

Rasheed Mohammed Al Maraj: Regulatory insights – successfully supporting the next phase of development for the regional insurance markets

Keynote speech by HE Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain, at the 7th Annual Middle East Insurance Forum (MEIF), Manama, 7 February 2011.

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Distinguished Guests,

Ladies and Gentlemen:

On behalf of the Central Bank of Bahrain, it gives me great pleasure to welcome you to the seventh Middle East Insurance Forum. Over the years this event has become established as the leading event in the region for the insurance industry to meet and exchange views on current market and economic developments. I would like to thank the organisers, sponsors and speakers for supporting this important gathering and congratulate the organisers on having put together such a strong speaker list over the next two days.

My theme today is “Successfully Supporting the Next Phase of Development for the Regional Insurance Market”. This theme is certainly very timely as the regional insurance industry has now reached the point where it is ready – in the title of this Forum – to translate potential into growth. Although I will briefly discuss the CBB’s role as a regulator, my main focus will be on the way in which the industry needs to change and develop to capture the growth opportunities that undoubtedly exist. I will discuss three issues in particular: the need to provide customers with high service standards; the need to obtain greater economies of scale in the industry; and the need for owners and investors to adjust to a new environment in which returns are likely to be lower than they were in the past.

Let me first say a few words about the CBB’s role as a regulator. As I am sure many of you know, we have introduced a comprehensive set of requirements for Insurers, both conventional and Islamic, as part of Volume 3 of the CBB Rulebook that has been progressively introduced since 2005.

Over the year ahead the process of refining and modifying these requirements will continue. One of the most important recent developments was the introduction of the revised module HC on corporate governance. The changes we have made are to reflect the provisions of the Kingdom of Bahrain’s Code on Corporate Governance which was introduced last year. At the same time, one of the lessons of the global financial crisis has been to put corporate governance arrangements under the spotlight. Several of the firms that failed during the crisis appear to have suffered from serious shortcomings in their corporate governance. Regulators will have to consider ways of strengthening the effectiveness of boards of directors in overseeing the operations of the firms they run. This applies especially to ensuring high standards of risk management. We may also make changes to our framework with respect to the regulation of insurance brokers in the near future.

In addition, we continue to monitor new recommendations originating from the international standard setting bodies, including the Islamic Financial Services Board and the International Association of Insurance Supervisors. We are currently considering how to implement the standards that the IFSB issued last year on corporate governance and on solvency standards for Takaful companies. Both of these standards could have a significant impact on Takaful firms.

We also continue to play a role in the work of the IAIS in developing international standards and in this regard the CBB’s role has been enhanced by being selected as a member of the IAIS Executive Committee for a two-year term. The CBB’s selection is recognition of our

efforts among the 17 Middle East and North Africa regulators to ensure the development and enforcement of high standards of insurance supervision and regulation. As a member of the IAIS Executive Committee the CBB will aim to represent the interests of all regulators in the MENA region. Our new role will allow us to shape major new regulatory initiatives and also to alert the industry to upcoming changes in regulation.

While the CBB as a regulator can lay the groundwork of rules for the industry to follow, the industry's development and future growth potential is primarily a matter for its shareholders and managers. This is not to say that we, as a regulator, are not keen to see the industry to grow and prosper. Far from it. The development of the insurance industry is a major component of the Kingdom of Bahrain's Vision 2030 strategy that outlines the competitive, dynamic and diversified economy we aim to develop for a post-oil era. In our latest national economic strategy we have identified insurance and asset management as two sectors of the financial industry that have enormous potential for future growth. However, my point is that while regulators can provide the conditions for industry development, whether these opportunities are seized is a matter for shareholders and the managers of insurance firms.

There are three specific topics that I think are worth emphasizing as we look to the industry's future growth and development.

The first of these is the need for the industry to ensure that it can meet high standards of customer service. The CBB has played its role in encouraging better customer service by mandating all insurance representatives (agents) to comply with training requirements focused on their areas of expertise and mandated by the internationally renowned Chartered Insurance Institute (CII).

At the same time, however, customer service is primarily the responsibility of the firms themselves. The regional insurance market is becoming highly competitive as we see more entrants, both established international firms and local companies, offering a growing range of services, including medical and life coverage. Although insurance penetration rates in the region are still relatively low, in the long run not all the firms currently competing in the market will be able to build viable franchises. Those that do will be the ones that can offer their customers the best standards of service.

This will not mean simply competing on price, particularly if it means cutting premiums to levels that are simply not viable in the long run. Good customer service has many different dimensions. It includes, for example, ensuring that at the point of sale the firm's representative is well trained, knowledgeable about the products, and places the customer's interests first. It involves devoting resources to the development of new products that can meet customer needs. It also involves ensuring that policy-holders receive quality and reliable service when presenting their claims. The firms that will emerge strongest from the current highly competitive environment will be those that are capable of providing the best customer experience in all its dimensions.

My second issue concerns the need for economies of scale in the industry. In many of the MENA countries locally-incorporated insurance firms remain relatively small and are therefore unable to compete with large internationally active firms that have the benefits of scale. These benefits range from the ability to construct large diversified investment portfolios to efficiencies in IT for claims handling and processing. Over the long run, there is a need for locally-incorporated insurance firms to achieve greater scale economies if they are going to be able to compete on level terms with their international competitors.

Firms will only be able to achieve economies of scale if they become larger. Inevitably, this means that there will need to be some industry consolidation. To-date, however, the shareholders of locally-incorporated firms have been reluctant to enter into mergers, perhaps because they fear that this will lead to a dilution of their control. However, if the industry's growth opportunities are to be realized, shareholders will need to take a broader perspective and to recognize that future profit growth will require firms that are larger than those that

currently exist. In this respect, I think it is particularly important that a session of this Forum is devoted to the subject of merger and acquisition activity in the insurance industry.

My third issue is closely related to the second. One reason why shareholders have been slow to grasp the need for industry consolidation has been the expectation that the returns on capital that they were able to achieve during the boom years will swiftly return. During the boom years all sections of the financial industry were able to achieve returns on equity that were quite exceptional. However, we need to recognise that the global financial crisis was not just a temporary interruption, and that we will soon return to the period of strong profits and quick and easy returns.

As we gain more perspective on the global financial crisis it is becoming increasingly clear that the boom years immediately before the crisis were the exception rather than the rule. Shareholders and investors in all financial firms, including in the insurance industry, will need to adjust to a world in which the returns on their investments will be lower than they came to expect in the boom times. In the insurance industry, with its many competing firms, this adjustment is particularly important.

We are currently living through a period of adjustment. Once shareholders and investors recognise that they will need to accept lower returns on their investments than during the boom years, the process of industry consolidation is likely to begin. Improved returns on investment will require greater efficiency, better standards of customer service, and new product innovation, all of which are more likely to be delivered by larger more diversified insurance firms.

Let me conclude by returning to the title of this keynote address. Successfully supporting the next phase of development for the regional insurance markets is a process that must be led by the industry itself, particularly by its shareholders and managers. The next phase of the development of the insurance markets is likely to require the consolidation of firms, the development of new product offerings, the expansion of insurance firms in the region, and high standards of customer service that only the private sector can deliver. While we as the regulator can work to ensure a sound and stable insurance market and the protection of policy-holders, ultimately it is for you in the industry to take advantage of the growth opportunities that the Middle East and North Africa region can offer.

As the regulator, the CBB will continue to provide a strong framework of rules based on international best practice and will apply them in a transparent and fair way. We will continue to consult with the industry and to ensure that we are responsive to your needs. Ultimately, however, the future of the industry is in the hands of the industry itself.

Thank you for your attention.