SECTOR UPDATE

Non-Life Insurance

December, 2018

Insurance policies are instruments used to hedge against the risk of financial losses of all magnitudes that may emanate from damage to the insured property. The coverage also includes liability for damage or injury caused to a third party. Businesses require different types of insurance policies to insure against specific types of risks faced by the particular business. For example, a fast food restaurant needs a policy that covers damage or injury that occurs as a result of cooking. While a car rental company is not subject to this type of risk, it requires coverage for damage or injury that could occur while a vehicle is driven.

Global Insurance Scenario

As technology innovation and higher customer expectations redefine the marketplace, insurers remain focused on growing top-line sales, earning positive bottom-line, addressing challenges, and competing in a dynamic industry. The global insurance industry has gone through its own digital transformation over the past five years. Most insurers have implemented adhoc capabilities to make their businesses faster and cheaper, creating online tools to further engage their distribution channels. These insurers have also strengthened areas such as marketing, digital portals, customer self-service capabilities, and automation of some back-end processes. However, these companies need to continue to comply with the increasing quantum of regulatory changes being imposed.

Global non-life premium is expected to grow at a steady rate of 3% in the next two years but could be stronger depending on price increases. Premium growth in emerging markets is also expected to improve steadily and may end at a higher rate of around 7% in 2019. Assuming that these years have average losses, profitability levels of insurers may improve.

Prior to 2017, the market was based on shaving off its expense base in order to offset its low investment returns and pricing of all business classes of insurance. However, there were a significant number of catastrophic losses which were reported during the second half of 2017. As a result, it may become difficult for the reinsurance market in particular, especially entities to make a profit with trade-offs between increased retentions on net account and decreasing reinsurance costs.

Pakistan's Insurance Market on the Global Map

During the outgoing year, the non-life insurance sector in Pakistan has grown at a (CAGR) of 9.5% from period falling between 2013 to 2017, thereby reaching a cumulative total of Rs. 70.0b at end-2017. This growth was largely emanated from new infrastructure projects coming into the country. Total gross premiums emanating from the general insurance sector amounted to Rs. 36.9b at end-June 2018 and are expected to surpass the preceding year's premiums.. Overall insurance industry's fundamentals have improved during last three (3) years mainly on account of improvement in the law and order situation, improvement in political stability and uptick in the economic fundamentals.

Despite sizeable growth in gross premiums, Pakistan has a nominal market share of 0.04%[1] in the world market in terms of gross premiums from the general insurance industry. Similarly, insurance penetration and insurance density of general insurance in the country remained on the lower at 0.27%[2] and $3.9[3] respectively.

Pakistan lags behind its South-Asian peers (excluding Bangladesh) in terms of general insurance penetration and insurance density. As per key market players in Pakistan, there still lies significant room for business growth given these metrics.

1 Swiss Re: Figures correspond to 2015

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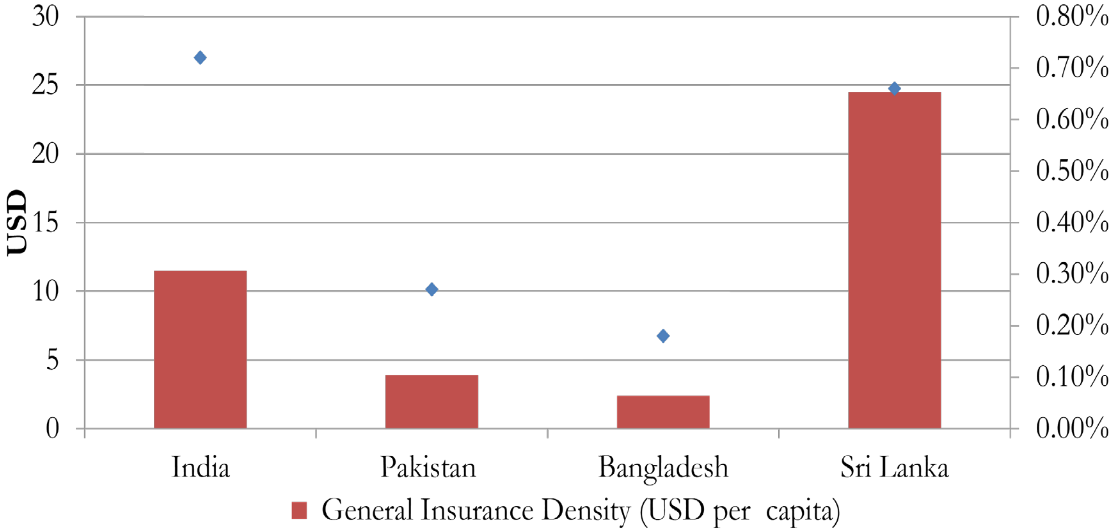
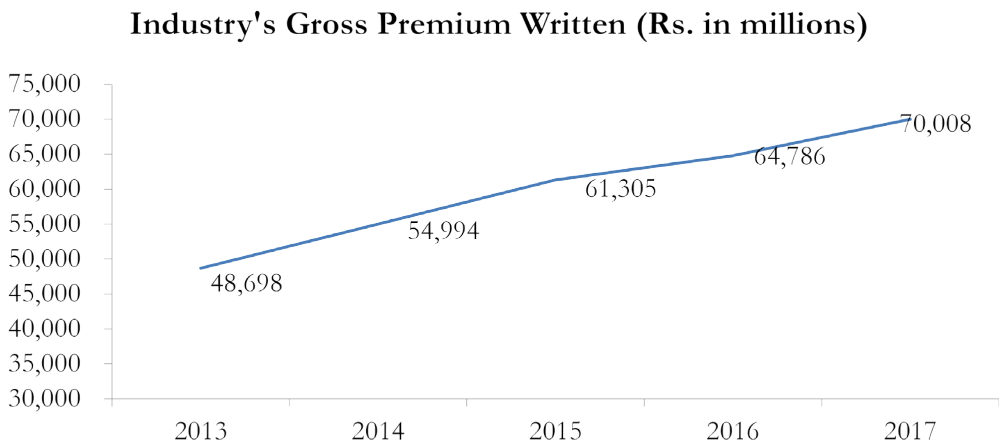
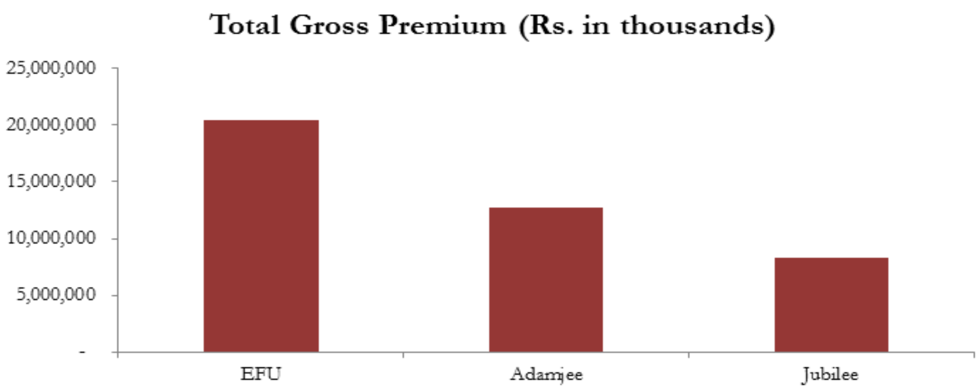


Lower penetration and density levels in Pakistan are largely on account of the widely held perspective that insurance is an un-Islamic product / service. In order to address this religious gap, a number of conventional insurers in Pakistan have launched window operations for providing Islamic insurance coverage. Moreover, insurance coverage in Pakistan is only bought when it is either mandatory by law or when it is a requirement from 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 about insurance products. In order to improve this metric, key players in Pakistan have also started inculcating the importance of insurance into the minds of its people through informal educational sessions.



Pakistan's Insurance Industry

At present, 30 general insurance companies operate in Pakistan; these are further segregated into, (1)Takaful, and (2) Conventional. The market follows an oligopolistic structure with top three insurance companies contributing to almost 55% of total gross premiums written by the industry.



Classification

Given that risk profile of different insurance companies varies considerably, we have accordingly divided these companies, on the basis of their relative market share[4] , into three different categories: large (relative market share > 3.0x), medium (0.75x < relative market share < 3.0x) and small (relative market s\hare < 0.75x).

Large Insurance Companies	Medium Insurance Companies	Small Insurance Companies
EFU Insurance Company Limited (7.14x)	Allianz EFU Health Insurance Limited (2.46x)	East West Insurance (0.71x)
Adamjee Insurance Company Limited (5.90x)	United Insurance Company Limited (1.19x)	Alfalah Insurance Company Limited (0.68x)
Jubilee Insurance Company Limited (3.54x)	IGI Insurance Limited (1.07x)	Premier Insurance Limited (0.66x)
	SGI Company Limited (0.91x)	
	UBL Insurers Limited (0.59x)	
	Askari General Insurance Company Limited (0.88x)	TPL Direct Insurance Company Limited (0.54x)
	Atlas Insurance Limited (0.83x)	Habib Insurance Company Limited (0.51x)
	New Hampshire Insurance Company Limited (0.81x)	Reliance Insurance Company Limited (0.49x)
		Pak Qatar General Takaful (0.45x)
		Century Insurance Company Limited (0.40x)
		Chubb Insurance Pakistan Limited (0.31x)
		PICIC Insurance Limited (0.26%)
		SPI Insurance Company Limited (0.25x)
		PGI Company Limited (0.2%)
		Shaheen Insurance Company Limited (0.15x)
		Asia Insurance Company Limited (0.15x)
		Takaful Pakistan Limited (0.14x)
		Alpha Insurance Company Limited (0.11x)
		Crescent Star Insurance (0.1x)
		Universal Insurance Company Limited (0.04x)
		Sindh Insurance (0.01x)

4 Relative Market Share = Average Gross Premium Written of the Company / Average Gross Premium Written of the Industry

Business Volumes

General insurance industry in Pakistan is highly concentrated as large insurance companies account for more than half of the industry's gross premiums. Increase in gross premiums was largely on the back of growth in business volumes written under facultative arrangements. Given that larger and medium players tend to retain an optimal level of premium on their net account, a significant proportion of business is retained on own books by smaller players. Another reason for the same is that it is difficult for smaller insurers to negotiate desirable term with international reinsurers given their claims history and financial strength.

With conventional players launching window operations for Takaful covers, business prospects of the two existing Islamic players have reduced significantly. With prevailing pricing war, the conventional companies were able to absorb exposures at lower prices in comparison to Takaful companies. An impact of business cannibalization where customers moved from conventional to window Takaful operations of the same company was also witnessed in the previous years; no further impact is expected in the coming period.

	Gross Premium	%	Net Premium	%	Contribution of Takaful in Total Business
Large	41,460,871	54.4%	20,346,788	49.5%	7.1%
Medium	15,315,240	20.1%	8,350,373	20.3%	8.5%
Small	19,446,003	25.5%	12,372,064	30.1%	10.1%

Going forward, a number of companies are focusing on building business volumes in the motor segment given that the law and order situation has improved during the years and that such a business provides a cushion to its cash flows. Given that such a segment incurs higher number of small quantum losses, the companies must ensure that their underwriting abilities are not compromised.

Profitability

Similar to business volumes, large insurance companies cumulatively represent almost 60% 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. Return on investments from larger companies contributed 57% of total investment profits earned in the industry. This was on the back of higher quantum exposures held by the three companies.

A few of the smaller companies have been reporting 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.

	Underwriting Profit	%	Investment Income	%	Net Profit	%
Large	3,088,758	49.6%	3,657,330	57.0%	4,695,067	59.9%
Medium	2,042,376	32.8%	1,745,135	27.2%	2,251,897	28.7%
Small	1,095,324	17.6%	1,011,419	15.8%	889,453	11.4%

Loss ratios for the conventional business have remained within manageable limits during 2017. However, there is still room for improvement across the industry for the Takaful business. Accounting for their relative expenses, large 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.

	Net Claims - Conventional	Net Claims - Takaful	Net Claims Ratio – Total
Large	47.8%	67.5%	49.4%
Medium	45.3%	32.6%	43.9%
Small	46.6%	56.0%	47.5%

Capitalization

Given the structure of the insurance market, the top three players contribute the highest to equity base of the industry; contribution of large insurers was almost 54%, at end-2017. Similarly, medium sized insurance companies cumulatively constitute one-fourth of the industry's total asset and 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 impose a threat to such companies where they have lower levels of risk absorption capacities.

	Equity	%
Large	40,963,143	53.8%
Medium	18,539,275	24.3%
Small	16,668,915	21.9%

Challenges/Opportunities for the Insurance Market in Pakistan

- In 2016, the government imposed uniform corporate tax rate of 31% on all sources of income of the insurance companies, coupled with an additional super-tax of 3%. Previously, the tax rate on capital gains and dividend income earned by insurance companies were in the range of 7.5% to 15.0%. This increase in tax rates will have negative impact on profitability of several general insurance companies as rely most of these companies heavily on investment income in the form of both capital gains and dividends.
- In a bid to improve insurance penetration, Securities & Exchange Commission of Pakistan (SECP) is considering various alternatives for promotion of micro-insurance market in the country. In this regard, SECP is revising the regulatory framework for micro insurance and changes are expected in the SEC (micro Insurance) Rules, 2014. At present, options under consideration include introduction of lower capital requirements for dedicated micro-insurance companies, relaxation in solvency requirements to encourage investment in micro-insurance infrastructure and allowing collaboration between life and non-life insurance companies to offer integrated products to the low income groups.
- China Pakistan Economic Corridor (CPEC) worth $45.6b is expected to facilitate growth in engineering and bond segments of general insurance industry on account of initiation of infrastructure projects. Work on projects has already started with timeline of all projects being 15 years. CPEC constitutes the following initiatives :
    - 24 energy projects (US$34.4bn).
    - 4 infrastructure projects (US$9.8bn).
    - Development of Gwadar port (US$800mn).
    - Formation of over 30 Special Economic Zones.
- Considering the recent uptick in the rupee dollar parity, premiums of the insurance industry are expected to increase at healthy rates. Given that most of the infrastructure projects coming in are dollar-denominated, insurance premiums on these projects are also expected to increase.
- Along with insurance related operations, companies also maintain a sizeable investment portfolio. During 2017, equity exposures were adversely impacted on account of the downturn in stock market, as was witnessed across the entire financial sector. As a result, a number of companies shed off these investments and earned one-time gains. Going forward, ability to reinstate returns on investments would be amongst the key rating drivers.

Analyst Contact

Muniba Khan
Senior Manager
muniba.khan@jcrvis.com.pk