SECTOR UPDATE

Non-Life Insurance

December, 2019

Insurance is an arrangement by which a company undertakes to provide a guarantee of compensation for a specified loss, damage, illness, or death to an entity or person in return for payment of a pre-determined premium price. Every business requires a different type of insurance policy to insure against specific types of risks faced.

Insurance in Pakistan

Out of the 54% that Pakistan's service sector contributes to the national GDP, insurance, along with transport, storage, communications and finance occupy almost one-fourth of the sector. During the fiscal year ended June 30, 2019, growth of Pakistan's Gross Domestic Product (GDP) depicted a slowdown as economic policies were formulated to address the twin deficits. Growth slowed to 3.3% in FY19 vis-à-vis 5.5% in the previous year. Over the past year, the exchange rate also depreciated with a cumulative depreciation rate of 25.5%. As a result, the services sector also depicted a lower growth rate of 4.7%, less by 1.5% compared to that in FY18.

Insurance in Pakistan is broadly classified into three business areas including life, general insurance and health insurance. The insurance industry in Pakistan is relatively small compared to its peers (excluding Bangladesh) in the region. Both insurance penetration and density remained very modest as compared to other jurisdictions while the insurance sector remained underdeveloped relative to its potential. Despite sizeable growth in gross premiums on a timeline basis, Pakistan has a nominal market share of 0.04% in the world market in terms of gross premiums from the general insurance industry. Similarly, insurance penetration (ratio of premium underwritten in a particular year to the GDP) and insurance density (premium per capita) of general insurance in the country remained on the lower side at 0.22% (2017: 0.27%) and $2.30 (2017: $3.93) respectively for 2018. As per key market players in Pakistan, there still lies significant room for business growth given these metrics.

Figure 1: Insurance Penetration

Source: World Bank

A primary reason for lower penetration and density levels of insurance in Pakistan is also related to the unIslamic image associated with the products. In order to address this religious matter, a number of conventional insurers in Pakistan launched window operations for providing Islamic insurance coverage. Moreover, insurance coverage in Pakistan is only bought when it is either mandatory by law or when it is a requirement by a specific lending institution. This is in vast contrast to other players on the global map who buy insurance as a necessity of life. Lower literacy rate has also contributed to negligible penetration levels in the region over the years as population based in rural areas still lack awareness of insurance products.

Given the ongoing regulatory initiatives related to Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), several modifications have also been made to the insurance related regulatory framework including directives related to financial security and transparency, code of good governance and sound market practice. The Pakistani insurance market has undergone major structural changes in last few years in line with the increased statutory requirement of minimum paid up capital. According to regulations issued in 2017, the regulator specified a minimum paid-up capital requirement of Rs. 500m for non-life insurers. Moreover, further changes in regulations also entail development of a risk management framework and maintenance of a risk based capital for insurance market players. General insurance market players will also need to abide by the new IFRS accounting standards which relate to booking losses related to all policies having a maturity of more than one year. As a result, there may be a greater impact on the company's underwriting liabilities with this standard.

At present, 29 general insurance companies operate in Pakistan which are further segregated into, (1)Takaful, and (2) Conventional. There are currently 2 dedicated Takaful operators. The market follows an oligopolistic structure with top three insurance companies contributing to almost 55% of total gross premiums written by the industry. Given that risk profile of different insurance companies varies considerably, we have accordingly divided these companies, on the basis of their relative market share, into three different categories: large (relative market share > 3.0x), medium (0.75x < relative market share < 3.0x) and small (relative market share < 0.75x). Relative market share is defined as 3-year average gross premium written by the company as a proportion of 3-year average gross premium written by the industry.

Large		***Small***	
1. EFU Insurance Company Limited	6.01x	10. Alfalah Insurance Company Limited	0.71x
2. Adamjee Insurance Company Limited	5.89x	11. TPL Insurance Limited	0.70x
Medium		12. Security General Insurance Company	0.68x
3. Jubilee Insurance Company Limited	2.74x	13. Allianz EFU Health Insurance Limited	0.63x
4. United Insurance Company Limited	1.51x	14. Habib Insurance Company Limited	0.40x
5. IGI General Insurance Limited	1.07x	15. Reliance Insurance Company Limited	0.35x
6. UBL Insurers Limited	0.96x	16. Sindh Insurance Limited	0.34x
7. Askari General Insurance Company	0.85x	17. Century Insurance Company Limited	0.34x
8. Atlas Insurance Limited	0.82x	18. Premier Insurance Limited	0.31x
9. East West Insurance	0.79x	19. SPI Insurance Company Limited	0.25x
		20. Pak-Qatar General Takaful Limited	0.20x
		21. Asia Insurance Company Limited	0.19x
		22. Chubb Pakistan Limited	0.14x
		23. Shaheen Insurance Company Limited	0.11x
		24. Takaful Pakistan Limited	0.08x
		25. Alpha Insurance Company Limited	0.04x
		26. Crescent Star Insurance Limited	0.04x
		27. Universal Insurance Company Limited	0.01x
		28. The Co-operative Insurance Society of Pakistan Limited	0.002x
		29. Excel Insurance Company Limited	0.001x

Business Underwritten

During the outgoing year, the non-life insurance sector in Pakistan has grown at a (CAGR) of 5.7% from period falling between 2015 to 2018, thereby reaching a cumulative total of Rs. 85.0b at end-2018. Growth in premiums has largely been a function of infrastructure projects. Overall insurance industry's fundamentals have improved during last three (3) years mainly on account of improvement in the law and order situation and improvement in political stability. However, in the backdrop of weakening economic indicators, ability to maintain these growth patterns may be challenging. Given the prevailing competition in the insurance market, there is significant pressure on premium rates as well. As a result, companies are expected to differentiate themselves through service quality while building up business volumes.

Rs. in millions	Large		Medium		Small		Total	
	2018	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
Gross Premium	39,167.2	45,053.8	30,039.7	17,319.9	15,840.7	15,281.8	85,047.6	77,655.5

General insurance industry in Pakistan is highly concentrated as large insurance companies account for almost half of the industry's gross premiums. While gross business of large and medium sized companies has increased during the outgoing year, premium size of smaller companies remained at similar levels on account of stronger competition amongst players. Increase in gross premiums was also on account of higher business volumes written under facultative arrangements. Given that large and medium players tend to retain an optimal level of premium on their net account, a significant proportion of business is generally retained on own books by smaller players. However, this trend has not been prevalent in the past two years given that most players are now focusing on building their motor business aggressively. With non-proportional treaties negotiated for the motor segment, a higher proportion of business must be retained on net account. Although such a business provides a cushion to its cash flows, motor segment incurs higher number of small quantum losses; the companies must ensure that their underwriting abilities are not compromised.

Rs. in millions	Large		Medium		Small		Total	
	2018	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
Net Premium	21,368.1	23,760.3	15,891.1	9,021.5	8,953.2	9,969.3	46,212.4	42,751.0
Cession Ratio	46.3%	43.3%	45.1%	44.2%	43.3%	43.7%	45.4%	43.6%

With conventional players working on building business through their window operations for Takaful covers, there is a greater level of awareness prevailing in the market for the product. Resultantly, independent Takaful players opine that this has aided them in improving business prospects. However, performance amongst Takaful players may primarily be defined once the participants are paid dividends from the surplus accounts. A key concept in Takaful business is that participants of a company are entitled to claims out of the Takaful fund. Any remaining surpluses, after making provisions for the likely cost of future claims and other reserves, belong to the participants in the fund and not the Takaful operator. Those funds may be distributed to the participants as cash dividends or distributions, or via a reduction in future contributions. To date, no Takaful company has paid such distributions.

Profitability

Rs. in millions	Large		Medium		Small		Total	
	2018	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
Net Claims Ratio	53.7%	54.1%	49.7%	46.2%	51.5%	48.8%	51.9%	51.2%
Expense Ratio	37.1%	35.9%	37.7%	37.2%	49.4%	54.7%	39.7%	40.5%
Combined Ratio	90.8%	90.0%	87.4%	83.3%	100.9%	103.4%	91.6%	91.7%
Net Income	3,410.3	4,837.9	3,136.2	1,617.0	1,404.6	1,409.7	7,951.1	7,864.5
ROAE	8.8%	9.8%	15.0%	13.0%	4.6%	4.5%	8.8%	8.4%

Similar to business volumes, large insurance companies cumulatively represent almost 42.9% of the sector's profits. Although their insurance related operations provide a significant support to the bottom line, their investment portfolios also generate healthy returns. Returns on investments of large companies are primarily contributed by exposures in the stock market. However, given current scenario of the stock market, funds with equity exposure are expected to subside to lower levels across the industry; ability to maintain positive returns to support underwriting operations may be challenging. Moreover, given limited avenues for Shariah compliant investments, building a profitable investment portfolio for Takaful players is also challenging.

Loss ratios for the conventional business have remained within manageable limits during 2018. However, there is still room for improvement across the industry for the Takaful business. Accounting for their relative expenses, medium sized insurers have a favorable combined ratio in comparison to the remaining market players. Going forward, trend in profitability indicators is expected to remain favorable for the prominent players while smaller sized insurers will need to focus on their underwriting abilities. Smaller companies have reported an underwriting loss for the past few years on account of significant losses retained on net account. Ability to maintain their performance metrics remains a challenge given the underwriting practices of these smaller companies coupled with the prevalent competition that they face in the industry.

Capitalization

Rs. in millions	Large		Medium		Small		Total	
	2018	2017	2018	2017	2018	2017	2018	2017
Equity	38,961.8	49,518.7	20,874.1	12,464.4	30,723.5	31,676.0	90,559.4	93,659.1
Financial Leverage	44.6%	35.7%	38.9%	46.0%	73.7%	15.9%	45.7%	30.7%
Operating Leverage	54.8%	42.8%	60.8%	68.7%	113.4%	30.4%	63.3%	42.1%

Given the structure of the insurance market, the top three players contribute the highest to equity base of the industry while small sized insurance companies cumulatively constitute almost one-third of the industry's total equity base. While all companies comply with the minimum paid up capital requirement issued by the regulator, a number of companies are still struggling with their leverage indicators where they have underwritten higher business on their net account in comparison to their equity base; this may pose a threat to such companies where they have lower levels of risk absorption capacities. Given that equity base defines the risk absorption capacity of a company; smaller companies will need to focus their efforts towards building their equity base in tandem to their underwriting operations.

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