9 PERFORMANCE REVIEW OF THE INSURANCE SECTOR

9.1 Introduction

Insurance is a form of risk management, used to hedge against the risk of a *contingent* loss. It involves the transfer of the risk of potential loss from one entity to another, in exchange for a risk premium. Given this role, the Insurance sector fosters financial stability by enabling economic agents to undertake various transactions with the facility of transfer and dispersion of risks. As a crucial component of the financial system, life insurance plans are an important source of savings and long-term institutional investments essential for the development and growth of bond markets. The role of life insurance as a financial intermediary is particularly important in countries like Pakistan with low levels of financial penetration. Overall Insurance penetration[1] itself is also just 0.8 percent in the country, much lower than the regional average of 2.0 percent (**Box 9.1**).

Box 9.1: Global Insurance: Impact of the Global Crisis and Outlook for 2009

In 2008, global insurance premiums amounted to approximately USD 4,270 billion. The life business accounted for USD 2,490 billion; non-life insurance accounted for USD 1779 billion. The industry's paid-up capital shrank by 15-20 percent in non-life and 30-40 percent in life. Life premiums declined by 3.5 percent, largely in the second half of the year as a direct consequence of the financial crisis. Non-life premiums declined marginally by 0.8 percent in 2008 due to lower demand for insurance cover and softening premium rates.

For 2009 and 2010, the outlook for the insurance industry is mixed. Even though the medium and long-term outlook for life insurance remains positive, growth in premiums in 2009 will be downcast or even negative as turbulent stock markets continue to negatively impact the unit-linked saving products. With the recovery of the real economy, both higher life premiums and better investment results are expected as asset prices recover.

Table 1: Comparison of Asian Countries

	Insurance Penetration: Premiums as % of GDP 2008				Premium volume (million USD)			Share of world market (%)
Country	Ranking	Total Business	Life	General	Ranking	2008	2007	2008
India	31	4.6*	4.0*	0.6	14	56,190*	57,782	1.32
Malaysia	33	4.3*	2.8*	1.5*	34	9,335*	8,633	0.22
China	43	3.3+	2.2+	1.0+	6	140,818+	92,483	3.30
Sri Lanka	71	1.4**	0.6**	0.9**	78	623**	469	0.01
Philippines	73	1.4*	0.9*	0.5*	54	2,299*	2,105	0.05
Indonesia	75	1.3*	0.9*	0.4*	39	6,903*	6,983+	0.16
Iran	78	1.1+	0.1+	1.1+	47	4,243+	3,645	0.10
Bangladesh	80	0.9**	0.7**	0.2**	75	717**	617**	0.02
Pakistan	83	0.8**	0.3**	0.4**	63	1,133**	1,094	0.03
Saudi Arabia	85	0.6	0.0`	0.6	50	3,070	2,290	0.07

+ provisional *estimated ** estimated USD value assuming constant insurance penetration

Source: Sigma 03/2009, World Insurance in 2008

This chapter gives the performance analysis of the insurance sector as a crucial component of the financial system, discussing in detail developments in both the General and Life insurance sectors, in addition to giving a brief overview of the scope of Reinsurance in the country, and the newly established Takaful industry.

9.2 Regulatory Framework

Similar to the standard framework for capital adequacy set forth by the Basel Committee of Banking Supervision (BCBS) in the form of Basel II, a uniform and standard code of prudential standards for the regulation of the insurance industry is planned to be introduced

[1] Defined as total premiums as a percent of GDP.

in Europe[2] in the form of *Solvency II*, often referred to as the *Basel for insurers*. Solvency II introduces a comprehensive framework for risk management for defining required capital levels and for implementing procedures to identify, measure, and manage risk levels.[3]

The expansion of quasi-banking activities in insurance and the increasing ownership cum business connection between insurance firms and banks underlines the importance of strengthening the regulation of insurance and increasing the coordination between regulators. The domestic insurance sector is regulated by the SECP and the Ministry of Commerce, and governed by the Insurance Ordinance 2002. SECP has made consistent efforts over the years for implementing best practices in the industry, as a member of the International Association of Insurance Supervisors (**Box 9.2**) and devising rules and regulations notified from time to time.

Box 9.2: International Association of Insurance Supervisors (IAIS)

International Association of Insurance Supervisors (IAIS) was established in 1994. It represents insurance regulators and supervisors of nearly 140 countries, constituting 97 percent of the world's insurance premiums. It also has more than 120 observers. IAIS sets out principles that are fundamental to effective insurance supervision. Principles identify areas in which the insurance supervisor should have authority or control and that form the basis on which standards are developed. These principles comprise of:

- Principles applicable to the supervision of international insurers and insurance groups and their cross-border business operations (Insurance Concordat), December 1999
- Principles for conduct of insurance business, December 1999
- Principles on capital adequacy & solvency, January 2002
- Principles on minimum requirements for supervision of reinsurers, October 2002
- Principles No. 3.4 on Group-Wide Supervision
- Insurance core principles and methodology, October 2003
- Principles on the supervision of insurance activities on the Internet, October 2004

Source: International Association of Insurance Supervisors (IAIS)

9.3. Overview of the Insurance Sector

The insurance industry has enjoyed robust growth in the last few years, driven by favorable economic conditions, expansion of the financial sector as a whole, privatization of large state owned entities and foreign investments. But factors such as the emergence of macroeconomic instability since late 2007, turmoil in global financial markets and dislocation of the domestic equity market along with the deteriorating security situation, posed substantial challenges to the performance of the insurance sector in CY08. In response, the insurance industry showed its resilience in that it was able to absorb a sudden and unexpected shock of meeting insurance claims of more than Rs. 6.0 billion arising from the riots caused by the assassination of former Prime Minister Benazir Bhutto on 27th December, CY07. At the close of CY08, the asset base of the insurance sector stood at Rs. 341.4 billion, up 5.0 percent in comparison with CY07. The share of insurance assets in the total assets of the financial sector is 4.5 percent and the sector assets constitute 3.3 percent of GDP. **Table 9.1** shows the sector-wise assets of the insurance industry.

9.3.1 Ownership structure

It is evident from **Table 9.1** that given the size of the state-owned life insurance company, the public sector is still the predominant player in the overall insurance industry with a share of 66.8 percent in total assets at end CY08. Notably, the private sector dominates the non-life insurance business, with a share of about 78.0 percent in the total non-life sector

[2] Scheduled to be implemented in 2012 by the European Commission.
[3] Details of the Solvency II Framework can be seen in Chapter 8, Financial Sector Assessment 2004, State Bank of Pakistan.

assets, while life insurance is dominated by the public sector with a share of 90 percent in the total life insurance sector assets.

Table 9.1: Assets and Structure of the Insurance Industry

	CY01	CY02	CY03	CY04	CY05	CY06	CY07	CY08
Total Assets (billion Rs.)	113.4	129.7	151.3	174.6	201.7	246.1	325.1	341.4
Share in percent								
Life	73.7	73.7	71.4	71.0	70.6	67.1	59.0	62.7
State owned	71.6	71.2	67.7	66.8	65.5	61.5	52.1	56.6
Domestic	1.2	1.5	2.4	2.6	3.1	3.3	4.2	3.6
Foreign	0.9	1.0	1.3	1.6	2.0	2.3	2.5	2.5
Non-Life	23.4	23.1	24.5	25.2	26.6	30.2	37.2	32.9
State owned	9.9	9.4	9.3	8.6	8.4	7.4	6.6	6.5
Domestic	12.7	12.8	14.2	15.9	17.4	22.0	29.8	25.7
Foreign	0.8	0.9	1.0	0.7	0.8	0.8	0.8	0.7
Reinsurance								
State owned	2.9	3.2	4.1	3.8	2.8	2.6	3.2	3.7
Takaful	-	-	-	-	-	0.3	0.5	0.8
Share in total financial sector assets	3.7	3.8	3.8	3.8	3.9	4.1	4.6	4.5
Percentage of GDP	2.7	2.9	3.1	3.1	3.1	3.2	3.8	3.3

Source: Annual Audited Accounts of Insurance Companies

In CY08, 45 insurance companies were operating in Pakistan. Among these, 34 were general insurance companies, 5 were in the business of life insurance, with 1 Reinsurance company and 5 Takaful companies in the industry. The Insurance business in Pakistan is heavily concentrated: State Life Insurance Company (SLIC) has a share of 56.2 percent in overall assets, and 90.0 percent in life insurance assets. The level of concentration is still high, though relatively less skewed in general insurance companies such that the top five companies hold more than 70 percent of the total assets of the general insurance sector. 4 of the top 5 general insurance companies are part of the KSE-100 index, with a market capitalization of 2.8 percent (**Table 9.2**).

Table 9.2: Insurance Companies in the KSE-100 index

Company Name	Index Weightage (percent)	Market Capt* (billion Rupees)
Adamjee Insurance	0.4	9.8
EFU General Insurance	0.8	20.8
EFU Life Assurance	0.6	17.2
IGI Insurance	0.2	5.8
New Jubilee Insurance	0.3	7.2
Pak Reinsurance	0.5	13.6
Total	2.8	74.8
KSE-100 Market Cap		2,588.9

*As on October 31, 2009
Source: Karachi Stock Exchange

Risks in the insurance sector can be categorized broadly as Technical risk, Credit risk, Market and Liquidity risk, in addition to other risks such as operating, managerial, and control structure risk.[4] The magnitude of these risks varies in line with the nature of business in non-life and life insurance.

The most important risk factor in life insurance arises from the technical assessment of the underlying transaction for which insurance cover is required. Inaccurate actuarial calculations and errors in associated parameters[5] can potentially result in a situation where the assured returns are not commensurate with the given amount of insurance claims.

[4] "The Insurance Sector and Financial Stability: An International Perspective and an Assessment of the Situation in Israel" Weitzman Nagar, November 2005, Bank of Israel.
[5] Mortality and sickness rates, life expectancy, future earning capacity etc

9.4 Life Insurance

Life insurance provides the facility of financial intermediation in generating long term financial savings. In this context, the main threat to the stability of the life insurance companies arises from the mismatch in the return assured and the returns generated by investments made by the companies in a risk-bearing portfolio. As shown in **Table 9.3**, investments form a dominant portion of the assets of life insurance companies, with a 77.3 percent share in total assets. About 80 percent of these investments are in risk-free government securities, while around 19 percent are in the equity market, such that the potential probability of occurrence of market risk is low. However, this portion of investments can acutely affect the financial viability of the smaller companies in the life insurance sector, which in pursuance of higher returns tend to invest in equities rather than government securities and other fixed return securities.

Table 9.3: Asset Distribution of Life Insurance in CY08

billion Rupees, Share in percent

	Amount	Share
Cash and Bank Balances	23.1	10.8
Loans	13.7	6.4
Investments	165.3	77.3
Investment property	2.4	1.1
Premiums due but unpaid	4.8	2.2
Accrued Investment Income	2.1	1.0
Others	2.5	1.2
Total	214.0	100.0

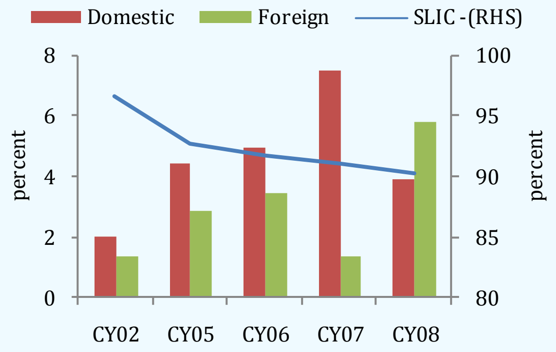
Source: Annual Audited Accounts of Life ICs

Notably, life insurance assets form 3.4 percent of the overall financial system assets and its deposits[6] are less than one percent of banking sector deposits, indicating a weak inter-connectedness of the banking sector and life insurance companies.

9.4.1 Performance Review

Life insurance companies had a 63.0 percent share in the total assets of the insurance industry in CY08, as against 59.0 percent in CY07, based on 5 operating companies. The state-owned company SLIC maintained its share as shown in **Figure 9.1** but the domestic companies lost their share to foreign companies during the year. Encouragingly, two new companies[7] have been issued licenses in CY08 to operate as life insurers.

Figure 9.1: Assets Structure of Life Insurance

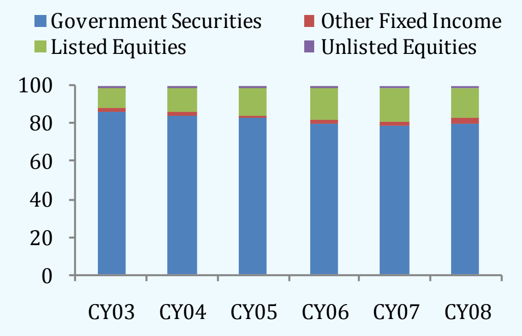


Source: Annual Audited Accounts of LICs

Investments

As mentioned earlier, the composition of the investment portfolio of life insurance companies indicates that government securities constitute the key portion (80 percent) of the total investments (**Figure 9.2**). However, until CY07, the major portion of the income was derived from equity investments. The equity market turmoil in CY08 has had an adverse impact on the sector's income which declined by Rs. 730 million in CY08 alone (**Table 9.4**).

Figure 9.2: Investment Portfolio of Life Insurance Companies



Source: Annual Audited Accounts of LICs

[6] Insurance companies place a part of their assets with banks in current deposits and short term fixed deposits.
[7] Asia Care Health and Life Insurance Company, and Adamjee Life Insurance Company.

Claims and Premiums

Claims and premiums are important constituents of the insurance business: premiums are the primary source of revenue for an insurance company, while the honoring of claims mitigates the losses incurred by the customers.

The claims ratio (net claims/net premium) for life insurance companies was 47.5 percent in CY08, down by 1.0 percent in comparison with CY07 due to a higher growth in premiums, and much lower than the 62.3 percent claim ratio of the general insurance companies during the same period. Notably, life insurance claims are of a different nature and materialize in case of death, or the maturity or surrender of life insurance policies. Another reason for the lower claim ratio is the increase in premiums with growing public awareness of life insurance savings products and introduction of new products by the sector (**Figure 9.3**).

Life Insurance Individual Claims

The amount of individual life insurance claims increased to Rs. 11.3 billion during CY08 compared to Rs. 9.1 billion in CY07 as shown in **Figure 9.4**. The dominant portion (50.8 percent) of individual claims still comes from those customers who keep the life insurance policy upto its maturity. It can be seen from **Figure 9.4** that the share of the maturity claims has had a rising trend in the last few years. This is a positive sign in that people are aware of this avenue of investment and keen to save for their future.

Claims due to policy surrender constituted 35.8 percent of the total in CY08, compared to 34.4 in CY07. Claims by death stand at 12.3 percent at end-CY08 as compared to 14.3 percent at end-CY07.

Life Insurance Group Claims

In this category, claims due to death are still the most predominant albeit their share decreased from 82.1 percent in CY07 to 76.9 in CY08. Group policies are primarily subscribed by various companies for the benefit of their employees (**Table 9.5**).

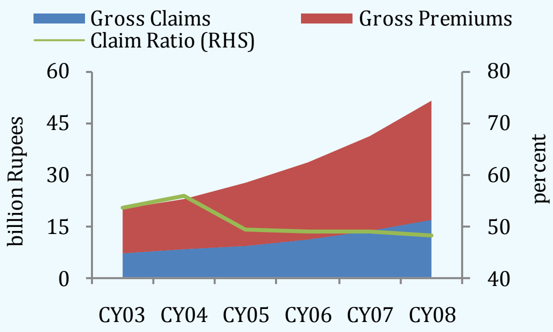
Table 9.4: Investment Income of Life Insurance Companies

million Rupees

	CY07	CY08
Government Securities	99	122
Other fixed Income	41	62
Dividend Income	25	30
Sale of stock and Shares	863	-730
Total	1,028	-516

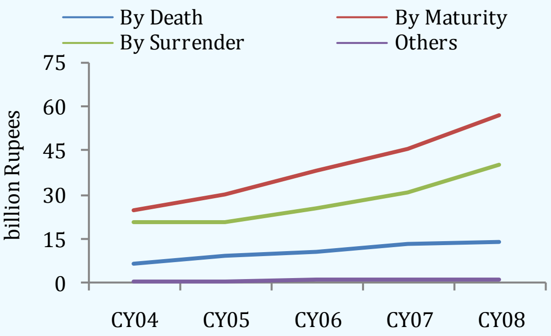
Source: Annual Audited Accounts of LICs

Figure 9.3: Gross Premium and Claims



Source: Annual Audited Accounts of LICs

Figure 9.4: Classification of individual Life Insurance Companies



Source: Audited Annual Accounts of LICs

Table 9.5: Classification of Group Life Insurance Claims

percent

	CY05	CY06	CY07	CY08
By Death	92.9	86.8	82.1	76.9
By Maturity	0.5	0	0.1	0
By Surrender	0	0.6	1.2	2.8
Experience Refund	1.8	7.9	9.2	13.6
Others	4.8	4.7	7.4	6.6
Total (million Rupees)	**3,015**	**3,541**	**4,321**	**5,442**

Source: Annual Audited Accounts of ICs

Life insurance Financial Soundness Indicators

For an assessment of the financial health of life insurance companies, this section analyzes the financial soundness indicators as detailed in **Table 9.6**.

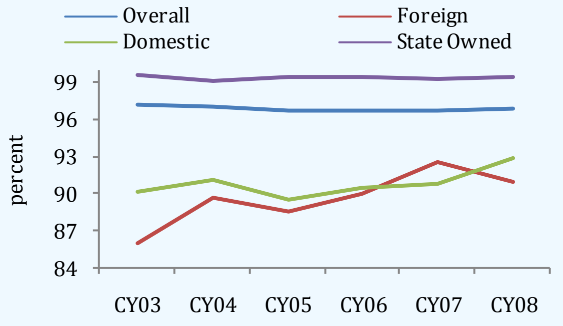
Table 9.6: Financial Soundness Indicators for Life Insurance Sector

Category	Formula	CY02	CY03	CY04	CY05	CY06	CY07	CY08
Capital Adequacy	Capital/Total Assets	1.4	1.7	1.5	1.5	1.7	2.1	2.1
	Growth Rate of Equity	18.6	20.2	37.6	31.5	28.9	40.4	2.0
	Growth Rate of Assets	14.4	12.6	15.1	14.9	15.4	16.8	11.6
Asset Quality	Investment income/Net Premiums	113.7	82.5	98	78.9	73.1	78.3	(1.9)
Operating Ratio	Claim Ratio = Net claims/Net Premium	47.4	64	56.5	62.2	49.5	48.5	47.5
	Expense Ratio = Management exp/Net premium	39.3	38.1	40.5	36.7	32.1	34.2	36.8
Earning and Profitability	ROA = profit/total assets	0.3	0.4	0.3	0.3	0.4	0.9	(0.1)
	Investment Income/Investment assets	15.2	12.6	14.4	13.5	12.6	9.7	(0.4)
Reinsurance and Actuarial Issues	Risk Retention Ratio =Net prem.\gross prem.	96.9	97.2	97	96.8	96.8	96.8	96.9

Source: Annual Audited Accounts of Life Insurance Companies

Capital adequacy ratios indicate that the growth rate of equity has shown substantial deterioration in CY08, primarily due to the impairment of the value of equity investments and higher losses. Operating ratios on the other hand, show consistent improvement. The overall risk retention ratio is still quite high, which implies a low dependence on the re-insurance companies (**Figure 9.5**). The earning and profitability ratios are not significant due to the losses incurred in CY08.

Figure 9.5: Risk Retention Ratio of Life Insurance Companies

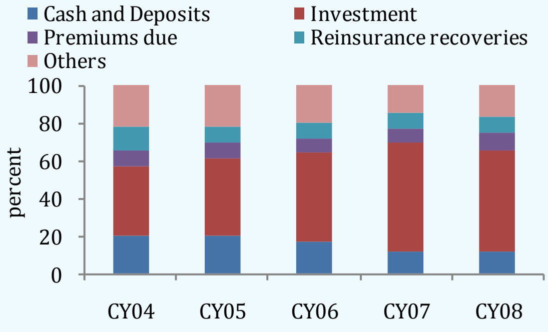


Source: Annual Audited Accounts of LICs

9.5. General Insurance

The asset allocation of general insurance companies (**Figure 9.6**) reveals that while investments have a dominant share as in case of life insurance, the absolute level is relatively less at 54.0 percent.

Figure 9.6: Assets Allocation of General Insurance Companies



Source: Annual Accounts of General ICs

Table 9.7 gives details of the aggregate investment portfolio of general insurance companies. Unlike life insurance, general insurance due to the short-term nature of its premiums tends to invest in the equity market and short term instruments in pursuance of higher returns and meeting short term obligations. This investment behavior of general insurance companies carries the element of market risk for the sector. Any development in the equity market directly affects the overall investment of the sector and consequently the returns.

General insurance companies also face problems with the assessment of technical risk, as reflected in some suspicious cases where some chemical and paint manufacturers did not take appropriate safety measures which increased the risk and intensity of losses by fire.

In contrast with life insurance, general insurance contracts and premiums are for a maximum period of one year and cover the risk component. Liquidity management is also different from life insurance, in which case the return to the saver is assured at the time of policy purchase, which allows the company to easily work out the liquidity needs for liability management. On the other hand, general insurance is more exposed to calamitous or unforeseen risks. General insurance firms' liability is realized only if such an incident occurs. General insurance companies' deposits are less than one percent of the total deposits of the banking system, and its assets are 1.2 percent of the total financial sector assets, again reflecting a weak degree of inter-connectedness with the banking sector.

Table 9.7: Investment Portfolio of General Insurance Companies

billion Rupees share in percent

In related parties	**Amount**	**Share**
Investment in an associate	9.1	28.7
Held for trading	0.0	0.0
Available for sale	6.0	19.0
sub-total	15.2	47.7
Others		0.0
Held for trading	0.4	1.2
Held to maturity	0.0	0.0
–Government securities	8.9	27.9
–Term finance certificates (listed)	0.3	0.9
–Other Fixed Income securities	0.8	2.6
Available for sale		0.0
Equities Quoted/Unquoted	6.3	19.7
TOTAL	31.8	100

Source: Annual Audited Accounts of General ICs

9.5.1 Performance Review

General insurance companies have grown and expanded in the last few years, in the backdrop of a favorable economic environment, booming equity market and the increasing auto loan portfolio of the banking sector which led to an increased demand for car insurance. This period of growth was dealt a severe blow on December 27, 2007 when the assassination of ex-Prime Minister, Benazir Bhutto resulted in strikes, riots and a prolonged period worsening security conditions when substantial damage to property etc took place. On the other hand, the slowdown in the economy and rising interest rates led to a low demand for auto finance, with a consequent impact on general insurance. Events of December 27, 2007 led to insurance claims of Rs. 6.0 billion for the general insurance sector which the sector managed to handle due to the backing of strong foreign reinsurers, and there was no serious threat to solvency. The sector faced another blow in mid CY08 when the value of its investment portfolio suffered due to the substantial decline in the value of the equity market. The general insurance sector like life insurance is very highly concentrated as shown in **Table 9.8**.

Table 9.8: Asset Share in General Insurance Sector

percent

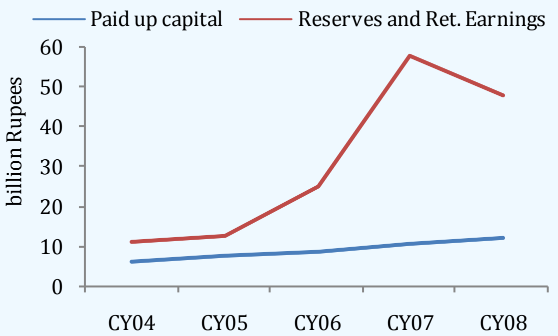
Year	**Top Five**	**Top Ten**
CY02	76.0	85.8
CY03	73.9	84.6
CY04	72.5	83.4
CY05	71.1	82.8
CY06	74.0	85.4
CY07	73.5	87.8
CY08	70.0	79.8

Source: SECP

Capital Structure

Despite the challenges in its operating environment, the general insurance sector enhanced its paid-up capital base to Rs. 348 million in CY08, as compared to Rs. 301 million at end CY07. Notwithstanding, some individual companies are still non-compliant with the minimum capital requirements set forth by the SECP. **Figure 9.7** shows the level of paid up capital and

Figure 9.7: Equity Structure of General Insurance Companies



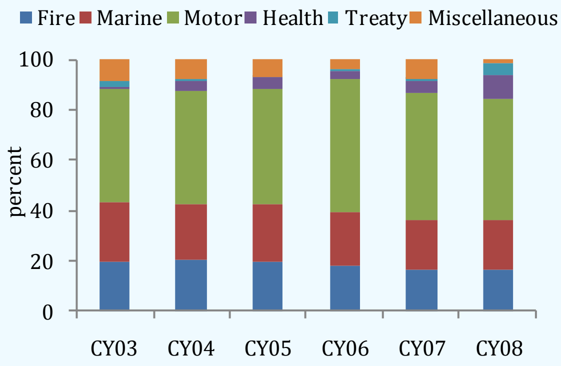
Source: Annual Audited Accounts of ICs

reserves of the general insurance sector, which indicates that after a robust growth of 132 percent in CY07, the level of reserves and retained earnings registered a negative growth of 20.0 percent in CY08. Notably, the aggregate paid-up capital base is increasing gradually in line with the regulatory requirement for the general insurance industry. SECP in a recent circular[8] increased the statutory deposits of all insurance companies with SBP from Rs. 5.0 million to Rs. 10 million, plus 10 percent of the insurer's paid-up capital as a safety cushion.

Premiums and Claims Composition

The various categories of general insurance include motor, fire, marine, health, treaty and miscellaneous insurance. Motor insurance forms the largest portion of general insurance with a share of 48.2 percent in the total net premiums, followed by marine and fire with a 19.8 percent and 16.7 percent share respectively at end CY08. The remaining share is held among the categories of miscellaneous, health and treaty (**Figure 9.8**).

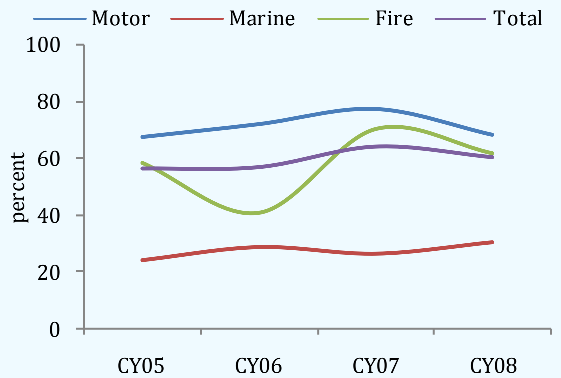
Figure 9.8: Composition of Net Premiums



Source: Annual Account of ICs

In CY08, general insurance premiums could not maintain the growth momentum seen in previous years: on average, net premiums grew by 24.4 percent from CY04 to CY07, while in CY08 they only grew by 10.9 percent. The loss in the growth momentum is the direct result of the slowdown in economic activities, and the demand for auto finance.

Figure 9.9: Claim Ratio



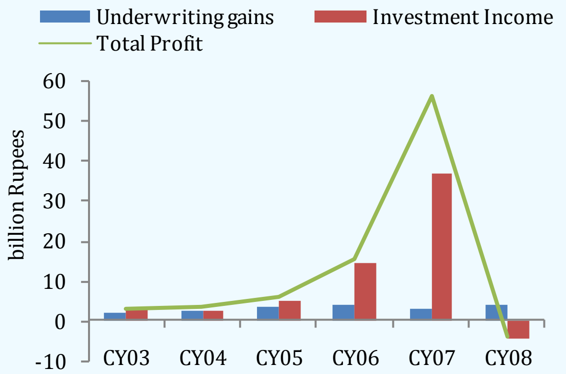
Source: Annual Audited Accounts of ICs

The claims ratio of general insurance in CY08 decreased to 60.6 percent from 64.4 percent in CY07 (**Figure 9.9**). The deteriorating law and order situation, gradually improving though still weak economic conditions and increase in reinsurance premiums are some of the challenges for the sector in the near-term.

Profitability

The general insurance sector recorded a net loss of Rs. 4.1 billion in CY08, after an outstanding year of profits at more than Rs. 56 billion in CY07. **Figure 9.10** shows the major sources of profit for the sector. It is evident that underwriting gains showed some improvement in CY08. But the investments portfolio recorded a loss in excess of Rs 4.0 billion, as compared to gains of Rs. 36.8 billion in CY07. The turmoil in capital markets and below average earnings of the corporate sector contributed to the negative investment income.

Figure 9.10: Major Sources of Profit



Source: Annual Audited Accounts of ICs

[8] SECP Circular No. 15 dated July 7, 2008 and Corrigendum dated July 21 2008.

Table 9.9 shows the net profits of the sector on the basis of the ownership structure. The state-owned and foreign companies, due to their prudent investment policies managed to record investment gains in CY08. The private sector, on the other hand, in pursuance of higher returns and aggressive investment policies registered a loss of Rs. 5.2 billion.

Table 9.9: Net Profits of General Insurance

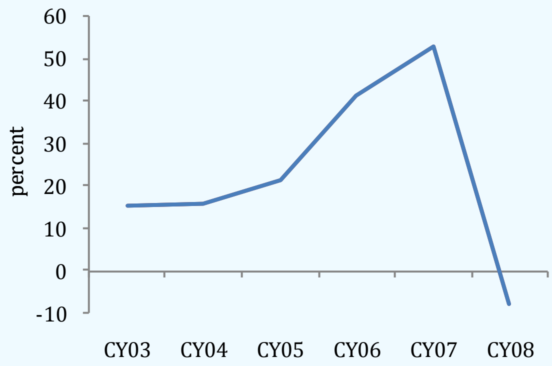
billion Rupees

	CY07	CY08
Sate owned	22.2	1.1
Foreign	0.1	0.1
Private	33.8	-5.3
Total	56.2	-4.1

Source: Annual Audited Accounts of ICs

Figure 9.11 shows the return on investments of the sector for the last five years. It is obvious that general insurance benefited from the booming equity market and corporate sector performance during this period. In CY06 and CY07, general insurance on average recorded return on investments of about 47.0 percent. But the ensuing turmoil in the equity market and weak performance of the corporate sector had an adverse impact on these companies, which was further aggravated by the slowdown in economic activities and worsening law and order situation. In CY08, general insurance recorded losses of Rs. 4.7 billion on investments with a -7.8 percent return on investments.

Figure 9.11: ROI of Non-Life Companies



Source: Annual Audited Accounts of ICs

General insurance Financial Soundness Indicators

For an assessment of the financial health of general insurance companies, this section analyzes the financial soundness indicators as detailed in **Table 9.10**.

Table 9.10: Financial Soundness Indicators for General Insurance

Percent

Category	Indicator	CY02	CY03	CY04	CY05	CY06	CY07	CY08
Capital Adequacy	Capital / Total Assets	17.0	15.0	15.0	12.0	11.0	17.5	19.2
	Paid-up Capital / Total Equity	40.6	37.6	36.1	32.5	32.0	14.1	18.0
	Growth rate of Equity	18.1	15.3	19.1	27.4	59.3	72.2	(9.8)
	Growth rate of Assets	18.7	13.8	45.8	22.1	34.8	53.5	(7.4)
Operating Ratio	Underwriting Expense / Gross Premium	14.3	13.4	14.4	15.4	15.6	12.9	11.9
	Claim Ratio	55.7	52.6	55.9	56.6	57.1	64.4	62.8
	Expense Ratio	8.0	9.0	11.0	24.0	8.0	8.2	8.3
	Combined Ratio	63.7	61.6	66.9	80.6	65.1	72.6	71.1
Earning and Profitability	Investment Income/ Net Premiums	26.0	28.0	30.0	31.0	71.0	158.7	(18.2)
	Growth Rate of Profits	(12.3)	80.4	23.0	74.6	154.8	229.6	(107.3)
	ROA	5.7	9.0	7.6	10.9	20.6	46.3	(3.6)
Reinsurance and Actuarial	Risk Retention Ratio	60.0	50.0	50.0	70.0	50.0	52.5	63.2

Source: Annual Audited Accounts of Insurance Companies

Capital adequacy indicators showed mixed trend in CY08. Capital to total assets ratio increased but not because of an increase in capital but due to the decline in the asset base. The decline in the general insurance business was a direct result of the slowdown in banks' consumer finance business, in particular auto-finance, which is a major source of premiums for general insurance. Operating ratios of general insurance showed a slight improvement. Claim ratio has improved by 1.6 percent, whereas the expense ratio has increased by a mere 10 bps. The overall risk retention ratio has reached 63.2 percent which implies a higher dependence on re-insurance companies. The earning and profitability ratios are not significant due to the losses incurred in CY08.

9.6 Reinsurance

Reinsurers contribute to the stability of insurance markets by improving the risk profile and financial soundness of primary insurers. In doing so, these companies limit territorial accumulations of exposure and consequently enhance underwriting capacity. Reinsurers offer alternative risk transfer products, and provide services across borders either directly or by establishing subsidiaries or branches. In conducting their business, reinsurers take into account the risk of the location, types of business and differences in regulation among jurisdictions due to their global coverage. Reinsurers in some jurisdictions are fully or partly directly supervised, while some rely on rating agencies. In some jurisdictions, reinsurers are required to post collateral to cover the likely liabilities.[9]

The only reinsurer in the domestic financial sector is the Pakistan Re-insurance Company Ltd (Pak Re), which is a state-owned company. In CY08, it held 3.7 percent of the total insurance sector assets. The total assets of the reinsurance company were Rs. 12.5 billion during CY07, compared to Rs. 10.4 billion in CY06, a fair growth of 20 percent over the period of assessment (**Table 9.11**).

Table 9.11: Reinsurance Business in Pakistan

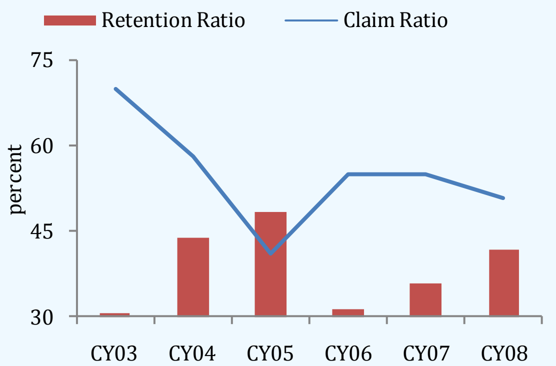
Amount in million Rupees

	CY02	CY03	CY04	CY05	CY06	CY07	CY08
Paid up Capital	450	450	450	450	450	540	3,000[10]
Reserves and Retained Earnings	796	981	1,306	1,789	2,280	5,827	4,266
Investments	1,905	1,886	2,719	2,873	3,588	6,412	5,459
Gross Premium	3,500	4,697	5,241	4,160	4,499	4,731	4,555
Net Premium	1,588	1,447	2,289	2,005	1,415	1,695	1,896
Net Claims incurred	848	1,011	1,329	823	777	931	962
Management Expenses	108	140	134	171	146	158	250
Net Profit after tax	297	333	325	594	672	3,727	886
Total Assets	4,192	6,232	6,613	5,634	6,464	10,447	12,528

Source: Annual Audited Accounts of Pakistan Reinsurance Company Limited

The claim ratio of Pak Re declined to 51 percent in CY08, as compare to 55 percent in CY07. The risk retention ratio is increasing and reached 42 percent as shown in **Figure 9.12.** Gross premiums have declined but net premiums increased due to a decline in reinsurance expenses and the increase in treaty premium.

Figure 9.12: Reinsurance Retention



Source: Annual Audited Accounts of ICs

The profit after tax of the reinsurance sector declined to Rs. 886 million during CY08 compared to Rs. 3.7 billion in the preceding year. The difference is due to the decline in investment income which was only Rs. 846

[9] Principles on minimum requirements for supervision of reinsurers, October 2002, IAIS

[10] Paid up capital has been enhanced from Rs. 540 million to Rs. 3000 million, in order to strengthen the equity base as the company is planning to expand locally as well as abroad, as detailed in the annual audited report.

million at end-CY08, as compared to the substantial amount of Rs. 3.7 billion in the previous year. This difference is attributed to the volatility in the performance of the equity market which impacted the return on investment.

9.7 Takaful

Takaful originates from Arabic word *Kafala*, which means mutual guarantee. Takaful is an Islamic insurance concept which is rooted in Islamic *muamalat* (man-to-man relationship), keeping in view the rules and regulations of Islamic sharia. This concept of mutual guarantee has been practiced in various forms throughout Islamic history. In principle, the takaful system is based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose. Currently, two types of Takaful are in practice i.e. General Takaful and Family Takaful. General Takaful focuses on short term protection of property and liabilities against any loss or damage; it comprises of all kinds of non-life risk coverage. Family Takaful provides a combination of long term savings and protection for participants and their dependents arising from death, disability or survival.

Under SECP's regulatory supervision, Takaful business started in 2006. SECP has issued the necessary regulations and prudential policies under the *Takaful Rules 2005*. At present, 3 general takaful companies[11] and 2 Family Takaful companies[12] are operating in the sector, with total assets of Rs. 2.57 billion end-CY08. This asset base constitutes about 0.8 percent of the overall insurance sector, a slight increase from the previous year **(Table 9.12)**. Given only two years of effective operation, its claim ratio seems rather high, even though it has declined in CY08. Notably, the emergence and success of shariah-compliant financial services in Pakistan have led to new opportunities for commensurate mutual guarantee products. The takaful sector is recognized as one of the major components of the Islamic financial system, indicating high growth potential in years to come due to the present low rate of Islamic insurance market penetration.

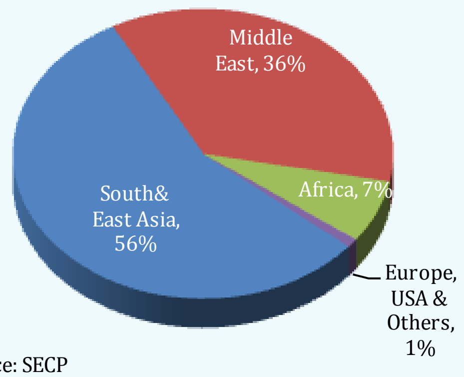
Table 9.12: Takaful companies Financial Highlights
million Rupees

	CY07	CY08
Total Assets	1,286.9	2,573.5
Investment	330.2	1,027.1
Gross Contribution	263.1	829.7
Net Contribution	105.9	357.2
Net Claims Total	158.5	345.5
Underwriting Results	(54.5)	(103.1)
Profit after tax	(35.8)	(146.8)
Claim Ratio	149.6	96.7

Source: Annual Audited Accounts of Takaful Companies

In recent years, takaful business has seen an unprecedented growth across various regions in the world **(Figure 9.13)**. Iran, Saudi Arabia, Sudan, Malaysia and the UAE are the current leaders in this area. The future of global takaful is bright given the growing awareness and demand for Islamic financial instruments including insurance. There is a great potential for established financial institutions to set up takaful windows.

Figure 9.13: Geographical Spread of Takaful Companies



Source: SECP

9.8 Conclusion

The insurance sector has shown commendable resilience to challenges emanating from the slowdown in economic activities during CY08, and its share in total financial sector assets

[11]Takaful Pakistan Limited, Pak-Kuwait Takaful Company Limited and Pak-Qatar General Takaful Limited.
[12] Pak-Qatar Family Takaful Limited and Dawood Family Takaful Company

has only decreased marginally over the period of assessment. Notwithstanding, insurance penetration continues to be less than 1.0 percent, and concerted efforts are required by the regulators to increase the outreach of insurance products.

Notably, the insurance sector is the only component of the financial sector which continues to be heavily dominated by state-owned entities. The privatization of State-Life Insurance Company is still pending, and the process of implementation of the planned reforms has been rather gradual. Given the extent of concentration in the industry, efficiency and competitiveness will only be enhanced once these reforms pave the way for the existing companies to acquire a stronger footing based on sound financial performance.

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