RATING REPORT

Pakistan Reinsurance Company Limited

REPORT DATE:
December 28, 2021

RATING ANALYSTS:
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RATING DETAILS		
	Latest Rating	Initial Rating
Rating Category	**Long-Term**	**Long-term**
IFS	AA	AA
Rating Date	*December 28,2021*	*April 2, 2021*
Rating Outlook	Positive	Positive

COMPANY INFORMATION	
Incorporated in 2000	**External auditors:** Grant Thornton Anjum Rahman Chartered Accountants
Public Limited Company	
Key Shareholder(s):	
Secretary Ministry Of Commerce – 44.88%	
State Life Insurance Corporation – 24.41%	
PRCL Employees Empowerment Trust – 6.12%	
General Public – 13.26%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria : General Insurance (November 2019) **http://vis.com.pk/kc-meth.aspx**

Pakistan Reinsurance Company Limited

OVERVIEW OF THE INSTITUTION

Pakistan Reinsurance Company Limited (PRCL) was incorporated as a public limited entity in March 2000. Majority shareholding of company lies with Government of Pakistan. It operates through its head office in Karachi and North Zonal Office in Lahore.

RATING RATIONALE

Pakistan Reinsurance Corporation Limited (PRCL) is engaged in the provision of reinsurance and retakaful services in Pakistan. It provides reinsurance protection to the local insurance industry as well as managing insurance schemes assigned by the Federal Government of Pakistan.

Insurance Sector Update

Table 1: Insurance Industry Financial Indicators (Source: IAP)

(Rs. in Billions)	2019	2020
Insurance Premium (Gross)	83.7	89.6
Takaful Contributions (Gross)	11.0	12.6
Industry Total (Gross)	94.6	102.3
Combined Ratio	89.1%	95.3%
- Net Claims Ratio	51.7%	54.8%
- Underwriting Expense Ratio	37.4%	40.5%
Net Operating Ratio	72.5%	78.6%
RoAA	4.7%	4.4%
RoAE	10.5%	10.1%
Operating Leverage	49.6%	52.5%

- The gross premiums/ takaful contributions underwritten by the industry grew by 8% in 2020, as data published by Insurance Association of Pakistan.
- Growth in insurance industry premiums receded to 8% in 2020 vis-à-vis 10% in the preceding year. Historically, growth in the insurance premiums has been reported at more than 2x of the GDP growth. However, in last 5 year period, this has dropped. Future industry growth is likely to pick pace as the ruling government enters its final 2 years, wherein historically it has been noted that infrastructure projects are ramped up. Nevertheless, industry experts remain conservative in their projections, maintaining the same within the single digit domain and close to the GDP growth projection of ~5%.
- As a result, non-life insurance penetration, estimated at ~0.2%, remains notably lower than regional peers.
- Given the meagre growth in premiums, the industry's combined ratio posted an uptick, which was driven by an uptick in both net claims and expense ratios.
- The investment performance remained strong during the period, with overall investment income posting an uptick of 13%.
- The sector's operating leverage remains around ~50%, which is considered to be on the lower side and there is certainly room for additional insurance penetration in the domestic market.
- Overall capitalization & liquidity buffers in place are considered to be adequate. Industry capitalization & liquidity are expected to persist.
- The implementation of IFRS 17 has been further postponed to January 1' 2023. The SECP has issued instructions of phase-wise implementation of IFRS 17, as per which the insurance companies have been instructed to submit a gap analysis with SECP by end-September'2021. So far, an estimate of related provisioning impact on the industry is yet to be ascertained.

Business Update - PRCL

Table 2: Business Mix

In Rs. Millions	**2019**	**2020**	**9M'20**	**9M'21**
Fire	10.8%	11.6%	11.1%	9.9%
Marine Cargo	0.2%	0.2%	0.2%	0.1%
Marine Hull	2.8%	2.2%	1.9%	1.8%
Accident & Others	1.5%	1.3%	1.2%	1.0%
Aviation	19.4%	2.1%	2.5%	5.4%
Engineering	37.7%	57.3%	58.7%	52.7%
Treaty	27.6%	25.4%	24.5%	29.1%
Total Gross Premium	**17,655.5**	**16,896.3**	**13,742.8**	**14,747.6**

- Given pandemic-induced slowdown, the company's business volumes contracted in 2020. This contraction mainly resulted from loss of a major Aviation segment client, as a result of which aviation segment underwriting was lower by Rs. 3b. Nevertheless, the impact on total underwriting was reduced by the strong growth achieved in engineering segment. This is illustrated by the change in business mix depicted in table 1.
- Underwriting operations in 2021, have depicted growth, with gross premium being 7% higher in 9M'21 vis-à-vis SPLY. The growth so far has mainly emanated from treaty and aviation segment business. On the back of treaty business growth and aviation segment premiums being recouped - as the major aviation segment client that was lost last year is likely to be regained in 2021 - management expects growth in gross underwriting to be ~10-15%.

	2018	**2019**	**2020**	**9M'21**
Gross Claims Ratio (%)	25.6%	69.6%	60.5%	31.6%
Net Claims Ratio (%)	54.8%	61.7%	58.5%	65.9%
Underwriting Expense Ratio (%)	34.8%	31.2%	30.4%	24.8%
Combined Ratio (%)	89.6%	92.9%	88.9%	90.6%

- PRCL's profitability indicators have been affected by an increase in claims ratio, as reflected by the RoAE falling from 15.4% in 2019 to 13.9% in 2020. RoAE remained under pressure in the ongoing year, with the same receding to 12.8% (Annualized).
- The increase in claims ratio is mainly attributable to adverse performance of Fire segment in 2020. In the ongoing year, Fire segment loss ratio depicted improvement, however, the same was offset by adverse performance of Treaty and Engineering segments.
- So far, the management has done well in managing the impact of higher loss ratios on the company's combined ratio, by minimizing the uptick in overhead despite a high inflation environment. In 2020, the company's overheads contracted by 6% and then grew by 2% in 9M21 vis-à-vis SPLY.
- Furthermore, on the back of strong growth in (recurring) investment income, the company's net operation ratio depicted improvement (2020: 74.9%; 2019: 83.1%). Investment income in 9M'21 remained comparable to SPLY, albeit the net operating ratio stood higher given adverse underwriting performance (9M21: 76.3%; 9M20: 72.8%).

- The investment portfolio has depicted a shift in asset class exposures with proportion of equity exposure reducing from 35% as of Dec'19 to 29% as pf Sep'21. Furthermore, the duration of the debt portfolio has been reduced, given significant growth T-Bill holdings. As per management, the duration of the debt portfolio as of end-Nov'21 was less than 1 year, being reduced mainly on account of interest rate increase anticipation. Given the reduction duration as well as equity holdings, exposure to market risk has reduced on a timeline.

In Rs. Millions	Dec'19	Dec'20	Sep'21
Equity Securities	3,866	3,763	3,507
Debt Securities	7,077	8,272	8,705
- PIBs	2,531	3,199	2,510
- T-Bills	4,446	4,973	6,094
- TFCs	100	100	100
Total	**10,942**	**12,035**	**12,211**

- Exposure to credit risk has remained similar on a timeline, with insurance debt comprising 58% of the gross premium (annualized) (Dec'20: 7/%; Dec'19: 48%).
- Given that growth in underwriting has remained contained, the operating leverage remains conservative. We have noted an increase in financial leverage, as technical reserves have been growing on a timeline. The financial leverage as of Sep'21 stood even higher. The increase in interim period is line with trend, wherein technical reserves are usually elevated as of 9M-end. Accordingly this is likely to recede by year-end.

In Rs. Millions	Dec'19	Dec'20	Sep'21
Net Worth	9,829	10,242	10,035
Operating Leverage (%)	70.3%	65.5%	66.6%
Financial Leverage (%)	116.6%	128.7%	136.5%

Key Rating Drivers

Assigned ratings are underpinned by strong sponsor profile

- The rating draws comfort from strong sponsor profile of PRCL, with Government of Pakistan (GoP) directly and indirectly owning 75% (controlling) stake. Given its shareholding stake in the organization, the GoP nominates the CEO and six out of eight Directors on the Board.
- As the sole national reinsurer in Pakistan all insurance companies operating in Pakistan have to mandatorily offer at least 35% of their business to PRCL under treaty arrangements, whereby the company enjoys discretion for first right of refusal.
- Recently in November 2021, the Board of Privatization Commission approved divestment of 20% stake in PRCL. This is likely to be concluded in 2022. Major changes in the Company's shareholding could imply a review of the assigned rating.

Rating incorporate PRCL's Reinsurance Panel and Treaty Capacities

PRCL has a diversified reinsurance panel with mostly 'A' and above rated companies; Hannover Ruck SE, Germany enjoys the lead share in fire and engineering segments while cover for marine and marine cargo is mainly provided by Korean Reinsurance Company and Asia Capital Reinsurance, respectively. Treaty capacities have increased in major segments. Maximum retention on net account in relation to equity remained within manageable levels.

Liquidity & Capitalization metrics remain contained, albeit Financial leverage has been trending up on a timeline.

Given contained growth in underwriting, operating leverage remains range-bound and is viewed as adequately low. Financial leverage has been trending up on a timeline, which has been noted. In line with Q4 trends, the financial leverage is expected to recede by year-end. VIS will continue to monitor the same on an ongoing basis.

Liquid assets remain the mainstay of investment portfolio, thus providing almost full coverage to adjusted technical reserves (Sep'20: 97.6%; Dec'20: 103.2%; Dec'19: 102.6%).

Governance framework depicts room for improvement

Board of Directors: At present, the Board of Directors at PRCL includes 5 members, while 3 vacancies exist on the Board. During the past year, there have been 2 new additions at Board level and 1 resignation. Improvement has been noted in Board composition, given lesser vacancies and inclusion of at least one female director in accordance with SECP's Code of Corporate Governance for listed companies.

Senior Management: There is significant attrition in senior management positions. In the outgoing year, senior management changes included CEO, CFO and Chief Internal Audit positions. The newly appointed CEO, Mr. Farman Zarkoon is an internal appointment, and is serving as an Acting CEO. Stability in the senior management is considered important from a rating purview.

Qualified Opinion by External Auditor: The financial statements of PRCL have a qualified opinion from the external auditor, with following reservations:

- As disclosed in note 13 to the financial statements, loans and other receivables include receivable from Sindh Revenue Board (SRB) amounting to Rs. 2,573.89 (2019: Rs. 2,573.89) million which was recovered by SRB against the sales tax liability on reinsurance services. The Company has recorded this amount as an asset, however the Company could not substantiate any control over the underlying asset and the flow of economic benefits is improbable due to ongoing Court case. Had the Company not recorded this asset, total assets, accumulated profit, shareholders' equity and solvency would have been reduced by the same amount accordingly. \

2) As disclosed in 16, 24, 34, 35, 36, 20, 32, 43 and 50 to the financial statements, certain account balances and class of transactions have been recorded against treaty proportional business. We were unable to obtain sufficient and appropriate audit evidence in respect of such account balances and class of transactions because the Company does not obtain necessary documents from ceding companies for record keeping and verification, but solely relies on the amounts mentioned in statutory quarterly returns for the purpose of recording transactions. Consequently, we were unable to determine whether any adjustment to these amounts were necessary.

Pakistan Reinsurance Company Limited Appendix I

BALANCE SHEET	Dec'18	Dec'19	Dec'20	Sep'21
Cash and Bank Deposits	2,602.5	815.7	1,570.5	1,152.8
Investments	8,633.7	10,942.4	12,034.8	12,211.4
Investment Properties	28.3	26.8	25.5	24.5
Insurance Debt	5,435.8	9,775.5	8,141.1	11,477.3
Total Assets	24,459.2	35,836.0	35,765.0	38,618.3
Paid Up Capital	3,000.0	3,000.0	3,000.0	3,000.0
Net Worth	9,407.9	9,828.8	10,241.5	10,035.0
Underwriting Liabilities	9,349.4	16,915.3	17,327.9	19,087.6
INCOME STATEMENT	**2019**	**2020**	**9M'20**	**9M'21**
Net Premium Revenue	6,905.2	6,708.8	4,703.3	5,016.2
Net Claims	4,258.9	3,924.6	2,970.2	3,304.2
Expenses	2,141.2	2,018.2	1,220.0	1,238.5
General & Admin Exp	14.4	22.6	20.5	3.9
Underwriting Profit/(Loss)	490.7	743.4	492.6	469.6
Investment Income	868.4	1,043.4	690.9	808.3
Rental Income	69.9	83.4	62.4	75.8
Other Income	752.4	74.4	3.1	82.1
Profit Before Tax	2,189.2	1,972.0	1,276.6	1,435.8
Profit After Tax	1,484.3	1,391.4	869.2	975.1
RATIO ANALYSIS	**2018**	**2019**	**2020**	**9M'21**
Retrocession Ratio	44.2%	58.2%	64.0%	58.2%
Gross Claims Ratio	25.6%	69.6%	60.5%	31.6%
Net Claims Ratio	54.8%	61.7%	58.5%	65.9%
Underwriting Expense Ratio	34.8%	31.2%	30.4%	24.8%
Combined Ratio	89.6%	92.9%	88.9%	90.6%
Net Operating Ratio	78.6%	83.1%	74.9%	76.3%
Insurance Debt to Gross Premium	50.6%	55.4%	48.2%	58.4%
Operating Leverage	58.1%	70.3%	65.5%	66.6%
Financial Leverage	73.1%	116.6%	128.7%	136.5%
Adjusted Liquid Assets to Technical Reserves	163.4%	102.6%	103.2%	97.6%

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Pakistan Reinsurance Company Limited (PRCL)
Sector	Insurance
Type of Relationship	Solicited
Purpose of Rating	Insurer Financial Strength (IFS) Rating
Rating History	see table below

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: IFS			
12/28/2021	AA	Positive	Maintained
4/2/2021	AA	Positive	Maintained
12/19/2019	AA	Stable	Reaffirmed
10/12/2018	AA	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on insurer financial strength only and is not a recommendation to buy or sell any securities.
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Due Diligence Meetings	see table below

S. No.	Name	Designation	Date
1	Mr. Naveed Iqbal	Chief Financial Officer	December 8, 2021