IFRS 17 Adoption Will Test GCC Islamic Insurers

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Key Takeaways

- After a strong 2022, Islamic (Takaful) insurers in the Gulf Cooperation Council (GCC) look set to continue a favorable growth path in 2023, supported by higher insurance prices and demand--particularly in Saudi Arabia.
- The adoption of International Financial Reporting Standard 17 (IFRS 17) requires insurers to update their internal processes and IT systems, resulting in additional costs, time constraints, and other operational challenges, which will likely strain many smaller, under-resourced players.
- While we do not expect the accounting changes themselves to affect our ratings on GCC Islamic insurers, any significant implementation delays or inconsistencies in financial reporting standards could lead to negative rating actions in isolated cases.

S&P Global Ratings expects favorable economic conditions and higher insurance prices--reflecting increased claims frequency and costs--and demand will boost business growth prospects for Takaful insurers in the GCC over the next 12-18 months. This comes after strong year-on-year gross written premium/contribution (GWP/C) growth of about 23% in 2022. Islamic insurers in Saudi Arabia and some in other GCC countries adopted IFRS 17 from Jan. 1, 2023, with most remaining insurers likely to adopt on the same date next year. We believe the adoption of IFRS 17 will improve transparency, making it easier to identify and compare insurers' profit generation and risk management. While the implementation presents new challenges for all insurers in the region, including Islamic insurers, we expect our ratings on them to remain broadly stable. However, any significant implementation delays or inconsistencies in financial reporting standards could lead to negative rating actions in isolated cases.

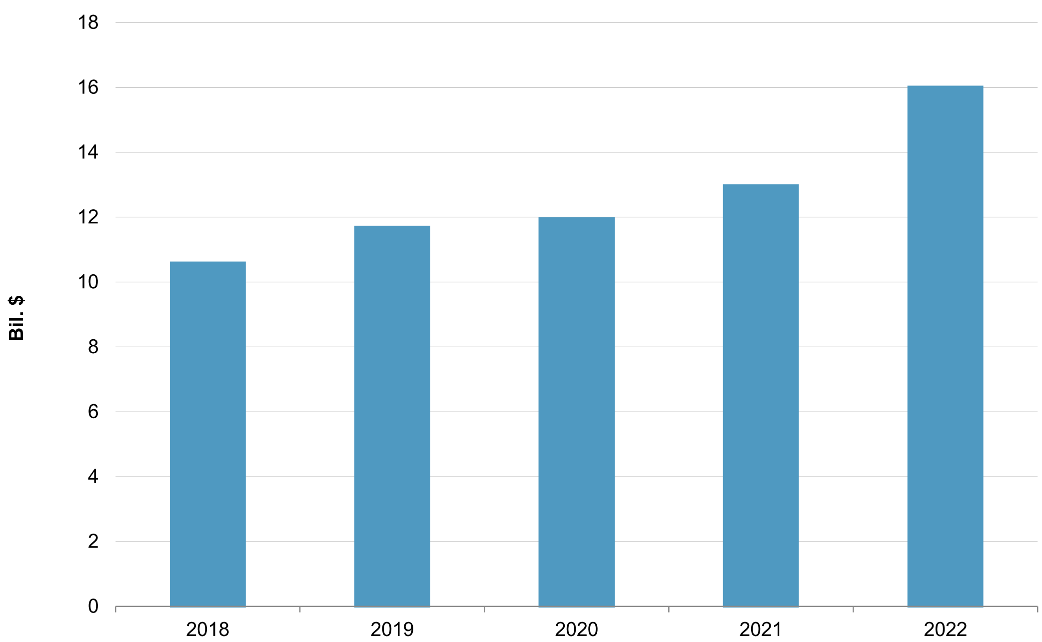
Saudi Arabia's Premium Growth Continues To Outpace Other Islamic Markets

The GCC Islamic insurance sector has grown steadily over the past five years. This was particularly evident in 2022, when the overall GWP/C among listed companies increased by about 23%. Aggregate post-tax earnings in the sector improved by almost 70% in 2022 compared with 2021. Industry growth mainly stemmed from the largest market, Saudi Arabia, which grew by almost 27% in 2022. At the same time, GWP/C in other GCC countries cumulatively declined by almost 5% over the same period, particularly because premium income fell significantly in the United Arab

Emirates (UAE)--the second largest Takaful market--mainly due to several mergers and rate pressure affecting motor and other lines.

Chart 1

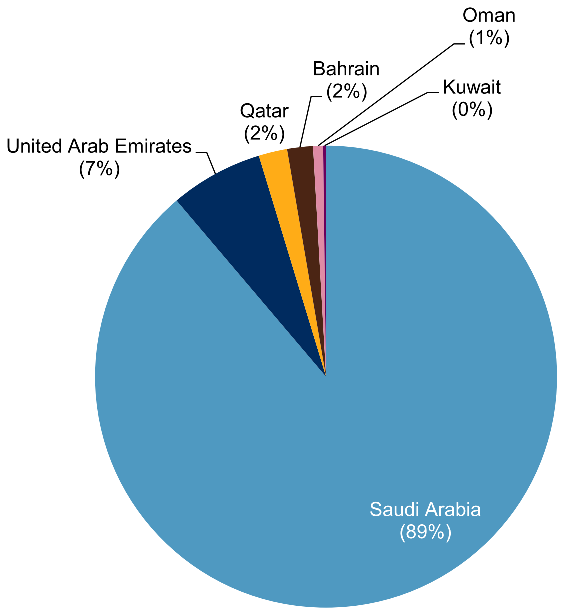
Gross written premiums/contributions in the GCC Islamic insurance industry



Source: S&P Global Ratings.

Chart 2

Split of estimated gross written premiums/contributions in the GCC in 2022 by country

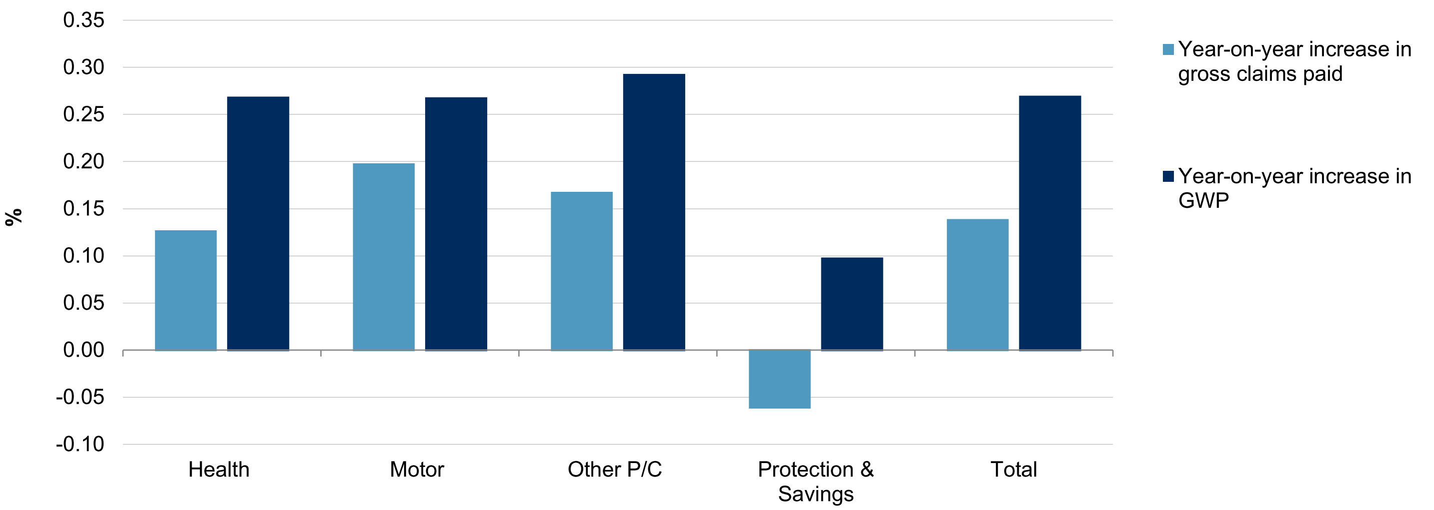


Source: S&P Global Ratings.

Like top-line growth, earnings were not evenly distributed because some Islamic insurance markets continued to be more profitable than others. Qatar's small insurance sector was substantially more profitable than other Islamic markets in the region, particularly when compared with Saudi Arabia. That said, new business, and motor and medical lines rate increases led to a substantial turnaround in Saudi insurers' first-quarter 2023 earnings. In the first quarter, Saudi Islamic insurers reported another strong increase in top-line growth, notably thanks to repricing and rate increases in motor and medical lines. We expect double-digit premium growth to continue in 2023, but more moderately as price adjustments will likely be lower than in 2022.

Chart 3

Premium growth exceeded increased claims in 2022



GWP--Gross written premiums. P/C--Property and casualty. Source: S&P Global Ratings.

Rate Adjustments And Stronger Investment Returns Will Support Earnings

Aggregate post-tax earnings in the sector improved by almost 70% in 2022 when compared with 2021. First-quarter 2023 results suggest it could be another profitable year, thanks to rate adjustments in previously underperforming lines and potentially stronger investment returns.

However, earnings were not equal and some Islamic insurance markets continued to be more profitable than others.

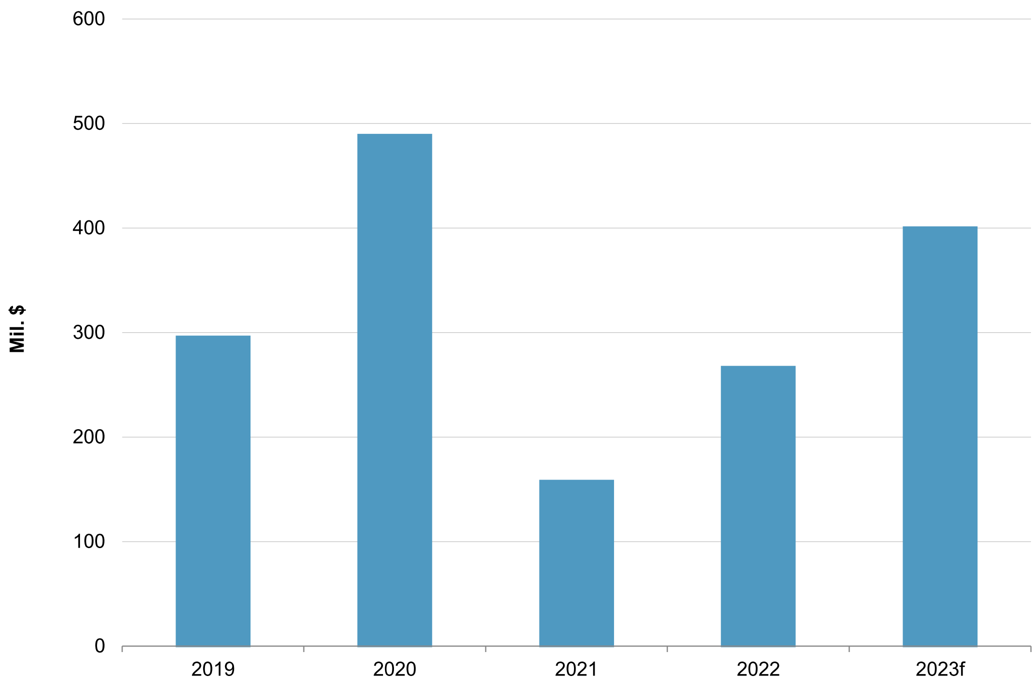
Like in previous years, Qatar's Takaful sector remained the GCC's most profitable market, with insurers reporting an average combined (loss and expense) ratio of lower than 80% (a lower combined ratio indicates higher underwriting profit).

Meanwhile, in Saudi Arabia, the overall combined ratio was roughly 101%, with about two-thirds of insurers recording underwriting losses. The number of Saudi insurers that recorded a post-zakat (tax) loss still stood at 52% in 2022, although some companies that reported losses still benefitted from profitable investment returns. This is an improvement on 2021, when almost 60% of insurers reported losses.

This improvement continued into first quarter 2023. Year-on-year pre-zakat profits under IFRS 17 in Saudi Arabia increased to roughly $168 million, from about $2 million during the same period in 2021. This indicates that the increase in rates has started to pay off.

Chart 4

Net income in the GCC Islamic insurance industry

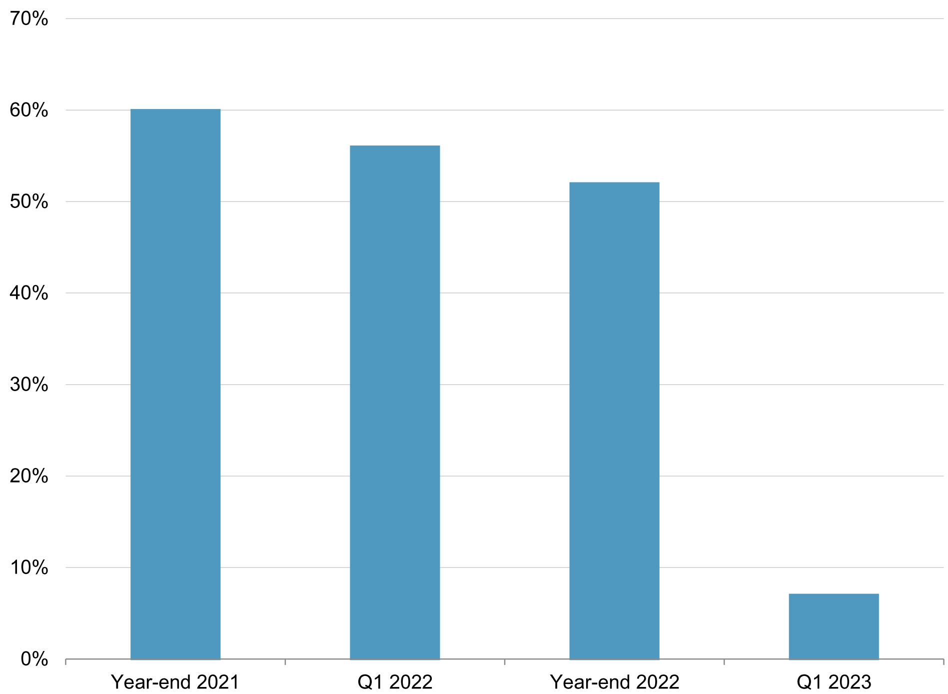


f--Forecast. Source: S&P Global Ratings.

In addition to better underwriting results, higher interest rates strengthened investment returns on fixed and cash deposits, boosting profitability in the first quarter of the year. Only about 7% of companies in the sector recorded a post-zakat loss, compared with about 56% during the same period in 2022.

Chart 5

Percentage of lossmaking insurers in Saudi Arabia



Q1--First-quarter. Source: S&P Global Ratings.

Although competition remains high, we expect the focus on better underwriting performance to continue in 2023 and the adoption of IFRS 17 to improve transparency, making it easier to identify and compare how insurers generate profits and manage risk.

New Accounting Standards Will Present Some Challenges

All Saudi Islamic insurers and a small number of those in other GCC countries adopted IFRS 17 from Jan. 1, 2023. We expect most remaining insurers to adopt it from Jan. 1, 2024. Although we anticipate the adoption will improve detailed published financials as companies enhance their data and processes, many insurers that have already implemented the new standard have experienced reporting delays and other setbacks. In Saudi Arabia and the UAE, regulators extended reporting timelines in the first quarter to provide insurers, auditors, and other industry participants more time to complete the first financial returns under the new standard.

Across the GCC region, we still see substantial differences in insurers' level of preparedness for IFRS 17. Many smaller and midsize Islamic insurers yet to implement will likely encounter difficulties given the lack of resources. This is because IFRS 17 requires internal process and IT system updates, resulting in additional costs and time constraints.

Alongside high competition and other increasing regulatory demands, this has already led to several mergers, with more likely to come. Consolidation is particularly prevalent among smaller and midsize insurers in Saudi Arabia and the UAE. The number of Saudi listed insurers fell by about 20% over the past five-to-six years, to 27 from 34. We forecast additional mergers in Saudi Arabia, and that the number of listed Takaful players in the UAE will almost halve following merger activity over the past year.

Although we do not currently expect any significant delays or inconsistencies in the adoption of IFRS 17 among rated GCC Islamic insurers, we think that such eventualities could potentially lead to negative rating actions in isolated cases.

Related Research

- Accounting Changes Keep GCC Insurers On Their Toes, June 15, 2023
- GCC Insurers In 2023: Strong Growth And Lackluster Earnings Could Squeeze Capital Buffers, March 1, 2023

This report does not constitute a rating action.