trends in the Lebanese economy as well as to take into account the investment needs of the Lebanese insurance sector.

Essentially, the decree modifies the investment limitations and provides more flexibility to insurers in their investment decisions. The revised decree is expected to be ratified and to go into effect within the coming year.

New Law

There was a definite need to reform the insurance law of 1968 to update and improve the sector's capitalization, regulations and supervision. However, international legal experts have prepared a new law that is expected to raise the sector's regulations to a new level.

The World Bank has commissioned a legal expert to draft a new insurance law based on known best practices and the core principles of the International Association of Insurance Supervisors. The consultant has extensive experience in insurance law, edits the reference book on Canada's insurance laws, and serves on the board of directors of the Insurance Law Review in Canada.

The law, which has been drafted specifically for the Lebanese insurance sector, opens the door for the evolution of the sector up to international standards. Among its many new items, the draft law integrates several supervisory aspects, raises capital requirements, provides for risk-based reserves, and introduces the notion of independent custodial for life insurers.

The new draft law would completely replace the current insurance reform law of 1999 and would supersede all decrees and past amendments. The Ministry of Economy & Trade has not yet introduced the law to various stakeholders and has not submitted it to

the Cabinet for debate. Once the Cabinet debates the law, it will send the draft to Parliament where it will be reviewed in committees before being voted on in plenary session. Given the scope and depth of the new law, it is difficult to predict a timeframe for its ratification by Parliament.

Rating

There is a significant lack of financial transparency in the Lebanese insurance sector, so insurers and other stakeholders have many reasons to encourage agencies to issue ratings:

• The incorporation of the Lebanese economy into the global economic system through the Association Agreement with the European Union and ongoing negotiations for membership in the World Trade Organization will mandate greater transparency and higher standards of reporting and corporate governance.

• Ratings are essential in providing a clear picture about the financial health of individual companies as well as about the sector in general, as the reliability of an insurance contract depends crucially on the company that issues it.

• Ratings would help improve the sector's image and raise the level of trust of various stakeholders starting with policyholders.

• Throughout advanced markets, financial regulators are incorporating ratings in their rules and regulations due to the fact that ratings contain valuable information on credit risk. Lebanese supervisory authorities can encourage ratings by following a similar strategy.

The listing of insurance firms on domestic or international exchanges would provide them with added credibility and help them raise capital.

Financial supervisory authorities should provide incentives for insurers to float their shares on the Beirut bourse as well as on foreign exchanges.

Insurance firms should be mandated to publish on a quarterly or semi-annual basis their audited financial statements.

The work of various stakeholders to provide updated and relevant data and statistics should improve transparency and help the in-depth analysis of the sector.

Takaful Insurance

One indicator of the perceived potential of takaful is the mushrooming of Islamic insurance firms in the Arab Gulf states. This trend is best reflected by the recent decision of several Arab Gulf investment firms and individual investors to set up a giant Islamic

insurance and reinsurance company. Based in Bahrain and named Solidarity, the firm has a paid-in capital of$ 100 million and an issued capital of $300 million. It will initially operate in Bahrain and Saudi Arabia and plans to extend its activities at a later stage to other markets in the Middle East and Asian Islamic countries. Solidarity will concentrate on life, education, marriage, retirement, medical, pilgrimage, umrah (minor pilgrimage), fire, marine, engineering, motor, home and travel insurance.

Solidarity has already acquired three Islamic companies in different countries. They are the Saudi-based Islamic Takaful, Luxembourg-registered Life Takaful and Bahama's Takaful-Re.

The Faisal Investment Company (Luxembourg) holds a 40% stake in the new firm, Bahrain's Pension Fund and the Qatar Islamic Bank hold a 20% stake each, with the rest held by individual investors from the Gulf.

There is one Islamic insurance company in Lebanon and it operates under the name Aman Takaful Insurance (ATI). The firm was established at the end of 2002 by the Saudi-based Islamic finance group Dallah al-Baraka when the latter acquired the license of Main Insurance & Reinsurance company. The group's banking subsidiary in Lebanon, Al-B araka Bank Lebanon, owns 70% of the firm while the other 30% is held by the Beit Iaadat El-Ta'amin Al-Saoudi Al-Tunisi (B .E. S.T. Re), an Islamic reinsurer.

ATI started offering all insurance categories in Lebanon with the exception of medical coverage. Its strategy is to enter the market gradually and to take a step-by-step approach. This reasoning is based on the need to raise awareness about takaful in the Lebanese market.

Mergers

The primary underlying reason for most of the domestic merger and acquisition deals that took place among insurers centers on firms in financial difficulties looking for an exit or bailout. Alliances between strong and financially sound players have yet to materialize.

The capital and reserve requirements of the 1999 reform law helped diminish the number of insurers but, clearly, there is still an unsustainable number of market players. The Ministry of Economy & Trade needs to raise capital requirements again and increase the solvency margin, with the aim to induce a new wave of consolidation to reduce the number of firms to between 15 and 20 insurers at most. This number of insurers would lead to a healthier market structure and would be more commensurate with the country's population, as developed markets have about 3 to 5 insurance firms per one million inhabitants. An added incentive to raise the minimum capital is that global reinsurers have begun to increase their minimum excess of loss imposed on local insurers. The raise in capital requirements would help insurance firms absorb the ensuing higher retention rate.

An increase in the minimum capital would lead to the following:

• Only the larger, well-capitalized and well-managed firms would survive.

• Improvement in the image of the sector as a whole.

• Better overall servicing of individual and corporate clients.

• Ability to offer more sophisticated and a wider range of products.

• Ability to cover more clients.

• Increased ability to attract large corporate clients, as the latter prefer to deal with bigger and more solvent insurers.

• Improved leverage with health care providers.

• Larger firms would be better prepared to face uncertainties.

• Increased transparency and possible listing on the stock market.

• Increased market share per firm, leading to a reduction in operating expenses and overhead costs per policy due to economies of scale and scope.

• Firms would be able to increase their retention rate, which would help them reduce the over reliance on global reinsurers.

• Improved profitability. The pie is small with aggregate profits divided by the number of current market players.

• Regulatory and supervisory authorities would need to maintain a balance between the smaller number of players and avoiding oligopoly tendencies. In other words, clear anti-trust laws need to be drafted, ratified and implemented in order to preserve competition in the market and maintain consumer choice.

A new wave of consolidation induced by an increase in capital requirements, the significant presence of global players, and the continuing trend of alliances between banks and insurers would converge to create favorable trends in the sector:

• Increase in the institutionalization of the shareholder base of insurers.

• Disappearance of family structure of firms.

• Emergence of a culture of institutions.

• Differentiation between ownership and management.

• Better management through the installation of operating systems, procedures, and management tools.

• Ability to attract and retain talent as well as increased focus on investing in human resources.

• Expansion of technology usage and know how, which is increasingly becoming an essential component in insurance operations. Technology so far has been limited to the few firms that have the vision to use it and the means to invest in it.

• Better lobbying power. The fragmented market has led to divergent interests and, therefore, ineffective lobbying on the part of the sector with various stakeholders, legislative bodies and government authorities.

• Focus on profitability and better financial health of the firm over strictly acquiring market share.

• Increased overall credibility of the sector as a whole and of individual insurers in particular.

• Improve the firms' ability to forge alliances with foreign players.

• Improve the firms' abilities to compete on a regional basis and to access Arab and overseas markets.

• Better preparation of the sector to face globalization as Lebanon integrates in the global economy through signing of the Association Agreement with the European Union in June 2002 and the ongoing negotiations to join the World Trade Organization.

• Attract foreign investment and play a bigger role in the capital markets, as insurers are main institutional investors in more advanced markets.

• Play a bigger role in economic development and financial deepening.

Reinsurers in Lebanon

Although most local insurers are authorized to engage in reinsurance, the overwhelming majority of reinsurance activity takes place with foreign reinsurers.

Lebanon is considered to be a small reinsurance market. Reinsurance firms consider the market to be fragmented and inefficient, with only about 10 firms considered to be large enough.

Reinsurance companies find several challenges to operating in the local market:

• Insurers' over-reliance on reinsurance firms.

• The large number of small insurers.

• The low capitalization of Lebanese insurers, limiting the risk retention rate of local firms.

• No large risks such as oil contracts to reinsure.

• The high cost of treaty insurance.

• Existing regulations lack clarity.

• Lack of figures and statistics related to the work of reinsurers.

• The limited number of professionals trained to deal with reinsurers.

III. Alternative Risk Transfer

As long as reinsurers control this concept (i.e. for now all ARTs which include some Cat Bonds are issued at the reinsurer's level) they will promote it in order to attract new investors. Currently, negotiations are taking place between some Turkish insurance companies and reinsurers asking the reinsurers to issue Epidemic Cat Bonds that cover Bird Flu (H5 in 1).

Eventually when investors become aware of such products and how they function, insurance companies will realize that they can take a shortcut to the financial markets without passing through reinsurers. For reinsures to accommodate such trend, reinsurance prices will fall to rates more competitive for the insurance company then issuing Cat Bonds or any financial instrument.

If after the cut in rates, some natural disasters are to happen; the premium earned from insurance companies will be insufficient to indemnify the losses causing maybe some reinsurers to go bankrupt.

On the other hand, things could continue smoothly with no huge disasters but reinsurance rates will always be bound by the ceiling of the alternative financial instrument.

Time will tell the outlook of Reinsurance.

APPENDIX 1: Insurance Companies in Lebanon

1	MEDGULF	**30**	SONAR
2	BANKERS	**31**	ASSALAM
3	AXA Middle East	**32**	AMANA
4	SNA	**33**	UNITED
5	LIBANO SUISSE	**34**	C.I.G.
6	MASHREK	**35**	MEARCO
7	LIBANO ARABE	**36**	LEADERS
8	FIDELITY	**37**	BYBLOS
9	CUMBERLAND	**38**	AL NISR
10	ALICO	**39**	VICTOIRE
11	AROPE	**40**	ARAB LIFE
12	FAJR AL GULF	**41**	CONTINENTAL TRUST
13	ALIG	**42**	L'HORIZON
14	ASSUREX	**43**	LIBANAISE
15	SECURITE	**44**	DUBAI NATIONAL
16	UNION NATIONALE	**45**	LCI
17	COMPASS	**46**	ALICO
18	UFA	**47**	OVERSEAS
19	NORTH	**48**	AL BAHRIA
20	COMMERCIAL	**49**	SOGENAR
21	ADIR	**50**	TRUST
22	UCA	**51**	ATI
23	PHENICIENNE	**52**	ALIG LIFE
24	ALPINE	**53**	AIG LEBANON
25	CAPITAL	**54**	BANCASSURANCE
26	BERYTUS	**55**	SOGECAP
27	ARABIA	**56**	SCOTTISH LIFE
28	A.U.G.	**57**	ITI
29	CLA	**58**	SOFRACE

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