RATING REPORT

EFU Health Insurance Ltd. (formerly Allianz EFU Health Insurance Ltd.)

REPORT DATE:
November 23, 2023

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Insurer Financial Strength	A(IFS)	A+(IFS)
Rating Date	*Nov 23, 2023*	*April 20, 2022*
Rating Outlook	Stable	Stable
Outlook Date	*Nov 23, 2023*	*April 20, 2022*

COMPANY INFORMATION	
Incorporated in 2000	**External auditors:** M/s EY Ford Rhodes, Chartered Accountants
Public unlisted Company	**Chairman of the Board:** Mr. Saifuddin N. Zoomkawala
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Kamran Ansari
EFU Services (Pvt.) Limited – 47.00%	
Mr. Jahangir Siddiqui – 33.82%	
Mr. Saifuddin N. Zoomkawala – 8.40%	
Mr. Rafique R. Bhimjee – 6.89%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: General Insurance (October 2023) *https://docs.vis.com.pk/docs/GeneralInsurance-2023.pdf*

APPLICABLE RATING SCALE(S)
VIS Issue/Issuer Rating Scale: *https://docs.vis.com.pk/docs/VISRatingScales.pdf*

EFU Health Insurance Limited (formerly Allianz EFU Health Insurance Ltd.)

OVERVIEW OF THE INSTITUTION

Incorporated in 2000, EFU Health Insurance (formerly Allianz EFU Health Insurance Ltd.) is a pioneer and one of the largest health insurers in Pakistan

RATING RATIONALE

EFU Health Insurance Limited (EFUH), formerly Allianz EFU Health Insurance Limited, is principally engaged in the provision of health insurance products catering to both individuals and corporate customers. The Company underwrites business under three broad categories: group business, individual business-bancassurance and individual business-consumer sales. The revision in the assigned rating factors in weakening in the financial risk profile over the rating review period. Given that high loss ratios are characteristic of the health insurance industry, the overall combined ratio of the Company has remained on a higher side in comparison to peers; the same has also resulted in underwriting losses recorded on a timeline. During the ongoing year, uptick in net claims ratio in line with inflationary pressure coupled with increase in underwriting expense ratio largely stemming from downward revision in commission rates from reinsurers have further impacted underwriting performance. The bottom-line, however, was supported with improvement in investment income in conjunction with rising policy rates. The rating also takes into account the exit of the majority shareholder, Allianz SE, a Germany-based financial services provider and holding company of the Allianz Group (rated AA on the international scale). Nonetheless, the rating is underpinned by the sponsorship backing of the EFU Group, one of Pakistan's leading insurance providers, which has taken up the main equity stake.

Although EFUH maintains adequate risk profile in terms of reinsurance coverage; however, the same still remains limited as the local reinsurer is the sole reinsurance provider. Moreover, both operating and financial leverage indicators have dipped over the rating review period on account of greater business volume relative to expansion of equity. The equity base exhibited limited growth on a timeline as persistent underwriting losses restricted internal capital generation. On the other hand, the rating reflects adequate liquidity given close to full coverage of net technical reserves. Moreover, aging of claims is considered sound with no outstanding claims due for more than a year at end of the ongoing year. Going forward, the rating remains sensitive to improvement in underwriting profitability and leverage indicators while maintaining liquidity metrics.

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. In addition, claims increased as high inflation increased the cost of repairing buildings, motor vehicles and other fixed assets that are usually covered by insurance. This led to continued rise in premium rates to cover the expenses. 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. In addition, 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 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. No final timeline for the same is announced yet.

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 non-life 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 high 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

Key Rating Drivers:

Business Strategy

During CY22, the Company booked a sizeable 24.7% YoY increase in gross written premium (GWP) amounting to Rs. 3.2b (FY21: Rs. 2.6b) which is attributable largely to the incorporation of inflation adjustments to premiums. The Company's primary customer base constitutes of small to medium sized corporate clients therefore significant client concentration exists with top 20 exposures constituting 51.6% of GWP. However, going forward the management plans to expand the individual segment owing to its lower loss ratio by broadening its bancassurance partnerships. The uptrend in the topline also continued during the ongoing year with the Company booking GWP of Rs. 2.3b during 1H23. The management plans to close FY23 with a GWP of Rs. 4.0b; the target seems realistic and achievable as Rs. 3.3b was booked till 10th Sep, 2023. Nevertheless, despite the increasing trend witnessed, the management plans to continue with cautious underwriting approach to rationalize increasing claim ratios. Annualized breakdown of growth in GWP can be seen below:

CY20	CY21	CY22	1HCY23
2,360.6	**2,578.1**	**3,215.1**	**2,255.9**
-0.9%	9.2%	24.7%	40.3%*

Annualized

While the Window Takaful Operations (WTO) also depicted an uptick during the outgoing year to Rs. 44.5m (CY21: Rs. 34.1m) in line with inflation adjustments to wakala fees, an annualized decline in the same to Rs. 21.4m was witnessed during 1HCY23. According to management, the decline was primarily an outcome of deliberate discontinuation of loss-making clients. Going forward, the management expects limited expansion of WTO contributions owing to higher loss ratios and restricted investment avenues for underwriting earnings.

Underwriting Performance

Given high claims ratio is a characteristic of the healthcare insurance segment, the Company has posted consistent underwriting losses on a timeline post FY20 as evident from combined ratio recorded over 100%. The combined ratio depicted a slight improvement to 103.5% during CY22 (CY21: 105.6%) owing to reduction in the loss ratio following lower COVID-related claims, offsetting increase in underwriting expenses resulting from inflationary pressure. However, during 1HCY23, underwriting performance weakened with increase in underwriting loss recorded at Rs. 136.4m due to uptick in both claim incurrence and underwriting expenses. The underwriting writing expenses increased to Rs. 256.6m *(if annualized)* (FY22: Rs. 397.5m; FY21: RS. 332.0m) owing to a combined impact of inflationary commodity super cycle experienced coupled with net commission income switching to net commission expense during the ongoing year. The net commission expense incurred was a function of reduction in commission income despite growth in business volume and largely constant cession ratio owing downward revision of commission rates from 15% to 12% by the sole reinsurer in line with weakening in macroeconomic conditions. The management plans to rescue to the aforementioned downward trend from impacting bottom line further by reducing the commission rates offered to sales agents. Given that this rectification strategy could result in lower business volumes, the Company plans to leverage the extensive branch network of the EFU Group to drive underwriting activity, mitigating the associated risk of diminishing market share. Despite increase in combined ratio on a timeline during the review period, the net operating ratio largely remained unchanged at 100.1% (FY22: 96.0%; FY21: 100.7%) at end-1HCY23 owing to growth in investment income witnessed.

Reinsurance treaties remained unchanged with a single local reinsurance company: Along with steady growth over the years, EFUH maintained an adequate risk profile. There was no change in the reinsurance panel or treaties during the rating review period with Pakistan Reinsurance Company Limited (PRCL) being the sole reinsurer. The ratings derive comfort from the pro-rata,

quota share treaty inked with a 65% retention rate. However, the commission rate receivable was scaled down to 12% during the ongoing year as opposed to 15% in the preceding year; the decline is attributable to the sharp dip in the country's macroeconomic environment coupled with the traditionally high claims ratio within the health insurance segment. Enhanced focus on underwriting quality is expected to result in a healthy bottom line over the rating horizon.

Investments

The investment portfolio augmented on a timeline during the period under review largely owing to higher investment in government securities primarily Treasury Bills (T-Bills). The T-bill portfolio majorly comprised of 3-month tenor securities with profit rate ranging between 21.85% to 21.99%, therefore the market risk originating from the investment portfolio is manageable given repricing is carried out every quarter on maturity. Moreover, the PIB portfolio amounting to meager Rs. 59.4m (FY21: Rs. 750.4m) at end-FY22 matured in Aug'23. The remainder of the investment portfolio constituting less than 2% consisted of equities; the stock market exposure continued to remain minimal owing to volatility experienced coupled with prevailing high interest rates that make investment in fixed income more lucrative. Subsequently, with majority of portfolio vested in government securities the credit risk is negligible. Underpinned by growth in investment portfolio along with high policy rates, the investment income exhibited upward trajectory during the rating review period; the same was recorded at Rs. 125.4m (FY22: Rs. 129.9m; FY21: Rs. 73.4m) during 1HCY23. With persistent underwriting losses registered, sufficient generation of investment income is vital to support bottom-line of the Company in the medium term. Going forward, the management's plan is to continue with the same investment strategy with primary focus on short-tenor government securities as opposed to the uncertain equity market to mitigate both credit and price risk. Breakdown of investment portfolio can be seen below:

(Rs. In mlns)	CY20	%	CY21	%	CY22	%	1HCY23	%
Government Securities	809.0	99.3%	730.2	96.0%	1,090.7	98.5%	1,335.6	98.7%
Equities	5.8	0.7%	30.1	4.0%	17.1	1.5%	17.3	1.3%
Total	**814.8**	**100.0%**	**760.3**	**100.0%**	**1,107.8**	**100.0%**	**1,352.8**	**100.0%**

Liquidity Profile

Despite expansion of the investment portfolio, the liquidity position in terms of liquid assets maintained in relation to net technical reserves exhibited a decline on a timeline to 92.3% (CY22: 108.1%, CY21: 95.5%) owing to jump in net technical reserves to Rs. 1.5b (CY22: Rs. 1.1b, CY21: Rs. 859.2m) mainly on the back of higher unearned premium reserves at end-1HCY23; however, the same still remains sizable. Moreover, the aforementioned liquidity indicator is expected to revert back to FY22's number by end of the ongoing year once unearned premium reserve is gradually realized as unearned premium has an element of cyclicality attached. Furthermore, the aging of claims was sound as no claims overdue for more than one year were outstanding at end-Dec'22. On the other hand, insurance debt to gross premium improved on a timeline to 12.2% (CY22: 9.5%, CY21: 13.4%) in the ongoing year; the aging of receivables is also satisfactory as no receivables from policy holders/reinsures were due for more than a year during the rating review period. Moreover, receivables aging schedule is considered healthy with only 0.4% of receivables due above 3 months at end-June'23.

Capitalization

The Company's Tier-1 equity depicted limited growth on a timeline to Rs. 623.1m (CY22: Rs. 621.2m, CY21: Rs. 545.2m) during 1HCY23 due to restricted internal capital generation on the account of persistent underwriting losses. Consequently, with the expansion of business volumes, the already high operating leverage further increased to 356.5% (CY22: 316.5%, CY21: 319%); the same suggests that the risk profile of the Company has elevated during the rating review period. Given, with no equity injection plan in the pipeline coupled with steady growth in operating scale, the operating leverage is likely to trend upward; the same already being higher than benchmarks can put pressure on ratings going forward. However, EFUH is considered sound from solvency risk point of view as the Company has adequate cushion in terms of total admissible assets over its liabilities. Additionally, financial leverage was also recorded higher on a timeline basis at 238.5% (CY22: 174.4%, CY21: 157.6%) at end-1HCY23 owing to uptick in net technical reserves on the back of higher unearned premium reserves. Similarly, adjusted financial leverage (inclusive of revaluation deficit) was recorder higher as well at 228.6% (CY22: 147.7%, CY21: 134.5%). However, after taking into account the impact of cyclicality on the same, the financial leverage level is expected to come within manageable range by end-CY23. Going forward, given that capitalization indicators remain on the lower side, enhancing profitability performance is considered critical from rating perspective.

EFU Health Insurance Limited (formerly Allianz EFU Health Insurance Ltd.) **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	31-Dec-19	31-Dec-20	31-Dec-21	31-Dec-22	30-Jun-23
Cash and Bank Deposits	30.4	88.1	62.5	65.1	21.1
Investments	594.2	814.8	758.3	1,105.9	1,351.1
Total Assets	1,741.2	1,918.6	1,865.3	2,280.4	3,034.0
Tier-1 Equity	446.6	591.3	545.2	621.2	623.1
Total Equity	446.6	590.9	532.4	620.2	620.4
Total Liabilities	1,741.2	1,327.7	1,333.0	1,660.2	2,413.6
INCOME STATEMENT	**CY19**	**CY20**	**CY21**	**CY22**	**1HCY23**
Net Premium Revenue	1,615.7	1,464.6	1,739.5	1,965.9	1,110.7
Net Claims	(1,493.6)	(1,097.4)	(1,504.6)	(1,636.3)	(990.5)
Underwriting Profit	(141.6)	61.6	(97.1)	(67.9)	(136.4)
Investment Income	64.7	97.5	73.4	129.9	125.4
Profit Before Tax	(47.8)	179.4	7.2	107.4	16.4
Profit After Tax	(73.3)	148.1	3.9	75.9	1.9
RATIO ANALYSIS	**31-Dec-19**	**31-Dec-20**	**31-Dec-21**	**31-Dec-22**	**30-Jun-23**
Market Share (Gross Premium)	2.5%	2.3%	2.3%	2.2%	2.7%
Cession Ratio	33.7%	34.1%	34.3%	34.6%	34.8%
Gross Claims Ratio	93.9%	76.1%	87.2%	83.8%	88.8%
Net Claims Ratio	92.4%	74.9%	86.5%	83.2%	89.2%
Underwriting Expense Ratio	16.3%	20.9%	19.1%	20.2%	23.1%
Combined Ratio	108.8%	95.8%	105.6%	103.5%	112.3%
Net Operating Ratio	102.7%	90.4%	100.7%	96.0%	100.1%
Insurance Debt to Gross Premium*	21.2%	15.2%	13.4%	9.5%	12.2%
Operating Leverage*	364.5%	247.7%	319.0%	316.5%	356.5%
Financial Leverage	197.6%	151.9%	157.6%	174.4%	238.5%
Liquid Assets to Adjusted Technical Reserves	71.3%	100.5%	95.5%	108.1%	92.3%

**Annualized*

REGULATORY DISCLOSURES					Appendix II
Name of Rated Entity	EFU Health Insurance Limited				
Sector	Insurance				
Type of Relationship	Solicited				
Purpose of Rating	Insurer Financial Strength Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Outlook**	**Short Term**	**Rating Action**
			RATING TYPE: IFS		
	11/23/2023	A(IFS)	Stable		Downgrade
	04/20/2022	A+(IFS)	Stable		Reaffirmed
	03/31/2022	A+(IFS)	Stable		Harmonised
	05/31/2021	A	Stable		Reaffirmed
	06/12/2020	A	Stable		Reaffirmed
	07/03/2019	A	Stable		Downgrade
	04/26/2018	A+	Stable		Reaffirmed
	09/19/2017	A+	Stable		Reaffirmed
	03/20/2017	A+	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.				
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 Conducted

	Name	Designation	Meeting Date
1	Mr. Nooruddin Jaffer Ali	Chief Financial Officer	Sept 9, 2023
2	Mr. Shaikh Nawabuddin	Senior Finance Manager	