RATING REPORT

EFU Life Assurance Limited

REPORT DATE:
December 29, 2023

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating	Previous Rating
Rating Category	**Long-term**	**Long-term**
IFS	AA++(IFS)	AA++(IFS)
Rating Date	*December 29, 2023*	*December 30, 2022*
Rating Outlook	Stable	Stable
Rating Action	Reaffirmed	Reaffirmed

COMPANY INFORMATION

Incorporated in 1992	**External auditors:** M/s EY Ford Rhodes
Public Limited Company	**Chairman of the Board:** Mr. Rafique R. Bhimjee
Key Shareholders:	**Chief Executive Officer:** Mr. Mohammad Ali Ahmed
EFU General – 46.32%	
Jahangir Siddiqui & Co. Limited – 20.05%	
Syed Salman Rashid – 10.03%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Life Insurance Family Takaful (Oct 2023)
https://docs.vis.com.pk/docs/LifeTakaful-Oct-2023.pdf

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

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 2022 were audited by EY Rhodes Chartered Accountants. Mr. Omer Morshed is the appointed actuary. The company is listed on Pakistan Stock Exchange.

The rating assigned to EFU Life Assurance Limited (EFUL) takes into consideration the Company's dominant market position in the private life insurance industry. The rating also derives support from strong sponsorship profile comprising of the EFU Group, Pakistan's largest insurance conglomerate, and also considers the quality and stability of the Company's senior management. In addition to this, EFUL has a dedicated and independent enterprise risk management (ERM) function that ensures sound risk recognition, assessment and development of controls in respective areas of operation. EFUL, over the years, has built sizable capital buffers to overcome the decline in the business activity due to weak macro-economic conditions, particularly in the individual life first-year business, over the rating review period. Additionally, the persistency levels, in line with industry trends, have also depicted a downtrend in the ongoing year. However, despite higher claims ratio, the bottom-line performance was supported by sizeable uptick in investment income generated from debt instruments as the overall investment portfolio is largely tilted towards the same amidst the high policy rate scenario. The rating also incorporates sound reinsurance arrangements with renowned international reinsurers with appropriate risk retention on net account to maintain risk appetite of the Company. Moreover, with sufficient available liquid assets along with adequate capital coverage of claims, liquidity and capitalization levels remained satisfactory. Going forward, improvement in the underwriting performance, particularly by restricting policy surrenders and uplifting business volumes in the individual segment, will be important from a rating's perspective.

Key Rating Drivers

Insurance Sector Update

Global Perspective

Despite building macroeconomic challenges, the insurance industry continued to grow in FY22, both globally and in Pakistan. Global insurance industry faced repricing of risks due to macroeconomic stresses and natural catastrophes with economic losses from natural disasters recorded higher in FY22; however insured losses covered 45% of these damages amounting to USD 125 billion. However, elevated interest rates augmented the investment income for insurers across the globe.

Local Perspective

Pakistan's insurance industry posted growth despite weak macroeconomic situation in CY22 with continued dominance of Life Insurance & Family Takaful segments in terms of assets and gross premiums. Gross premiums increased from Rs. 417.2 billion in CY21 to Rs. 531.7 billion in CY22 with Life & Family Takaful segment, and Non-Life & General Takaful segments posting increases of Rs. 81.9 billion and Rs. 29.4 billion respectively. Moreover, the industry's asset base grew by 14.8% in CY22 to Rs. 2,459.9 billion particularly on the back of significant growth in the Life Insurance segment. Moreover, despite building macroeconomic pressures characterized by dwindling foreign reserves, stabilization measures, slowdown in economic activity, etc. along with catastrophic floods affecting one-third of the country during the year under review, all segments of the industry continued to expand. This was the result of a combination of general factors affecting the whole insurance industry such as inflation leading to a rise in premium rates and idiosyncratic factors pertaining to all segments. The growth in Life Insurance segment was an outcome of the implementation of the government's health insurance programs carried out by State Life; the same increased health coverage to the low and middle-income strata of society. However, the claims ratio for the sector witnessed an increase due to a rise in group claims and higher surrender claims by individuals. Nevertheless, since life insurers maintain most of their investments in government securities due to lackluster performance of capital market, the resulting higher investment income boosted their profitability due to hike in interest rates. In non-life insurance sector, motor premiums drove the growth in net premiums as the cost of motor vehicles increased drastically during the outgoing year. However, torrential rains and flooding, some major fire incidents, and higher cost of repairing fixed assets contributed to the larger increase in claims. Accordingly, financial performance indicators for the non-life sector slightly weakened on a timeline. Further, the industry's combined ratio increased in CY22, which was driven by a spike in both net claims and expense ratios. With the increase in

combined ratio, insurers are expected to reprice their products in the ongoing year. Going forward, due to the prevailing slowdown in economic activity and stressed macro financial conditions, the growth trajectory in non-life premiums is expected to be uncertain while the growth in the life sector will continue to largely depend on traction in the health insurance programs. Moreover, the SECP has issued instructions of phase wise implementation of IFRS 17. The implementation is expected to translate in sizable provisioning burden for the industry; however, the actual impact of the same on industry capitalization is yet to be ascertained. The SECP has issued the deadline of 1st January, 2026 to complete the implementation of IFRS 17.

Future Outlook

Globally, it is expected that there will be premium rate hardening in CY23 in response to the high inflation, geopolitical tensions, natural catastrophes and financial market losses of CY22. These global insurance developments will lead to increases in reinsurance rates offered by international re/insurers which coupled with the exchange rate depreciation, may lead to increase in reinsurance expense for insurers in EMDEs, particularly non-life insurers that have extensive reinsurance arrangements with international reinsurers. The rate hardening along with the elevated policy rate is expected to influence insurers' financial performance in the near term. Global premiums are expected to grow at 2.1% in real terms on average in 2023. Given that nonlife insurance is correlated with economic growth and the latest data indicates that Pakistan's economy will significantly slowdown in 2023, accordingly the growth trajectory of non-life premiums in Pakistan could also face pressures. Moreover, if inflation remains elevated, then there could be further rate hardening leading to an uncertain growth trajectory for non-life premiums. Furthermore, in the backdrop of elevated interest rates, non-life insurers may also consider recalibrating their investment portfolios in order to pad the bottom-line. Life insurance business, with a longer time horizon, is expected to remain relatively immune to the prevailing macroeconomic pressures. The growth in this sector is now partially dependent on the continuity of the government's health insurance programs.

Source: Financial Stability Review – 2022 | State Bank of Pakistan

Business Update

The Company's topline decreased by 10.7% on an annualized basis during 3QCY23, amounting to Rs. 26.5b (CY22: Rs. 39.6b, CY21: Rs. 37.4b) largely due to decline in individual life new business. The same is a result of erosion of disposable incomes in line with steep inflation coupled with the already minimal penetration of life insurance in the local market. Additionally, the availability of alternative investment products offering competitive returns amidst the high interest rate environment further discouraged the adoption of unit-linked insurance policies. Moreover, the weakening in macroeconomic conditions also resulted in the quantum of surrenders increasing, reflected in the decline in renewal premiums in absolute terms by 8.3% on an annualized basis during 3QCY23. Consequently, overall persistency levels dipped over the rating review period to 76.85% (CY22: 81.4%, CY21: 86.9%) which is expected to impact the topline moving forward. On the other hand, the group segment exhibited a timeline increase in the business mix as corporate entities were better placed to absorb inflation adjustments to premium prices. However, the overall decrease in topline performance resulted in light of loss of market share at end-June'30, standing at 29.1% (CY22: 31.6%, CY21: 29.7%). The management projects the topline to reach CY22 levels at end-Dec'23, driven largely by renewal premiums emanating from the group segment during 4QCY23 in line with cyclical trends. However, going forward, given that macroeconomic conditions are expected to remain depressed in the medium-term, topline growth is anticipated to be limited, particularly in the individual segment. Consequently, the business mix is projected to continue to tilt towards the group division. Breakdown of business mix can be seen below:

Business Mix	**2021**	**2022**	**3QCY23**
Individual Policies	**90.2%**	**86.0%**	**84.0%**
First Year	20.8%	17.9%	13.4%
Second Year	12.0%	13.5%	12.8%
Subsequent Years	54.5%	52.8%	55.3%
Single Premium	2.8%	1.8%	2.5%
Group Policies	**9.8%**	**14.0%**	**16.0%**
Total Policies	**100.0%**	**100.0%**	**100.0%**

EFUL has an extensive branch network consisting of 320 locations spread across the country. However, the management aims to consolidate its outreach in order to reduce cost inefficiencies and boost profitability,

having already closed about 10-15 branches during the ongoing year. On the other hand, the management aims to expand its presence in the northern areas, particularly KPK, through its Window Takaful offerings given the social preference toward Shariah-compliant products in the region. Moreover, in terms of sales channels, there is an even split in individual gross premium generated between the Company's direct sales force and bancassurance arrangements. As per management, this trend is expected to continue in the medium to long-term as the Company relies notably on its partnerships across 15 banks to capture market share, particularly given the absence of a captive bank.

Moreover, EFUL's presence in the mass market and inclusive insurance segments have expanded on a timeline basis, providing coverage to an additional 3 million people during CY22. The Company has established 37 partnerships with various firms including telecommunication companies, branchless banks, microfinance institutions and technology platforms in order to provide small-ticket size, affordable insurance products to the general public. Additionally, an in-house tele-sales team was established during the ongoing year in order to boost penetration of microinsurance offerings. As per management, this division has contributed around Rs. 500m in gross premium during CY23 and is projected to grow to Rs. 1b over the next five years. While these developments are viewed positively, the weakened macroeconomic environment coupled with limited public awareness and willingness are significant hurdles constraining the expansion of the microinsurance product portfolio.

Profitability performance

The recent performance of the Company's claims has been impacted primarily due to increased policy surrenders in the period. However, death claims have remained consistent relative to the total in-force business. The elevated policy surrenders among individual life clients can be partially attributed to macroeconomic challenges. Despite a 15.3% annualized decline in acquisition expenses to Rs. 5b (CY22: Rs. 7.9b, CY21: Rs. 7.9b), in line with lower commission charges due to slowdown in business activity for first-year policies, slight uptick in the expense ratio to 28.7% (CY22: 27.2%, CY21: 28.2%) was exhibited. The aforementioned increase in expense ratio largely emanated due to decline in net insurance premium on an annualized basis coupled with increase in management expenses to Rs. 2.3b (CY22: Rs. 2.5b, CY21: Rs. 2.3b) owing to inflationary pressure, particularly manifesting in employee benefits. However, with cyclical uptick expected net premium during the ongoing year owing to group policy renewals, the expense ratio is anticipated to moderate by end-CY23. As a result of significant increase in claims ratio (including surrenders), combined ratio (including expense ratio) was recorded over 100% indicating the Company reported deficit from underwriting operations during the ongoing year. Moreover, net change in insurance liabilities grew sizably to Rs. 16.8b (CY22: Rs. 14.2b, CY21: Rs. 8.4b) on the back of upward revisions in premium prices for individual unit-linked policies. Additionally, net realized losses on financial assets amounting to Rs. (2.4b) (CY22: Rs. 207.8m, CY21: Rs. 2.2b) further impacted the bottom-line. Nonetheless, the same was largely offset by an appreciable uptick in investment income to Rs. 23b (CY22: Rs. 19.2b, CY21: Rs. 11.9b) due to higher returns generated from fixed income instruments amidst the high policy rate environment along with net unrealized gains on financial assets amounting to Rs. 4.0b as opposed to net losses at fair value in the preceding two years (CY22: (Rs. 5b), CY21: Rs. (6.7b)). Consequently, healthy profit after tax was reported at Rs. 1.4b (CY22: Rs. 1.7b, CY21: Rs. 1.5b) at end-Sept'23. Going forward, the ratings will remain sensitive to the Company's ability to bring down the loss ratios to manageable levels by arresting policy surrenders.

Reinsurance

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. Reinsurance treaty terms for individual life and group business remain unchanged during the period under review. However, change in the reinsurance panel has been witnessed during CY23 with Hannover Re (rated 'AA-' by S&P and 'A+' by A.M. Best) replacing Munich Re (rated 'AA-' by S&P and 'A+' by A.M. Best) in the conventional individual treaties, specifically, in the unit-linked business, additional illness cover and additional accidental death & disability segments. In the individual Takaful treaties, Munich Re Takaful was replaced by Hannover Re Takaful Bahrain across all segments. Moreover, in the group business, 20% share was taken up by Swiss Re during the ongoing year as opposed to full 100% parked with Hannover in the preceding year. As per management, the aforementioned changes in the reinsurance panel were instituted on account of better commission rates for new policies. Nonetheless, the overall risk profile of the panel remains robust as the ratings of all the reinsurers are within the 'A' band or higher.

Investments

The Company manages a total of eight unit-linked funds which vary in terms of investment avenues as per the risk appetite of the clients; three of which pertain to Window Takaful business. A new fund was introduced during CY22, namely, the Income Growth Fund, which is vested primarily in government securities and bank deposits to offer risk-averse clients competitive returns amidst the high interest rate environment. The overall investment portfolio expanded to Rs. 178.3b by end-Sept'23 (CY22: Rs. 164.6b, CY21: Rs. 150.9b), exhibiting a timeline shift toward government securities on account of the management's conservative approach, volatile stock market performance and policy rate hikes. Over the rating review period, investment in government securities were notably redirected from long-term PIBs toward short-term T-Bills; tenor of PIBs range from 2-20 years with returns between 7.0-22.88% while T-Bills constitute of 3M and 12M securities with returns between 15.67%-21.99%. Consequently, as the average duration of the government security mix decreased, the associated price and reinvestment risk was moderated amidst rising policy rates; the same is viewed positively particularly since the majority of the government instruments are available-for-sale, reducing impact of mark-to-market losses. Investment in government Ijarah sukuks also witnessed an uptick to Rs. 17.1b (CY22: Rs. 10.5b, CY21: Rs. 4.7b) with 5-year tenor and returns between 8.37%-22.68%. Remainder of government securities were vested in Pakistan Energy Sukuks amounting to Rs. 1.5b (CY22: Rs. 1.5b, CY21: Rs. 1.5b). Equity investments exhibited a decline on a timeline basis to Rs. 14.6b at end-Sept'23 (CY22: Rs. 20.2b, CY21: Rs. 31.9b) owing to the volatile stock market performance in line with macroeconomic deterioration; about Rs. 457.2m pertained to associated companies, namely, Jahangir Siddiqui and Company Limited (JSCL) and EFU General Insurance Limited (EFUG). The Company's investments in term deposits have also depicted a decrease over the rating review period, standing at Rs. 10.6b at end-Sept'23 (CY22: Rs. 14.4b, CY21: Rs. 24.4b) as the same was channeled largely into government securities. Debt securities, on the other hand, increased to Rs. 8.6b (CY22: Rs. 8.3b, CY21: Rs. 5.9b) manifested mainly in TFCs. The remainder of the investment portfolio constituted of mutual funds amounting to Rs. 2.9b (CY22: Rs. 391.1m, CY21: Rs. 1.5b). Given that the investment mix was dominated by government securities, the associated credit risk is considered low. Going forward, the management aims to increase the average duration of its debt portfolio by focusing on long-term fixed income instruments as policy rates are expected to slide down from May'24 following stabilization of macroeconomic indicators and positive developments in the IMF program. Additionally, given the long-term horizon of the client-base, the management is monitoring the stock market in order to rebalance its equity portfolio.

	CY21	CY22	3QCY23
Equities	21.1%	12.3%	8.2%
Gov Securities	57.9%	73.7%	79.4%
- PIBs	*53.5%*	*32.9%*	*28.5%*
- T-Bills	*0.3%*	*33.5%*	*40.5%*
- Pakistan Energy Sukuks	*1.0%*	*0.9%*	*0.9%*
- Government Ijara	*3.1%*	*6.4%*	*9.6%*
Debt Securities	3.9%	5.0%	4.8%
Term Deposits	16.2%	8.8%	6.0%
Mutual Funds	1.0%	0.2%	1.6%
Total	**100.0%**	**100.0%**	**100.0%**

Liquidity and Capitalization

Despite sizable profit generation during the review period, equity base only increased slightly to Rs. 6.4b (CY22: Rs. 6.4b, CY21: Rs. 6.2b) by end-Sept'23 on account of additional surpluses being paid out as dividends and dividend payouts were maintained on YOY basis culminating in aggregate dividend payout worth Rs. 2.9b during the rating review period. Nevertheless, overall risk absorption capacity of the Company is considered sound, in view of healthy solvency margin levels. However, as more liquid resources were utilized in meeting financial obligations in line with increase in claims payment to Rs. 24.0b (FY22: Rs. 26.2b; FY21: Rs. 24.1b) due to higher surrenders, liquid assets relative to total liabilities declined slightly on a timeline to 93.9% (CY22: 95.1%, CY21: 95.5%) by end-9MFY23; nonetheless, the same remained satisfactory in relation to the assigned rating.

FINANCIAL SUMMARY (amounts in Rs. mln)				
BALANCE SHEET	**CY20**	**CY21**	**CY22**	**3QCY23**
Cash and Bank deposits	5,335	4,608	4,559	5,897
Investments	142,432	150,902	164,633	178,347
Total Assets	154,480	163,180	178,514	195,398
Paid Up Capital	1,000	1,000	1,000	1,000
Net Worth	6,175	6,178	6,349	6,416
Liabilities of Statutory Fund	143,513	151,758	166,383	183,314
INCOME STATEMENT	**CY20**	**CY21**	**CY22**	**3QCY23**
Gross Premium Written	32,546	37,407	39,565	26,461
Net Premium Revenue	31,653	36,350	38,471	25,430
Net Claims	17,861	23,020	25,517	23,329
Investment Income	11,469	11,869	19,211	23,040
Profit Before Tax	2,527	2,142	2,842	2,823
Profit After Tax	1,784	1,508	1,692	1,369
RATIO ANALYSIS	**CY20**	**CY21**	**CY22**	**3QCY23**
Market Share (private life insurance)	29.0%	29.7%	31.6%	29.1%*
Cession Ratio	2.7%	2.8%	2.8%	3.9%
Gross claims ratio	57.1%	63.7%	66.6%	90.1%
Net claims ratio	56.4%	63.3%	66.3%	91.7%
Expense ratio	27.0%	28.2%	27.2%	28.7%
Combined Ratio	83.4%	91.5%	93.6%	120.5%
Persistency	82.5%	86.9%	81.4%	76.9%
Liquid Assets/Total Liabilities	95.3%	95.5%	95.1%	93.9%

*****_At end-June'23_

REGULATORY DISCLOSURES — Appendix II

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				
12/29/2023	AA++ (IFS)		Stable	Reaffirmed
12/30/2022	AA++ (IFS)		Stable	Reaffirmed
03/31/2022	AA++ (IFS)		Stable	Harmonized
8/04/2021	AA+		Stable	Reaffirmed
8/21/2020	AA+		Stable	Reaffirmed
3/15/2019	AA+		Stable	Reaffirmed
12/04/2017	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.
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Due Diligence Meetings

	Name	Designation	Meeting Date
1	Mohammed Ali Ahmed	Chief Executive Officer	December 8, 2023