RATING REPORT

EFU Life Assurance Limited

REPORT DATE:
August 04, 2021

RATING ANALYSTS:
Maham Qasim
maham.qasim@vis.com.pk

RATING DETAILS		
	Latest Rating	Previous Rating
Rating Category	Long-term	Long-term
IFS	AA+	AA+
Rating Date	*August 04, 2021*	*August 21, 2020*
Rating Outlook	Stable	Stable

COMPANY INFORMATION	
Incorporated in 1992	**External auditors:** M/s KPMG Taseer Hadi & Co. – Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Rafique R. Bhimjee
Key Shareholders:	**Chief Executive Officer:** Mr. Taher G. Sachak
EFU General –**44.37%**	
Jehangir Siddiqui & Co. Limited **– 20.05%**	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Life Takaful (February 2018) https://www.vis.com.pk/kc-meth.aspx

EFU Life Assurance Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

EFU Life Assurance Limited (EFUL) commenced operations in November 1992. The company offers individual and group life covers, with individual policies being the company's major business line in terms of premium income.

Financial statements for the year ending December 2020 were audited by KPMG Taseer Hadi & Company Chartered Accountants. Mr. Omer Morshed is the appointed actuary. The company is listed on Pakistan Stock Exchange.

The ratings assigned to EFUL take into account the company's sizable footprint and dominant market positioning in the private sector life insurance sector of Pakistan as evident from market share, based on gross written premium, of 14.7% at end-March'21. The rating is underpinned by strong shareholding, sustenance of business volumes, experience and stability in the senior management profile and sound governance framework. Slight dip in persistency levels was recorded during the outgoing year; decline was posed by the pandemic impacting the agent-client interface. Recovery of persistency levels to pre-pandemic levels would remain important from a rating perspective.

Financial risk profile of the company remains strong and within the assigned rating criteria despite recent market volatility; the increase in the claims ratios during the review period was a function of onslaught of Covid-19 given pandemic is covered under life insurance for existing policies. In addition, the rating takes into account the company's strong capitalization in respect to nature of risks underwritten. Liquidity profile is also sound as liquid assets, largely comprising government securities, provide adequate coverage against the company's liabilities. The rating further factors in reinsurance arrangements with counterparty having sound credit risk profile with appropriate risk retention on net account to maintain risk appetite of the company. Expense reduction initiatives and general favourable operating performance of EFUL's core business lines, particularly new business generation, will remain key rating drivers. The management envisages that the current mix of equities and fixed income in the investment portfolio is positioned to provide competitive returns to policyholders coupled with supporting new customer acquisition and enhancing customer stickiness. Moreover, improvement in market share and a demonstrated ability to scale up business volume with a diversified and profitable product mix would remain key rating sensitivities.

<u>Key Rating Drivers</u>

Despite an uncertain economic and political landscape along with a hit to the insurance industry on account of emergence of pandemic, EFUL has maintained its market share during the review period: Over the years, growth in life insurance industry has largely been a function of economic activity in the country, depicting a sizable over the last five years, mainly in unit linked business. Given life insurance penetration in Pakistan remains on the lower side, growth in gross premiums is expected to continue in the medium to long-term, although the rate is expected to be slightly stunted in line with uncertainty in economic environment. Further, with an increase in number of market participants, specifically Takaful windows initiated by conventional players coupled with structural improvements and new product development by the state-owned competitor, there is stiff market competition involving product features and pricing. Despite the challenging operating landscape, EFUL was able to slightly increase its market share to 14.7% (FY20: 14.1%; FY19: 14.6%) on gross written premium (GWP) and 14.4% (FY20: 13.9%; FY19: 14.5%) on net written premium (NWP) at the end of 1QFY21. As per the management, the first half of the outgoing year was severely impacted due to stressed economic activity owing to covid crisis; however, the company made a significant recovery in generating revenue during second half of the year and reported GWP of 32.5b (FY19: Rs. 31.8b) by end-FY20. Bancassurance was impacted to a greater degree due to limited banking activities during the second and third quarter of FY20, while the Agency Sales Force (ASF) was able to make a positive recovery towards end of outgoing year.

In line with historical trends, growth in premium was largely contributed by its regular premium policies. Given the positive relationship between development of life insurance and economic growth per capita and recent general economic indicators in the country, growth in Gross Written Premium is expected to remain modest around 8% for FY21; the management has projected to close the ongoing year at Rs. 35.0b. The company is on track of meeting the projected target given GWP of Rs. 9.1b was recorded for 1QFY21.

in Rs. Millions	FY17	FY18	FY19	FY20	1Q21
Gross Premium	31,499.5	30,790.4	31,750.1	32,545.7	9,114.4
First Year	*5,340.1*	*6,845.9*	*6,999.8*	*6213.8*	*1,640.1*
Second Year	*3,243.2*	*4,267.4*	*5,084.0*	*5,122.9*	*1,230.3*
Subsequent Years	*11,810.0*	*14,067.3*	*15,369.4*	*17,388.2*	*5,034.0*
Single Premium	*8,263.8*	*2,588.9*	*950.8*	*620.0*	*196.8*
Group Policies	2,842.4	3,020.9	3,346.1	3,200.8	1,013.3

Similar to previous years, business mix of the company has been largely contributed by regular premium policies, a critical indicator of customer satisfaction, followed by group life and single premium policies. Individual life new business was impacted by COVID-19 lockdowns as distribution channels were unable to reach out to prospective new clients. Moreover, given the volatile market conditions there was lower demand for single premium products across the industry. Further, there is a decline in group premium as well given uptick in the product is directly correlated with economic indicators. In times of economic growth organizations tend to spend more on employee welfare; however, the same is first to be cut down during challenging dynamics. Given the economic statistics are gradually improving post pandemic jolt, growth is likely to be manifested in group policies. SECP is advocating the concept of "compulsory life insurance coverage" of workforce for every organization having more than 10 employees and has submitted proposals to the relevant ministry in this regard in the last few years, however no decision has been finalized yet. Given a positive outcome on the same is achieved, management is hopeful the segment would witness growth of over 20%. Although conventional business remains the primary revenue driver, the company also demonstrated its strength towards diversification, and achieved growth in the Window Takaful Operations (WTO) during FY20. The increase in demand for Islamic financial products over the years has also benefited the company's takaful line of business. The individual family takaful new business was recorded at Rs. 2.0b (FY19: 1.8b), while renewal contribution amounted to Rs. 2.8b (FY19: Rs. 1.9b) recording a high growth of 46%. Overall, EFUL expects its takaful line to exhibit growth trajectory during the ongoing year.

Persistency reduced during the period under review: The company has various distribution channels for its two main lines of businesses; individual life and group life. For the former, EFUL utilizes the ASF and Bancassurance channels; individual life branch network of 278 locations, spread across the country while for Bancassurance, the company has partnership with 17 banks. Moreover, for the mass market and inclusive insurance segments, the company has inked agreements with 30 partners. In addition, given growth prospects of WTO segment, EFUL has established geographical footprint with 92 branches and dedicated agency sales force of over 1,500 agents. In both ASF and Bancassurance channels, given the recovery trend in FY21, the management expects double digit growth based on GWP. Further, in new business generation the higher contribution was from ASF at 53% while in renewal business both ASF and Banca had equal contribution. Going forward, management expects that the optimal mix for revenue generation for ASF and Banca to be at 50:50 in the medium to long term. With relatively lower growth of the industry, persistency remains a key profitability driver for the life insurance market players; EFUL reported slightly lower persistency level of 82.5% (FY19: 83.8%) during FY20. The persistency levels for ASF remain range bound and comfortable owing to stringent controls on indicators for maintaining persistency. EFUL has a setup for retention activities, for both ASF and Banca, so the persistency levels are expected to improve in the medium term

Conventional – 2020						
Persistency	Total		Sales Force		Bancassurance	
	Number of cases	Premium	Number of cases	Premium	Number of cases	Premium
2nd Year	71.2%	79.1%	68.1%	78.6%	74.3%	79.5%
3rd Year Onwards	81.1%	83.4%	81.7%	85.9%	80.3%	80.6%
Overall	79.3%	82.5%	80.0%	84.6%	79.0%	80.3%
Takaful – 2020						
2nd Year	68.1%	73.5%	53.6%	63.7%	76.4%	78.8%
3rd Year Onwards	80.8%	81.7%	77.4%	82.3%	82.1%	81.4%
Overall	74.9%	77.9%	64.9%	72.7%	79.7%	80.3%

Conventional – 2019						
Persistency	Total		Sales Force		Bancassurance	
	Number of cases	Premium	Number of cases	Premium	Number of cases	Premium
2nd Year	74.7%	81.4%	73.8%	83.5%	75.4%	79.9%
3rd Year Onwards	83.2%	84.6%	84.0%	86.9%	81.9%	81.5%
Overall	81.4%	83.8%	82.4%	86.3%	80.1%	81.1%
Takaful – 2019						
2nd Year	75.2%	79.2%	66.3%	75.8%	78.3%	80.2%
3rd Year Onwards	82.0%	82.1%	80.8%	84.2%	82.7%	81.0%
Overall	78.3%	80.5%	74.2%	80.5%	80.1%	80.6%

Product line extensions contributing to diversification: The company over the last few years has emerged as an active player in the micro and inclusive insurance arena, and plans to continue introducing new products and explore further alternative channels, including digital sales. EFUL consolidated its product range by adding to its list 14 new products launched during the outgoing year offered for sales force, bancassurance, micro finance banks and digital platforms. The daily insurance cover product was rolled out in collaboration with telecommunication companies providing micro and nano insurance cover during the year to an additional 1 million lives; the geographical reach of the product is widespread with potential customers around 100 million. The product is majorly targeted towards lower income group of the population; the product's major purpose has a sizable social aspect with higher focus on number of lives insured instead of revenue generation.

High attrition rate in ASF business line: In these challenging times, the company continues to focus on improving the productivity indicators of its team. While the industry has a case average of 1 for an agent each month, EFUL, over the medium term, targets to have each of its sales agent an average of 2 policies per month. Currently, the case average for EFUL remained at 1 for its ASF and 2 for its bancassurance team. As per the management, case average in ASF remains low owing to high attrition of sale agents; the higher turnover ratio is inherent given the industry dynamics. The company has to go through continuous recruitment process to mitigate the risk of high attrition.

Increased efforts are being made on first year recruits in terms of training and motivation to improve retention levels.

EFUL continues to be supported by a strong international reinsurer with treaties remaining unchanged: Life insurance underwriting is based on sum assured applied for and age of the client according to which medical requirements (based on medical underwriting tables) are generated automatically. Underwriting guidelines are primarily worked from Munich Re Internet Risk Assessor. Reinsurance treaties along with commission rates for individual life and group business remain unchanged during the period under review. Reinsurance treaties have been arranged from Munich Re (rated 'AA-' by S&P and 'AA' by Fitch). Going forward, given growth in scale of operations and loss absorption capacity of Takaful segment, the management plans to increase its retention limit.

Increase in claims' ratios; however, the same was offset by decline in expense ratio, hence healthy profit recorded: The loss ratios were reported higher during the period under review in line with additional claims incurred due to onslaught of pandemic; as per the management the event is categorized as one-in-hundred years so could not be factored in pricing of products. During FY20, EFUL settled total death and disability claims of Rs. 3.9b (FY19: 3.1 billion), an increase of 23%. Out of this, individual life claims were recorded at Rs. 1.3b and group life claims amounted to Rs. 2.5b. Both lines of business have been impacted by death claims due to COVID-19, however the incremental claims are within the mortality fluctuation tolerance levels set by the Company. Further, the company has appropriate and adequate reinsurance arrangements in place to mitigate the impact of these additional pandemic related claims. On the other hand, expense ratio improved to 27.1% (FY20: 26.9%; FY19: Rs. 29.2%) on a timeline basis during the rating review period owing to reduction in acquisition expenses; the same was a function of various reasons including reduction in business volumes during first half of FY20 that led to remuneration slab adjustments, lower collaborative promotions with agent banks and reduced branch overheads as limited visits were being made due to pandemic crisis. The company recorded sizable net change in insurance liabilities amounting to Rs. 23.6b (FY19: Rs. 11.0b) during the outgoing year. However, the impact of the aforementioned was largely offset by net realized fair value gains amounting to Rs. 3.8b, stemming from realized gains on government securities and equity portfolio, reaped during FY20 as opposed to loss of Rs. 7.8b on stock market in the preceding year. Subsequently, the company was able to close FY20 with a healthy bottom line of Rs. 1.8b (FY19: 1.5b). The positive trend in profitability has continued in the ongoing year with after tax profit of Rs. 408.0m (1QFY20: Rs. 361.5m) recorded during 1QFY21; the same is a primary function of growth in topline. Risk absorption capacity of the company is considered sound on the back of a sizable equity base of Rs.6.2b (FY19: Rs. 5.9b) at end-FY20; however, owing to dividend payout of Rs. 1.1b during the ongoing year the equity base declined to Rs. 5.5b at end-1QFY21. Nevertheless, at present risk adjusted capitalization levels of the institution are considered sound in view of healthy capital coverage of claims.

The company maintains a healthy mix of investments; ability to generate sufficient investment income to support operations will remain a key rating driver: EFUL manages a total of seven unit linked funds; three of which have been dedicated to its Window Takaful business. The investment portfolio including term deposits exhibited an increasing trend; the same was reported higher at Rs. 144.4b (FY20: Rs. 142.4b; FY19: Rs. 116.1b) at end-1QFY21 with asset mix largely tilted towards fixed income securities primarily government securities. The increase on the other hand was manifested in equity market exposure recorded higher at Rs. 37.1b (FY20: Rs. 39.2b; FY20: Rs. 10.5b) given the management is optimistic about the operational prospects of the stock market. Going forward, the company will continue monitoring the stock market and adjust and rebalance its exposure whenever necessary, keeping in view the interest rate environment and stock market outlook. Given, majority of investment mix comprises government securities, credit emanating from the same is considered low in the local context. In addition, market risk is also manageable as the average duration of T-bills and PIB portfolio is 4.5 months and 18 months respectively. As per management, given limited avenues for Shariah compliant investments, growing

Takaful business is challenging in terms of investment opportunities; however, management has adopted an active management strategy with respect to its portfolio performance to generate superior returns compared to peers/other avenues. Going forward, while the insurance companies may earn capital gains on investments in higher rate government securities, generating consistent investment results and the ability to cater to varying risk appetites will remain key differentiating factors over the long term.

Significant focus and investment on Information Technology initiatives: EFUL considers technology to be a key enabler in all aspects of its business including front-end support to distribution channels and back-end process efficiency. The company is using advanced Enterprise Content Management technology from IBM Filenet to digitalize paper documents and automate its business processes and operational workflows. In the aspect of implementing new technology, the company deployed mobile app to facilitate sales force and clients; the same resulted in sizable cost saving and minimized call center query load. Moreover, the company has also initiated online premium collection; around 15% of the premium was collected online during FY20. Similarly, online claim payment has also been rolled out during the ongoing year where payout is electronically disbursed to the customer/beneficiary's account. During FY20, the company upgraded its branch network infrastructure in 108 locations to Smart Branch Infrastructure with centrally managed services to enhance user performance and better provision of services. Moreover, for critical branches, redundant fiber connectivity has been deployed to increase their uptime and manage their auto fail-over. On the front end, website and digital presence of the company were also upgraded. The data center is equipped with the latest technologies including virtualization, robotic tapes, flex technology, blade servers and SAN storage devices. EFUL maintained its data center's uptime at 99.7% during the outgoing year; the same is deemed critical as ensuring the uptime for the data center directly contributes to customer satisfaction and business profitability by preventing loss of sensitive information, service unavailability and compliance issues. The company installed fire suppression and detection system to protect its data center during the outgoing year. EFUL maintains two disaster recovery (DR) sites; data back-ups are taken on a daily basis. Additionally, DR plan was further strengthened with use of data guard and online transfer of data to DR site using fiber optic technology. Going forward, the focus is going to be on process efficiency and improving market penetration.

The company exhibited stability at the senior management level comprising qualified and experienced personnel; a dedicated and independent enterprise risk management function is in place: The rating considers the quality and stability of the company's senior management as well as the team comprising of experienced and qualified professionals which include (but are not limited to) insurance sales personnel, accountants, IT professionals, underwriters, medical doctors, lawyers, business management graduates and actuaries, to name a few. Currently, no critical position is vacant in the organization. In addition to this, EFUL has a dedicated and independent enterprise risk management (ERM) function. Risk management committee (RMC) meetings are held on quarterly basis and all groups are responsible for risk recognition, assessment and development of controls in their respective areas of operation with sufficient monitoring by ERM. Moreover, enterprise risk management and compliance will have additional focus over the next few years.

EFU Life Assurance Limited Appendix I

FINANCIAL SUMMARY					*(amounts in PKR millions)*
BALANCE SHEET	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Cash and Bank Deposits	6,057.9	4,786.4	5,713.5	5,335.1	6,417.2
Investments	97,959.1	105,820.6	116,065.3	142,432.1	144,405.9
Total Assets	110,238.0	116,764.6	129,289.6	154,479.9	157,006.7
Paid up Capital	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0
Net Worth	5,962.7	5,958.4	5,907.9	6,175.1	5,511.5
Liabilities of Statutory Fund	103,582.51	107,695.8	119,153.7	143,513.0	146,008.3
INCOME STATEMENT	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Gross Premium Written	31,499.5	30,790.4	31,750.1	32,545.7	9,114.4
Net Premium Revenue	30,759.7	30,164.3	31,141.6	31,653.3	8,727.2
Net Claims	14,828.7	13,589.8	15,677.4	17,860.7	5,880.1
Net Investment Income	(3,605.5)	6,942.4	11,589.1	11,468.6	2,780.0
Profit Before Tax	2,680.8	2,282.9	2,354.2	2,527.2	570.4
Profit After Tax	1,812.4	1,546.3	1,549.3	1,784.2	408.0
RATIO ANALYSIS	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Overall Cession Ratio (%)	2.3	2.0	1.9	2.7	4.2
Persistency (%)	85.7	86.0	83.8	82.5	76.0
Gross Claims Ratio (%)	48.1	45.1	50.8	57.1	67.3
Net Claims Ratio (%)	46.1	43.4	50.3	56.4	67.4
Expense Ratio (%)	23.0	27.7	29.2	26.9	27.1

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

RATING SCALE & DEFINITIONS: INSURER FINANCIAL STRENGTH

AAA
Highest capacity to meet policyholder and contract obligations; Risk factors are negligible.

AA+, AA, AA-
Very high capacity to meet policyholder and contract obligations; However, risk is modest, but may vary slightly over time due to business/economic conditions.

A+, A, A-
High capacity to meet policyholder and contract obligations; Risk factors may vary over time due to business/economic conditions.

BBB+, BBB, BBB-
Adequate capacity to meet policyholder and contract obligations; Risk factors are considered variable over time due to business/economic conditions.

BB+, BB, BB-
Marginal capacity to meet policyholder and contract obligations; Risk factors may vary widely with changes in business/economic conditions.

B+, B, B-
Low capacity to meet policyholder and contract obligations; Risk factors are capable of fluctuating widely with changes in business/economic conditions.

CCC
Very low capacity to meet policyholder and contract obligations; Risk may be substantial.

CC
Weak capacity to meet policyholder and contract obligations; Risk may be high.

C
Very weak capacity to meet policyholder and contract obligations; Risk may be very high

D
Extremely weak capacity to meet policyholder and contract obligations; Risk is extremely high.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

REGULATORY DISCLOSURES					**Appendix III**
Name of Rated Entity	EFU Life Assurance Limited				
Sector	Insurance				
Type of Relationship	Solicited				
Purpose of Rating	Insurer Financial Strength				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: INSURER FINANCIAL STRENGTH				
	9/03/2021	AA+		Stable	Reaffirmed
	8/21/2020	AA+		Stable	Reaffirmed
	3/15/2019	AA+		Stable	Reaffirmed
	11/30/2017	AA+		Stable	Reaffirmed
	5/24/2016	AA+		Stable	Upgrade
	3/10/2015	AA		Stable	Reaffirmed
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.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Copyright 2021 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meetings		**Name**	**Designation**	**Meeting Date**	
	1	Mohammed Ali Ahmed	Chief Strategy Officer	June 15, 2021	