SAUDI ARABIA

The ramifications for the Saudi insurance sector of the new mortgage law

 

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The new Saudi Mortgage Law has been portrayed primarily as a solution for the social, economic and legal obstacles experienced by the Saudi real estate sector. It aimed at resolving the housing difficulties of around 2.3 million Saudi nationals over a period of 10 years. However, a review of the entire package of laws that have been issued demonstrates that it will also have material ramifications for the insurance sector in the Kingdom.

In a single meeting on July 1st, 2012 the Saudi Council of Ministers issued the Mortgage Law, the Financing Lease Law, the Enforcement Law, the Real Estate Financing Law and the Law on Supervision of Real Estate Financing Companies and amended article 5 of the Capital Market Law allowing Authorised Persons (APs) (i.e. licensed financial institutions) to establish special purpose vehicles (SPVs).

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The Mortgage Law essentially establishes the regulations for the financing of real estate and movables. It specifies the rights and obligations of the parties to a mortgage agreement, and includes details of the handling of the mortgaged property during the term of the mortgage and third party rights existing prior to the mortgage. However, it is clear from the amendments to the Capital Market Law that it is also envisaged that a securitisation market will be developed in the Kingdom in order to alleviate the liquidity risk that Saudi banks and real estate financiers would bear in respect of such mortgage financing. Put simply, it is a measure to avoid the risks that arise whilst awaiting the repayment of the loan over the life of the mortgage financing. In essence, the securitisation model involves a financier contracting with an AP licensed by the Captial Markets Authority to establish a SPV. The SPV will acquire a mortgage portfolio from the financier and issue to investors securities backed by the receivables of the mortgages. If all the underlying loans and dealings are Shariah compliant, the issued securities will likely be in the form of sukuk. If not, they will be conventional mortgage-backed securities. The purchase price paid by investors in return for the mortgage-backed securities will be used to finance the SPV to purchase the securitised assets.

The obvious beneficiaries of the new legislation will be those cooperative insurers that provide property insurance and protection and saving insurance (the Shariah compliant life insurance product). These products will inevitably be prerequisites required to be purchased by any borrower in order for a financier to approve a loan.

However, by creating the potential for securitisation, the laws also create an additional opportunity for the insurance sector. The emergence of securitisation will provide the Saudi cooperative insurance companies with a greater opportunity to market professional indemnity and, potentially, directors and officers' liability insurance. All of the entities playing a role in the mortgage market, including the banks and financiers, advisors and the APs involved in the securitisation process, are likely to require specialist coverages for these practices.

The growth in securitisation will likely also require financial guaranty insurance for many purposes, including to enhance the credit rating of the SPV and their securities. This will create new challenges for the Saudi insurance regulator, the Saudi Arabian Monetary Agency, as such insurance products are usually provided by specialised insurance companies, known as 'monolines'. Such entities do not currently exist in the KSA and further amendments to the Saudi insurance laws and regulations are likely to be required if such entities are to be established.

There will inevitably be a great many questions that arise following the application of the new laws. Certainly SAMA will face challenges as its jurisdiction expands to include the new real estate financing companies. However, that there is great opportunity for the insurance industry is undeniable. But only when the new laws are implemented will the true results show.

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