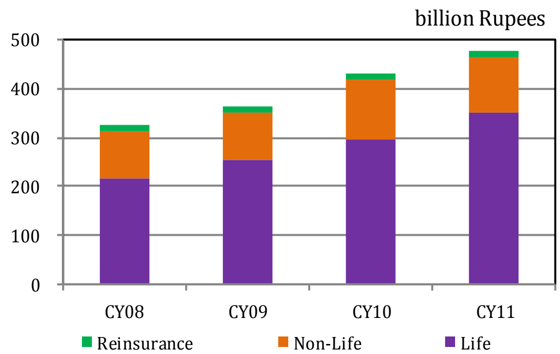
The insurance and reinsurance sector witnessed 11.1 percent growth in asset base during CY11. The performance of life insurance industry, both in terms of asset and premium accumulation played a major role in improving the overall performance of the sector, while the non-life segment witnessed deterioration in asset-base due to settlement of floods related outstanding claims. The period under review was also significant for the insurance industry as it witnessed decline in the claims and expense ratios for both life and non-life segments which contributed towards improving the overall profitability. Besides the positive developments in the insurance sector, it still lags behind in terms of density and penetration when compared with regional countries.

Insurance sector posted reasonable growth despite sluggish macroeconomic environment…

The asset base of the insurance and reinsurance sector witnessed a double-digit growth of 11.1 percent during CY11 mainly attributable to a 19.2 percent surge in the life insurance sector assets. The life insurance industry successfully attracted prospective policyholders by proactive marketing campaigns, expansion of agent services and offering innovative life products. Furthermore, the growing inclination of the urban population towards risk coverage in the wake of rising security and social concerns also boosted the demand for life insurance and overall asset base of the sector.

Figure 7.1

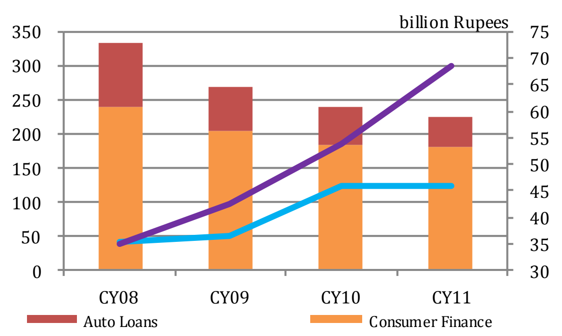
Size of the insurance industry expands



In contrast, the asset base of non-life industry reduced by 7.4 percent as the non-life companies were able to resolve their outstanding flood related claims that were incurred in CY10 . While the reinsurance industry – that constitutes only one non-life reinsurance company posted a marginal growth of 2.7 percent in its asset-base as the domestic non-life business remained subdued during CY11 **(Figure7.1).**

Figure 7.2

Consumer finance and insurance premiums



Despite a recent dip in non-life industry assets, the consistently high growth rates in the asset base of the insurance and reinsurance sector during the last few years have also accentuated the ability of the sector to withstand sluggish macroeconomic environment. In fact, even the rising inflation levels did not affect the growth pattern of life premiums. However, the trend of the non-life premiums seem to be positively correlated with the banking business in general and consumer finance business in particular ***(Figure 7.2)***[60].

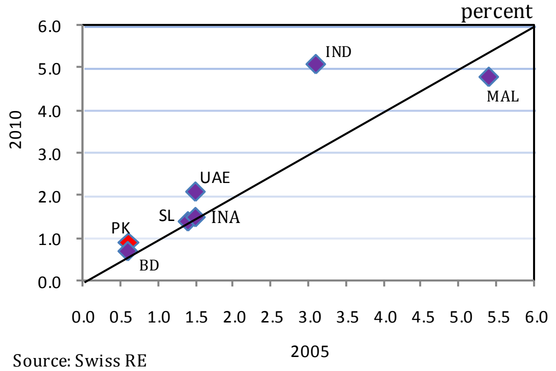
[60] In addition to the reduction in the banks' consumer finance business, other sectors such as the leasing sector also witnessed a drastic reduction in its auto lease.

....though penetration and density remained low

Though the domestic insurance industry has grown at a healthy pace, an international comparison shows that the country is not only lagging behind in terms of density and penetration of the insurance industry but the Pakistan's standing among the regional countries remained low in recent years[61]. Of 88 countries, Pakistan is consistently ranked lower (86th) with the insurance penetration ratio of 0.7 percent. Similarly, the country ranks almost at the bottom of the sample (87th) in terms of insurance density[62]. Even the less developed regional countries have better penetration and density ratios **(*Figure 7.3*)**. On the positive side, the inflation adjusted premium growth rates of the Pakistan's life insurance industry are comparable with that of the emerging market economies. However, the real premium growth of non-life insurance industry lags behind significantly **(*Table 7.1*)**.

Figure 7.3

Insurance penetration in selected countries



Source: Swiss RE

The measures of insurance density and penetration being very low in international perspective indicate the insurance service providers performing below their potential. For increasing penetration, the insurance service providers need to broaden their products and services, and enhance their outreach to new areas for effectively bringing the untapped segments into their insurance net.

Table 7.1: Real Premium Growth in 2010

in percent

	Life	Non Life	Total
Advanced	1.8	1	1.4
Emerging	13	8.5	11
Pakistan*	13	-4.1	2.6
World	3.2	2.1	2.7

Source: Sigma /Swiss Re 02/2011
* SBP calculations

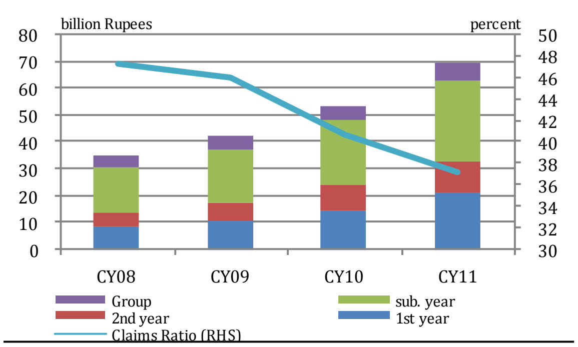
Life Insurance

Growth in life insurance driven by higher premiums

During CY11, the gross life insurance premiums witnessed a robust increase of 27 percent (YoY). Importantly, the family takaful business, that now represents 5 percent of life insurance (2.5 percent in 2010), also grew by 75.8 percent during the same period thanks to growing awareness of shariah compliant insurance services among the prospective policyholders. With the entry of new companies in the life and family takaful business in recent years, the industry asset and premium concentration ratios have improved significantly, with private companies successful in enhancing their business and profitability. In addition, the recent growth momentum in the premiums and rising investment income feeding into improved profitability of the life insurance industry

Figure 7.4

Rising life insurance premiums and declining claim ratios



[61] The insurance penetration is the ratio of the insurance premiums to GDP while insurance density is the ratio of insurance premiums to population.
[62] Source: Sigma / Swiss Re – World Insurance in 2010. No. 2/2011

Figure 7.5

Rising life insurance profitability

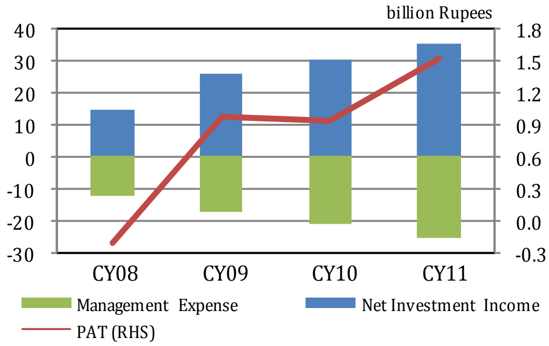


Figure 7.6

Marginal decline in net premiums of non-life sector

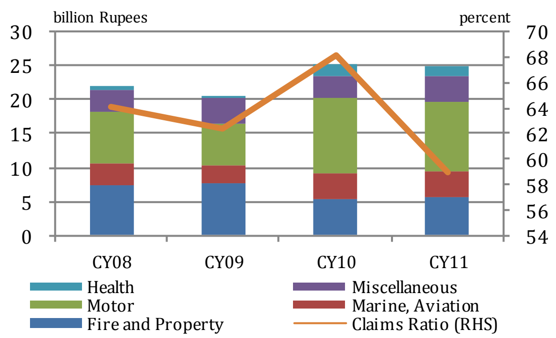


Table 7.2: Soundness indicators of Life Insurance

in percent

	CY08	CY09	CY10	CY11
Capital to Assets	1.8	1.9	2.2	2.1
Claims Ratio	47.3	46	40.7	37.1
Expense Ratio	36.7	41.8	40.5	38.5
Combined Ratio	84.1	87.8	81.2	75.6
Premium Retention	96.9	97.1	97.6	96.9
Return on Investment	9	13	13.4	13.2
Return on Assets	-0.1	0.4	0.3	0.4

may also encourage companies to venture into and offer (conventional and Islamic) new products[63].

A positive and encouraging feature of the rising gross premiums is the share of new business (1st year premiums) and the retention of the policy by the insured (subsequent years). Besides 44.5 percent improvements in the first year premiums, its share in total gross premium improved to 30 percent up from 26.8 percent a year earlier. Similarly, the subsequent premiums grew by 23.8 percent during CY11 **(Figure 7.4)**.

On the flip side, life insurance saw a considerable decline in the claims ratio. Much of the reduction in the claims ratio has been on account of increasing reinsurance coverage that substantially reduced the claims expense borne by the companies. This coupled with stronger growth in premiums and rising share of outstanding (unsettled) claims in gross claims has brought down the claims ratio to 37.1 percent in CY11.

Increasing stock of government securities surged the profitability of the life insurance.

Besides the banking sector, the life insurance companies are the largest investors in government securities and likewise the higher return on investments remained instrumental in improving the industry's earnings profile. As a result the profit after tax of the life insurance companies surged to Rs1.5 billion in CY11 from Rs0.9 billion a year earlier **(Figure 7.5)** and ROA improved to 0.4 percent.

Companies' analysis show that the conventional business continues to earn positive returns whereas, the two family Takaful companies incurred losses of about Rs100 million during CY11 on account of heavy investments on expansion of their operations and improving physical infrastructure activities.

Soundness indicators of Life insurance remained stable

Improved profitability and entry of new life insurance entities have enhanced the overall equity of the sector. As a result the capital to asset ratio of the insurance industry remained steady at 2.2 percent in CY11, down marginally by 6 bps from 2010. Majority of the life insurance companies complied with the minimum paid-up capital requirement specified by the SECP; however, in the absence of any solvency measure, the leverage of the life insurance seems high. To

[63] The asset concentration of SLIC (State Life Insurance Corporation) in life insurance declined from 93 percent in 2005 to 84 percent in 2011. Similarly, the gross premium concentration also witnessed a gradual decline from 95 percent in 2005 to 64 percent in 2011.

this end, the SECP has been working on revising the existing solvency requirements[64] **(Table 7.2)**.

The enhanced reinsurance coverage, being pursued by the life insurance companies, led to a decline in the premiums retention ratio during CY11, which consequently contributed towards lower claims ratio. The return on investments (ROI) remained healthy at 13.2 percent, though it observed a marginal dip of 17 bps on account of impairment charges on investments (other than government securities).

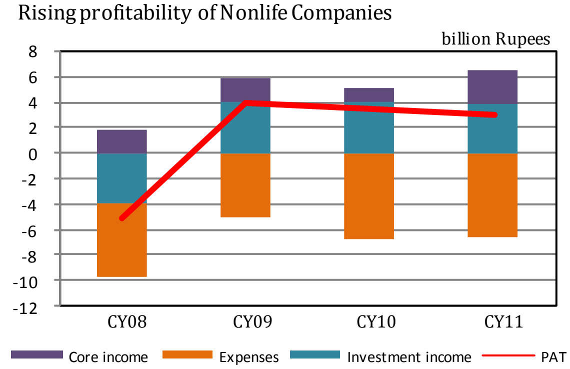
Nonlife Insurance

Decline in motor underwriting lowered the non-life premiums

The non-life industry witnessed a marginal deterioration in its gross premiums by 0.2 percent in CY11. Much of the decline occurred on account of slowdown in the motor insurance business that declined by 7.5 percent (YoY). As motor insurance constitutes almost 42 percent of total non-life business, factors such as reduction in auto loans extended by banks and leasing companies and the rising premium cost decreased the premiums of the non-life during CY11 **(Figure 7.6)**.

Figure 7.7

Rising profitability of Nonlife Companies



Similarly, the claims expense of the non-life sector also reduced by 16.9 percent on account of higher reinsurance, resulting in a steep decline in the claims ratio to 59 percent in CY11 compared to 68.1 percent last year. Takaful companies, though improved their share in the non-life business remained plagued with high claims ratio. The takaful claims ratio came down by almost 9 percentage points to 84 percent during CY11, however, it is still high and well above the industry average.

Increased provisioning and non-underwriting expenses lowered non-life profitability

The profitability of the non-life companies declined on account of rising provisioning and non-underwriting costs. However, healthy growth in core income represented by improved underwriting income and decline in claims kept the decline in the profitability under check. As a result, the PAT of the non-life industry came down by 15 percent to Rs 3.1 billion, while the ROA edged down to 2.7 percent in CY11 from 3 percent a year earlier **(Figure 7.7)**.

[64] SECP has revised the solvency requirements vide its Notification on Amendments in Solvency Rules 2012 http://www.secp.gov.pk/notification/pdf/2012/Amendments-Requirements-Solvency-Rules2012.pdf

Table 7.3: Soundness of Non-Life Insurance Companies

in percent

	CY08	CY09	CY10	CY11
Capital to Assets	57.6	57.8	47.9	52.8
Claims Ratio	64.1	62.4	68.1	58.9
Expense Ratio	24.8	23.5	27.1	27.1
Combined Ratio	88.8	85.9	95.2	86
Premium Retention	64.7	59.4	54.8	52.7
Return on Investment	-8	7.4	6.6	6.8
Return on Assets	-5.4	4.1	3	2.7

Among the other soundness indicators, the capital to assets ratio observed improvement on account of 7.4 percent decline in the assets. Similarly, with the decline in claims ratio and a rather stagnant underwriting, expense ratio has also managed to improve the combined ratio – though still very high in comparison to life insurance industry **(Table 7.3)**[65]. The premium retention in non-life continue to decline as non-life companies are required to compulsory reinsure at least 35 percent[66] of its surplus business from the local non-life reinsurer[67]. Though, low retention seems to affect the underwriting income however, in a constraining business environment and security concerns, it also turned out to be a positive development as most of the decline in the claims resulted from risk transfer.

Reinsurance

Rising investment income improved the profitability of reinsurance

Table 7.4: Profile of Reinsurance

billion Rupees

	CY08	CY09	CY10	CY11
Equity	7.3	6.8	6.4	6.4
Investments	5.5	5.5	4.7	5.8
Gross Premiums	4.6	5.8	6.6	6.9
Net. Premiums	1.9	2.2	2.9	3.5
Net Claims	1	0.9	1.7	2
Expenses	0.3	0.2	0.3	0.4
Profits	0.9	0.3	0.5	0.8
Assets	12.5	12.4	12.5	12.9

The country has one public sector reinsurer that caters to the need of the non-life insurance companies. The asset base of the reinsurance improved marginally by 2.7 percent while investments surged by 24 percent during CY11 **(Table 7.4)**. In terms of underwriting business, the gross premium grew by 4.5 percent as non-life insurance companies were required to reinsure their business to hedge the claims expense.

The net claims also recorded an increase of 17.6 percent as it resorted to maintain high premium retention on the back of its strong equity. With improved returns on its investments, the profitability improved by 60 percent during CY11.

[65] Combined ratio is the sum of claims ratio and management / underwriting expense ratio.
[66] According to Par VI, section 42 of the Insurance Ordinance 2000 of the SECP, every non-life insurance company is required to offer PRCL (Pakistan Reinsurance Company) the right of first refusal to reinsurance not less than 35 percent of its surplus business.
[67] Surplus business in insurance is the business against which company does not maintain reserves to pay for its losses.