

Reactions

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PATRICK KENNY

Crisis a mere blip for Middle East

Opportunities in the Middle East will be a big theme at this year's International Insurance Society (IIS) seminar, according to Patrick Kenny, president and chief executive of the IIS.

Economic growth in the Middle East may have slowed down as a result of the financial crisis, but Kenny is confident that the region's insurance market will continue to grow. "The financial crisis for the insurance industry has not been as severe in the Middle East as it has been in other parts of the world," Kenny told *The IIS Reporter*.

"Obviously the financial crisis in general has affected the Middle East. Fewer cars will be bought. Fewer buildings will be built this year versus last year or the year before. But it is a temporary slowing. What is happening there in terms of economic growth will continue, and as a result you will see a lot of development and the industry will respond to that."

There are a number of panels and special addresses this year with a Middle Eastern focus. On Tuesday morning, Ian Dilks, global insurance leader at PricewaterhouseCoopers, and Arif Naqvi, CEO of Abraaj Capital, will discuss the economic prospects of the Middle East and North Africa (MENA) region.

And in the afternoon Abdul Khalik Raouf Khalil, secretary general of the General Arab Insurance Federation in Egypt, will give his views on the future of the Arab insurance industry.

"You will hear about issues



Patrick Kenny

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surrounding emerging markets; you will hear issues surrounding opportunities that exist in the Middle East," says Kenny.

He adds that the Middle Eastern insurance market has already made big steps forward. "If you go back 10 or 15 years you would have said that the Middle Eastern insurance market was almost totally related to energy," says Kenny. "But with all the economic development in property, there is now a much greater market for property insurance and auto insurance, and there is the whole concept of takaful, which affects people's saving habits."

He adds: "There is a general

overall emphasis in the region on the development of financial services."

Another big talking point at the conference will be the effects of the financial crisis on different segments of the insurance industry. "Everybody talks about the financial crisis as if it's the same for everybody and it really isn't," says Kenny. "Some of the issues like capital and liquidity are the same but if you divide it up between the life industry, the non-life industry and the reinsurance industry, the issues are a little bit different."

Today, an executive panel will talk about the insurance industry's response to the financial crisis. Then on Wednesday there will be a panel about life securitisation.

But Kenny says some of the most important discussions will go on behind the scenes: "One of the purposes of the conference is to get people together and talk, and there will be some fairly prominent CEOs of life companies. I think you will see a lot of what I call off-line discussions related to this."

These informal discussions will not be limited to the life market. One of the main purposes of the conference is to give delegates the chance to exchange ideas with people from around the world. "The issues that affect the industry are the same worldwide, they are just in different stages of development in each country," says Kenny. "So if people get together and talk about it they are going to be able to benefit from other people's experiences and the opportunities and challenges they have faced."

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ASSET MANAGEMENT

Hard questions must be asked

Now the dust from the financial crisis is settling, insurers must be prepared to make tactical decisions about the future of their investment strategies. This will likely result in fundamental changes to the way the industry manages its asset portfolios, says Sherry Manetta, director of consulting services at Conning.

“Now is the time for insurers to ask hard questions about what got them here,” Manetta told the *IIS Reporter* in Amman yesterday. “Clearly the capital markets situation, no matter what companies were doing, was going to affect them. They must ask some tough questions about their investment process and if it is being optimally managed.”

Over the past couple of years companies were reaching for yield, so much so that they reached a stage where their risk and reward was

“totally out of whack” with their overall strategy, Manetta says. She adds that companies are starting to talk about operational risk within their risk management strategies.

“As a third-party asset manager and strategic consultant we are there to look at a firm’s risk appetite, look at the structure of its investment portfolio and what happens in its asset allocation,” she says. “Firms need to bring a process in place to evaluate when deviations from the benchmark occur.

“We hope to see companies focusing on risk tolerance and have a more dynamic process where they look constantly at integrating what is happening on the liability side with what is happening on the asset side.”

Most insurers have been affected by the financial crisis in some way, whether through direct investment losses,

mark-to-market accounting or liquidity effects, and have been frantically de-risking their balance sheets by pulling out of certain riskier asset classes, which had been gaining popularity in the industry – such as equities, hedge funds, and other alternative investments – in order to redeploy their capital in low-risk, low-return areas, like government bonds.

“The biggest risk insurers face is liquidity risk,” says Manetta. “They are de-risking but the question is how fast they can do that and at what pace they can take toxic assets off their balance sheets.”

Instead of the alternative investment strategies previously favoured by the industry, insurers are building up cash and short-term investments in an attempt to sell assets with unrealised losses attached to them.

While banks have struggled to maintain liquidity by de-risking their portfolios and selling assets at reduced prices, insurers have been able to hold back and wait for value to return to their asset portfolios. Maintaining cash has also given insurers the flexibility to support their liquidity without being forced to sell assets.

“Life and annuity insurers were hit by higher lapse rates and surrenders in 2008 and were not certain of their cash flow in the short term,” says Manetta. “That interplay between liability and assets got lost when companies were managing their asset portfolios. It is important to look at the underlying business and have an asset strategy that makes sense.”

However, Manetta adds that the industry still has a long way to go to get from where it is today to achieving its long-term strategy.

AIR FRANCE PLANE

Axa is lead insurer on missing plane

French insurance group Axa has confirmed it is the lead underwriter on the hull account for the Air France plane which disappeared from radar off the coast of Brazil en route to Paris shortly after taking off from Rio de Janeiro at 7pm local time on May 31.

According to **Reactions’** sources, UK-based Jardine Lloyd Thompson brokered the contract for Air France, and lead insurer Axa was joined by Global Aerospace Underwriting Managers on the slip.

The source added that the insured value of the Airbus 330 hull is estimated to be around \$99m.



Flight AF 447, which had 216 passengers and 12 crew members on board, was scheduled to arrive in Paris at 11.10am local time. According to reports, the flight disappeared 186 miles north-east of the Brazilian city of Natal.

It is thought the airbus crashed after being hit by lightning after entering a

thunderstorm with strong turbulence at around 3am (GMT).

Air France told *BBC News* that it plans to accelerate replacement of speed monitors on its Airbus A-330s after speculation suggested that faulty data on the old-type sensors may have caused the crash. The airline said it had noticed problems with icing on the monitors last year and had begun changing them in April.

Brazil’s air force is conducting a search and rescue mission near the island of Fernando de Noronha, which is an archipelago about 1,500 miles north-east of Rio. On

Saturday (June 6), it reported that two male bodies had been recovered, along with debris including a suitcase containing an Air France ticket.

Much of the search effort so far has been focused on finding flight data recorders – known as black boxes – which have sonar beacons attached to them. A French submarine, which is fitted with sonar equipment, is being sent to join in the search. The US is also sending specialised listening equipment.

The crash marks the first large incident in Brazilian air space since a TAM Airbus crashed in Sao Paulo killing 199 people.

STEPHEN MAY

Captives set to grow



Captive formation in centres such as Qatar is tipped to boom

The Middle East is a fertile breeding ground for captive insurance, according to Stephen May, CEO of Heritage London and Middle East. Until recently, captives – which are a form of self-insurance – could not be set up in the Middle East, although some Middle Eastern companies had established captives in offshore domiciles outside the region.

But, during the past few years, the Central Bank of Bahrain, Dubai International Financial Centre and Qatar Financial Centre have all established legislation allowing for the formation of local captive insurance companies.

May expects the region's interest in captives to grow. "Where captives have been particularly popular in the rest of the world is where you've got large and growing value of assets and where you've got vibrant economies, strong balance sheets, and better-than-average risk," says May.

"It would be logical that in a place like the Middle East – where across the GCC [Gulf Cooperation Council] you've got one of the largest and fastest-growing economies in the world, with so far one of the lowest take-ups for insurance in the world – that as they are likely to buy more insurance and the assets and liabilities they insure are growing, it would be a good time to start looking at self-retention."

He adds that the main reason companies choose to use captives, rather than placing their risk with external insurance companies, is because they want the flexibility of holding more risk than they want on their balance sheet. Companies also opt for captives when the traditional market is very expensive or is not offering the coverage they require.

So far, only three captives have been established in the region – one in each of Dubai, Qatar and Bahrain – but there are more applications in the pipeline. May says captives are likely to keep more risk – and premiums – in the region, rather than ceding this to companies which have fronting arrangements with international reinsurers.

"The insurance industry which has evolved so far in the region is not like the traditional markets in the rest of the world," says May. "It holds very little risk and cedes most of it into the global markets."

He adds: "The Middle East is a market which is in a relatively high level of transformation at the moment and during that transitional phase it is likely that buyers will consider how much they want to hold themselves before passing it straight through the local insurance companies."

Reactions IIS Reporter

QUOTES OF THE DAY



"Everybody talks about the financial crisis as if it's the same for everybody and it really isn't."

Patrick Kenny, president and chief executive of the International Insurance Society



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about their investment process and if it is being optimally managed."

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"The DIFC is proving to be the centre of gravity for foreign insurers in the GCC region."

Wayne Jones, partner in law firm Clyde & Co's Middle East regional office



"We believe in a win-win strategy, where there is room for multi-players, which ultimately will lead to the development of the regional insurance industry. Jordan can be an appropriate window to the region."

Bassel Hindawi, director general for the Insurance Commission of Jordan

DUBAI

No 'one size fits all' in Middle East

Insurers should consider carefully where to set up in the Middle East, because they will not find a regulatory system that applies to the whole region, says Wayne Jones, partner in law firm Clyde & Co's Middle East regional office.

According to Jones, the Dubai International Financial Centre (DIFC) has been particularly popular with international insurers setting up in the Gulf. But he says it has a long way to go before it can be counted as a true regional hub

"The DIFC is proving to be the centre of gravity for foreign



insurers in the GCC [Gulf Cooperation Council] region," Jones told market participants at a Clyde & Co seminar on June 3.

At present, there are 34

regulated insurance and reinsurance firms writing business in the DIFC, including American International Group, Generali, Flagstone Re, Gulf Re and Zurich.

But Jones added: "A lot of people come to us and say they want to set up a regional hub, but at the moment there is no passporting system so that insurance for the whole region can be written from one single hub."

Insurance regulations vary throughout the region, meaning that rules in one GCC country may not be applicable in others. This creates a regulatory minefield for

insurance companies wishing to write business throughout the Middle East.

Even the mainland United Arab Emirates – which is made up of seven emirates, including Dubai and Abu Dhabi – is overseen by a different insurance regulator to the DIFC, where insurance rules are imposed by the Dubai Financial Services Authority.

As a result, insurers expecting to take advantage of the entire Middle Eastern market, simply by setting up one regional office could be sorely disappointed. "There isn't one size that fits all," Jones said.

UK

Lloyd's Names facing financial ruin

A group of more than 30 Names, the individuals who backed insurance policies underwritten at Lloyd's of London, are facing financial ruin after reaching the end of a long legal battle against Lloyd's.

The individuals sued Lloyd's, claiming the market misled them about the exact nature of the insurance deals they bought into before the market's near-collapse in 1992. They alleged that the description of reinsurance to close (RITC) in Lloyd's brochures and its verification forms in the 1980s was fraudulent.

The High Court ruled against the Names in July last year saying there was "no deliberate concealment" of what the Names were taking on.

In February this year the Court of Appeal described the Names' application to appeal

"We sincerely hope that this transfer will be the final chapter in the Equitas story, which started back in 1992."

Jane Barker, CEO of Equitas

as "totally without merit" and "just part of the continuing abuse of process of the court by dissatisfied Names who are perpetually trying to find new ways of accusing Lloyd's of fraud".

On June 5, the Names' case reached its final chapter in the Bankruptcy Court.

The case comes against a backdrop of Names facing an end to their exposure from claims emanating from the market's pre-1993 liabilities, should a UK court approve the transfer of liabilities to a new company at the end of June.

Equitas, the Lloyd's vehicle



set up in 1996 to manage the liabilities that arose from escalating asbestos, pollution and health hazard claims from the early 1980s, is to transfer all of its 1992 and prior year non-life liabilities to a new company through a Part VII transfer.

If the transfer is approved by the court, it will see around \$7.8bn of liabilities transferred to the new company, Speyford, which the Financial Services

Authority is expected to authorise in the next few days.

"We sincerely hope that this transfer will be the final chapter in the Equitas story, which started back in 1992. It will mean that the Lloyd's Names who were underwriters in the years up until the end of 1992 will have legal finality in the UK, in terms of their exposure to claims from policyholders," said Jane Barker, CEO of Equitas.

Equitas will also purchase a further \$1.3bn of reinsurance cover from National Indemnity, the unit of Warren Buffett's Berkshire Hathaway that struck a deal with Equitas in 1996 to take on its liabilities. The law at the time did not allow the transfer of the liabilities, only their reinsurance.

If the ruling goes ahead, the majority of Lloyd's Names will be off the hook for any future claims.

A glimmer of hope

Managing risk and capital are significant challenges following the financial crisis, but global insurers are still cautiously optimistic about their growth prospects over the next 12 months, says Frank Ellenbürger, Global Head of Insurance, KPMG in Germany.

Despite some recent well-publicised casualties, the insurance industry is weathering the current economic conditions better than banking. Mainstream business operations are holding up well. Problems have only arisen from exposures to risky financial instruments such as credit default swaps (CDS) and collateralised debt obligations (CDO) or losses on investment portfolios. Profitability is more likely to have been impacted than underlying solvency. The current troubled capital markets, falling ratings and plunging share prices have prompted many to rethink their risk and capital management strategies. With this in mind, KPMG International recently commissioned the Economist Intelligence Unit to survey insurance executives around the world to gain insight into their current perception of business prospects and risk priorities.

Insurers cautiously optimistic about growth

Our research found many were anticipating growth to improve over the next 12 months. Over half of our respondents thought prospects for both organic growth and growth by acquisition were positive. North Americans appeared most confident, which may reflect a perception that this region should rebound most quickly from the current economic slump. The less optimistic news is that the same executives said a continuing lack of confidence in the capital markets could stifle their recovery. Less than 4 in 10 respondents said that they expected an improvement in their share price over the next year. Well-designed and actionable procedures for mitigating the risks that created so much recent instability will undoubtedly be one of the keys to restoring faith in the markets.

Risk management is significantly higher priority

It is clear that concerns over the impact of

the weakened economy, and particularly the capital markets, have prompted many insurers to place significantly more emphasis on risk management and capital performance. At board level, respondents indicated that the proportion of time spent on both risk management and capital management has increased substantially. Over 80 percent of board members are now spending at least 20 percent of their time on risk management issues. We also found that almost two-thirds of respondents have appointed board-level risk committees in addition to their longer-established audit committees. In terms of priorities, market risk and credit risk are top of the agenda.

Greater focus doesn't equal more spending on risk

Interestingly, a significant majority of respondents regard themselves as already good at managing risk activities. When asked to rate their effectiveness in 11 different categories of risk management, at least six in ten respondents believed themselves to be effective in each area. And despite devoting more time to risk from the board level downwards, not everyone was intending to spend more money on the risk

function. Around half of our respondents expected to invest more. But this leaves a substantial proportion (47 percent) expecting to achieve stronger performance with the same resources in both risk and capital management as before, and no plans to increase training resources, recruiting or other investments in risk functions.

Enough capital in the industry?

Meanwhile, there is an apparent contradiction around responses we heard on capital. Most respondents (85 percent) believe they are well capitalised relative to their risks, and most believed that the industry as a whole has sufficient capital reserves. But more than half nonetheless believe they will need to strengthen their capital over the next 12 months, which is more in line with messages we are hearing from the marketplace. Our survey continues over the summer and will track any shifts in attitude.

Link to better valuation

The impact of the current financial crisis on the insurance industry is clear in terms of lower valuation in the market. But our survey respondents clearly feel a sense of optimism that they have seen the worst now, and have the attributes to prepare for a more favourable environment. If they can demonstrate excellence in managing risk, continue to be profitable and communicate this achievement effectively, we may well see market confidence and valuations boosted in the year to come.

This article was published first in "frontiers in finance – the long road to recovery," June 2009.

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KPMG's global risk and capital management insurance survey 2009

In April 2009, KPMG International initiated a two-part research programme to explore how the financial crisis is changing insurance industry attitudes to risk and capital management. We commissioned the Economist Intelligence Unit to complete the research; on our behalf they asked senior executives how they are responding to prevent further losses and position their businesses for growth in future. The initial report, capturing the thinking of 315 industry executives from 49 countries, was launched in early June 2009.

Key findings in April 2009

- Over half see positive prospects for growth in the next 12 months.
- Managing risk is a much higher priority and two thirds of companies have appointed board level risk committees.
- At least 6 in 10 think they are already effective at managing risk across the board.
- Around half don't intend to increase investment in managing risk.
- Top three activities where risk management plays an active role are new product development, strategy development and pricing.

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HURRICANE SEASON

US P/C rate hikes are manageable

With the 2009 North Atlantic hurricane season now underway, insurers' main concern is that this year will not be a repeat of 2008 – or, even worse, 2005 – with intense hurricanes making US landfall and causing high insured losses, in the style of hurricanes Ike and Katrina.

Scientists indicate that insurers may get lucky this year. Hurricane forecasters are, in general, predicting a near-average season.

The National Oceanic and Atmospheric Administration (NOAA)'s National Weather Service Climate Protection Center gives a 50% chance of a near-normal season, a 25% chance that the season will be above-normal, and a 25% chance of below-normal activity. The NOAA's forecasters say there is a 70% chance of having between nine and 14 named storms, of which four to seven will become hurricanes, including one to three intense hurricanes (category 3 or above).

Other forecasts are slightly lower. This month, the Colorado State University (CSU) reduced its forecast to 11 named storms, five hurricanes and two intense hurricanes from its April 2009 forecast, in which it predicted 12 named storms, six hurricanes and two intense hurricanes.

UK-based Tropical Storm Risk (TSR) also expects this season to be slightly below average, with approximately 11 named storms, five hurricanes, and two hurricanes of category 3 or above. TSR is one of the few organisations to predict US landfall frequency. This year, it says only one hurricane is likely to make US landfall.

According to the NOAA's



Insurers hope this year's hurricane season does not bring devastation such as that caused by Katrina in 2005

2009 Atlantic hurricane season outlook, multi-decadal atmospheric conditions – which have been in place since 1995, and which result in high activity in the Atlantic Basin – are likely to contribute towards an above-average season.

But the NOAA and CSU cite cooler sea surface temperatures in the Atlantic as a reason for the expected decrease in hurricane activity compared with last year, which had 16 named storms, eight hurricanes, and five intense hurricanes.

Peter Dailey, director of atmospheric science at risk modelling firm AIR, explains: "Ocean temperatures are a little bit warmer than average but they are not nearly as warm as they have been since the 2004 and 2005 seasons. We are just in advance of the season but because the ocean temperature changes vary little over short periods of time, the temperature of the ocean now is a pretty good indicator of what the ocean temperatures will be in the hurricane season."

Scientists also expect an El Niño-Southern Oscillation-neutral year, or the development of slight El Niño conditions before or during August, September and October – the peak months of

the season. According to the CSU, the potential for weak El Niño to develop is one of the main reasons it reduced its forecast from early December.

El Niño – and its opposite La Niña – are ocean temperature anomalies off the coast of Peru and the Pacific Ocean. These affect the amount of wind shear in the Atlantic, particularly near the Caribbean Islands, Dailey explains. "El Niño events tend to produce high levels of wind shear in the Atlantic," he says. "Wind shear tears apart hurricanes so when wind shear comes up in the Caribbean a lot of storms have difficulty making their way through that zone and across the US coastline."

In preparation for the 2009 season, property/casualty reinsurance rose at the April 1 and June 1 renewals. Reinsurance broker Aon Benfield reported price increases of 10% to 25% for treaties with east coast US hurricane exposure on April 1, as well as a tightening of capacity. Willis Re said in April that pricing for loss-free nationwide property/casualty accounts in the US was up 20% to 25%, and for regional accounts it was up 5% to 10%. Regional accounts with losses saw price rises of between 15% and 30%.

At June 1, Aon Benfield reported year-on-year increases of around 10% to 15% on catastrophe renewal pricing for Florida-influenced programmes. This view was backed up by fellow reinsurance broker Guy Carpenter, which also said in a briefing that Florida property-catastrophe reinsurance rates increased by 15% in June.

However, the increases still fall some way below expectation. "Given the unique characteristics of the Florida market, a 15% rate increase suggests that capacity conditions have not appreciably worsened through 2009 and that the market has, in fact, stabilised to a certain degree," said Lara Mowery, property specialty leader at Guy Carpenter.

According to the Guy Carpenter briefing, reinsurance capacity was more limited at the June 1 renewal than in 2007 and 2008. However, though capital was constrained as a result of the financial crisis, the shortage did not result in severe rate spikes as it did in 2006 as increased demand was modest enough not to exceed supply.

Demand for private reinsurance increased by around 5% to 10% as a result of a decline of \$2bn in the Florida Hurricane Catastrophe Fund's Temporary Increase in Coverage Limits layer.

"The Florida market is always watched closely, and we would expect the current trend – manageable rate increases driven by limited but available capacity – to extend through the July 1 2009, renewal, barring a mega-catastrophe, a new round of turbulence in the capital markets, or other extraordinary circumstances," said Mowery.

BASSEL HINDAWI

Jordan a 'window' to region



Dr Bassel Hindawi

Jordan is well-qualified to become a regional centre for insurance business, according to Bassel Hindawi, director general for the Insurance Commission of Jordan.

Hindawi says Jordan is recognised as one of the most promising emerging markets in the Middle East and North Africa (MENA). It is located at the cross-section of Europe, Asia and Africa, and offers investors easy access to many regional markets in the Middle East.

At the same time, Jordan's economy is characterised by free enterprise, individual entrepreneurship and market-driven business. The country has free trade agreements with Europe, the greater Arab region, the US and

Singapore, as well as several bilateral agreements with other jurisdictions.

"[Jordan's] political stability and strategic geographical location are backed by proactive macroeconomic policies, integration with the global economy and adherence to free market principles, and an advanced insurance and reinsurance regulatory framework that is in line with international best practices," Hindawi told *The IIS Reporter*.

He adds: "Another critical reason for the success of business in Jordan is the reasonable cost for setting up a business compared to other countries in the region."

According to Hindawi, investment gains, premiums and pre-tax profits in the Jordanian insurance market have doubled in the last 10 years. In terms of capital, the market has tripled in size. Meanwhile, insurance penetration has risen to 2.54% from 1.37%.

In addition to general insurance market growth in Jordan, Hindawi has noticed an increased uptake in takaful – or Shariah-compliant – insurance. At present, there are three takaful companies located in Jordan.

"Awareness of the need to make use of the growing demand for insurance services in the region has been demonstrated by the economic decision makers in the region," says Hindawi. "A considerable effort has been made to give the necessary flexibility to all insurance-related regulations so as to provide potential insurers with a wide range of investment platforms that facilitate their active presence in the MENA region."

Unlike in some emerging markets in the Middle East, Jordan's population has a good understanding of the need for – and benefits of – insurance, according to Hindawi.

He cites a Standard & Poor's report, released in April, which stated: "Jordanian insurers have the advantage of talking to an already well-informed, potentially interested target market when they seek to sell supplementary forms of cover."

The Insurance Commission is one of the main proponents in marketing Jordan as an insurance hub, and making the country more palatable for foreign investors. But Hindawi adds that there are plenty of other initiatives in the region.

He says: "We believe in a win-win strategy, where there is room for multi-players, which ultimately will lead to the development of the regional insurance industry. Jordan can be an appropriate window to the region."

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NEWS IN BRIEF

RenRe to buy Lloyd's managing agent Spectrum

Bermudian reinsurer RenaissanceRe Holdings has entered into an agreement to buy Spectrum Syndicate Management, a Lloyd's management agent.

The company received approval from Lloyd's in April this year to establish RenaissanceRe Syndicate 1458, for which Spectrum serves as the managing agent. RenaissanceRe's syndicate operations started in May, with underwriting of property and specialty business beginning from June 1.

Richard Murphy, chief executive officer of Spectrum, will continue in his role and Spectrum's management team will remain in place. The transaction is subject to approval by Lloyd's and the Financial Services Authority.

The price of the deal was not disclosed.