Chapter 7 Insurance Sector

Strong growth in life insurance business continued to strengthen the asset base of the insurance sector, which grew by 7.8 percent during H1-CY12. The life insurance business attracted 34 percent higher net premiums on account of non-conventional policies particularly, the unit linked contracts. In contrast, the nonlife net premiums reduced marginally owing to challenging business environment and a consistent decline in auto finance. In terms of performance, the profitability of the insurance industry thrived on the back of higher investments returns on government securities and booming stock market.

Figure 7.1

Growing size of the insurance industry

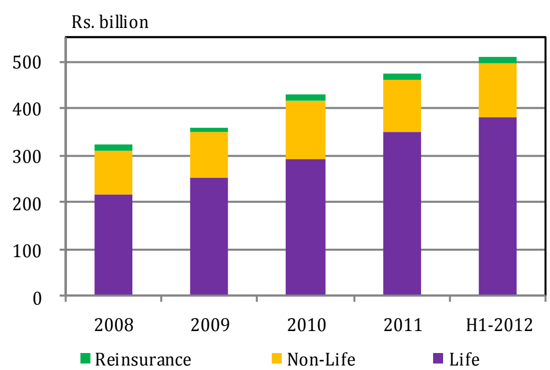


Figure 7.2

Insurance premium flows

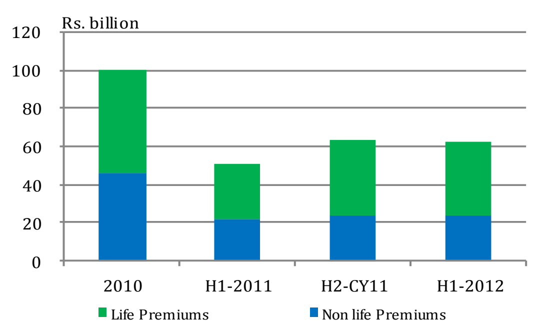
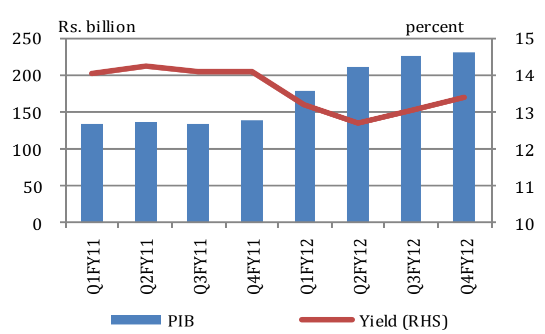


Figure 7.3

Rising volumes of insurance sector's PIBs



Overview

Life sector continues to expand the size of insurance market

The insurance and reinsurance sector witnessed a steady growth of 7.8 percent in its asset base surpassing Rs. 500 billion during the first half of CY12 (**Figure 7.1**). The increase was mainly contributed by a healthy 8.9 percent growth in asset base and 34 percent growth in net premium revenues of life insurance industry. The demand for life insurance not only increased as it provides indemnification towards loss, it has also evolved into an important avenue of generating long-term savings for the policyholders.

The general insurance industry grew by 5.3 percent during the first half of CY12 after observing decline in its assets base over the last two years. Though, the net premiums marginally declined year on year basis, however, improved premium retention helped industry to limit claims cost (**Figure 7.2**). While the reinsurance sector witnessed a 3.1 percent decline in its asset base during the period owing to a reduction in its stock of investments due to higher dividend payouts.

The earnings of the insurance sector improved remarkably by 84 percent to PKR 4.4 billion in H1-CY12 from PKR 2.4 in H1-CY11. Most of this increase resulted from 29 percent strong growth in investment income from higher returns on increasing share of risk free long term PIBs, which now represent almost 25 percent of the outstanding PIBs stocks (**Figure 7.3**). In addition, strong recovery in the equity market and higher dividend income from improved corporate earnings provided additional support to overall profitability. However, net premium revenue from core underwriting business remains subdued for non-life insurance industry due increasing reinsurance cost resulting from security concerns and prevailing economic conditions (**Figure 7.2**).

Table 7.1						
Correlation of Life Premiums and Macroeconomic Indicators						
	Premiums	KSE	EXR	CPI	GDPR	LR
Premiums	1					
KSE	0.81	1				
EXR	0.86	0.73	1			
CPI	0.38	0.27	0.11	1		
GDPR	-0.16	0.13	-0.22	-0.18	1	
LR	0.10	-0.15	0.06	0.34	-0.52	1

A host of factors (economic, political, and social) explain the robust growth in life insurance business over the years[75]. While considering only the macroeconomic aspects of the country, the CPI, lending rate (LR), exchange rate (EXR) and equity market performance (KSE) are positively correlated with the life insurance premiums. While the GDP growth rate is inversely related with the life premiums (**Table 7.1**). The risk averse behavior of the policy holders appears to be dominant in a declining GDP scenario. This behavior also explains the negative correlation between the GDP and life premiums in recent years as life insurance policyholder views his policy as an investment and uses this avenue to safeguard his interests by securing his savings.

The growth in insurance industry even in face of multiple challenges represents strong resilience of the industry towards stress events. However, penetration of the industry remains low[76] and the industry has to work on improving their client base through development of new products, expanding outreach, and improving insurance awareness. Such an approach will facilitates the insurance and reinsurance sector in improving the core business and enhancing revenues from underwriting business and providing additional resources for investment activities.

Life Insurance[77]

The life insurance industry continued its rapid growth thanks to 34 percent increase in premiums during H1-CY12 (YoY). Though growth was observable across the industry, however, shariah based takaful business performed better than the conventional insurance. With 50 percent growth in contributions, the takaful business enhanced its share in overall premium to 5 percent (2.8 percent in H1-CY11). Improved premium revenues and steady investment income provided for improvement in earnings and ROA of the Life Insurance industry, though a couple of companies contributed growth in profitability.

The rising gross premium written (GPW) was facilitated by improved new business and retention of subsequent years

[75] A survey of literature finds different studies that explore various macroeconomic and social factors contributing towards the demand for life and non-life insurance coverage. For instance see, Beck, Thorsten and Webb, Ian (2002), Determinants of Life insurance Consumption across Countries". World Bank and International Insurance Foundation, mimeo
Browne, M. J. and K. Kim (1993) "An International Analysis of Life Insurance Demand", Journal of Risk and Insurance, Vol. 60; pp 616-634
[76] See Financial Stability Review, Second Half – 2011, State Bank of Pakistan
[77] The life insurance market constitutes 9 companies. Out of which two are Family Takaful and seven are conventional. The share of Takaful contributions (premiums) improved from 3.1 percent to 4.6 percent (YoY).

Figure 7.4

Life insurance premiums and claims ratio

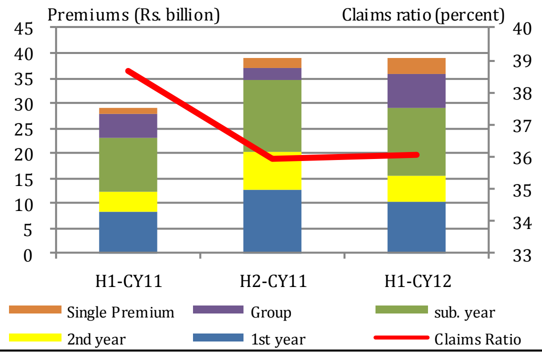


Figure 7.5

Rising trend of Unit linked policies

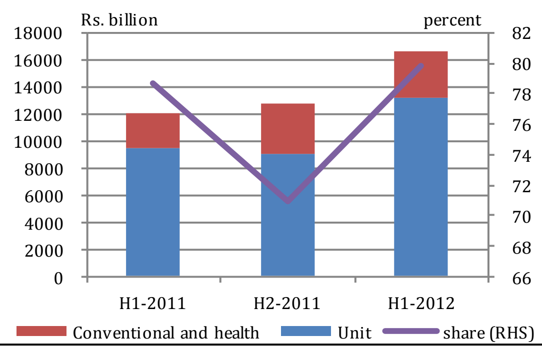
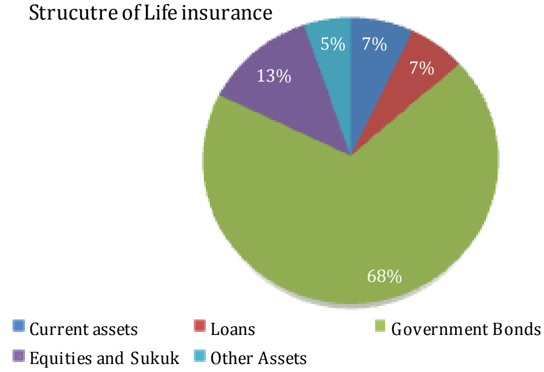


Figure 7.6

Strucutre of Life insurance



insured. The first year premiums and single premiums policy business improved YoY by 22.5 percent and 44.8 percent respectively; while the insured's retention – a measure of subsequent premiums also improved by 29 percent during the period. In addition to individual policies, the group life business also improved by 65 percent during the period (**Figure 7.4**).

Another important phenomenon that gained ground over years is the increasing share of unit linked insurance policies (ULIP) offered by private sector life insurance companies. The ULIP offers long-term investment avenues coupled with indemnification in case of a loss event, a flexibility that has attracted more investors and consistently contributed towards growing insurance premiums. The ULIP, which was first introduced in Pakistan in early nineties, now form major portion of the life insurance and family takaful businesses[78].

The surge in the ULIP premiums during the 2000s primarily resulted from an increase in the number of life insurance providers, improved marketing strategies and skilled agent force employed by the insurance companies and rise in financial literacy. Accordingly, the ULIP premium grew YoY by 41 percent during H1-CY12, enhancing its share in GPW by the private life companies to 80.5 percent against 75 percent in H1-CY11 (**Figure 7.5**). In the wake of prevailing macroeconomic dynamics, most investments are placed in government securities followed by the equities and corporate debt market.

The availability of risk free government securities and booming stock market enabled the insurance sector companies to improve its asset base robustly. Most of the 9 percent growth in assets resulted from surge in investment in risk free Government securities on account of increased supply of PIBs. Similarly, the recovery in the capital market and improved corporate performance incentivized the insurance companies to enhance their equity portfolio by 18 percent (**Figure 7.6**). As a result the overall investment surged by 14 percent in H1-CY12 increasing its share in asset base to 88 percent from 78 percent in CY11.

With the growing investment portfolio in government securities offering healthy risk free return, the net investment income observed 25 percent growth in H1-CY12. Accordingly, Return on Investments (ROI) improved to 14.9 percent (YoY) in H1-2012

[78] The government owned insurance provider, State Life Insurance Corporation (SLIC) having a share of 57.4 percent towards gross premiums accumulated during H1-CY12 does not offer unit / investment linked policies.

Figure 7.7

ROI of Life insurance companies (percent)

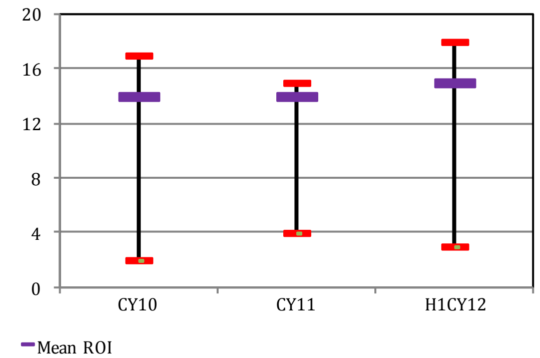


Figure 7.8

Life insurance profitability (Rs. billion)

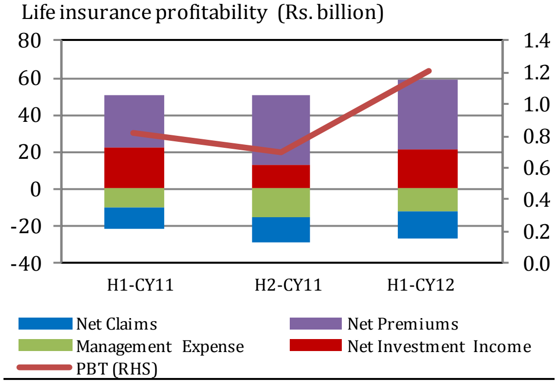


Table 7.2

Soundness of Life Insurance Companies

	2009	2010	2011	H1-CY12
Capital to Assets	1.9	2.5	2.1	1.9
Claims to Capital	399.3	291.6	336.5	365.4
Claims Ratio	46.0	40.7	37.1	36.1
Expense Ratio	41.8	40.5	38.5	32.6
Combined Ratio	87.8	81.2	75.6	68.7
Premium Retention	97.1	97.6	96.9	97.1
Return on Inv.	13.0	13.4	13.2	13.9
ROA	0.4	0.3	0.4	0.3

from 14.2 percent in the first half of 2011. Importantly, the dispersion of returns improved and all the companies reported positive and improved ROI during the first half of CY12 (**Figure 7.7**).

With augmentation in the life insurance business, claims also increased by 21.8 percent (YoY) during H1-CY12. A relatively low growth in claims as compared to the premiums improved the claims ratio of the life insurance business to 36.1 percent during the H1-CY12 as against 38.7 percent in the first half of the preceding year. A hefty proportion of claims were related to realization of event of loss or maturity of policies while 28.5 percent claims were due to surrender of policy contract.

Management Expense of the life insurance business increased due to higher GPW during the period under review, most of which reflected in higher underwriting acquisition cost. However, with healthy growth in gross and net premium, most of the expense ratios declined over the period under review indicating improved efficiency of the operation of the Life insurance industry.

Profitability of the industry improved by 50 percent mainly on account of improved investment income and premium revenues (**Figure 7.8**) However, due to disproportionate increase in assets, ROA of industry declined marginally. Though majority of the companies posted profits, however, improved earning of a couple of companies provided for most of the increase in profitability.

The equity of the insurance industry saw a 1.8 percent growth mainly due to improved profitability. In addition, the statutory funds as required under the SECP solvency rules also improved on account of healthy growth in premiums. With the recent amendments in the solvency rules, it is expected that the statutory funds will further strengthen (**Table 7.2**).

Non-Life Insurance

The net premiums revenues of the non-life saw a marginal decline of 1.1 percent during first half of CY12[79] over the corresponding period of the last year. The decline resulted from shrinking premium revenues from Auto, Marine and Miscellaneous insurance due to higher reinsurance cost. Health

[79] Gross premiums = Net premiums + Reinsurance expense

Figure 7.9

Non-life net premiums and claims ratio

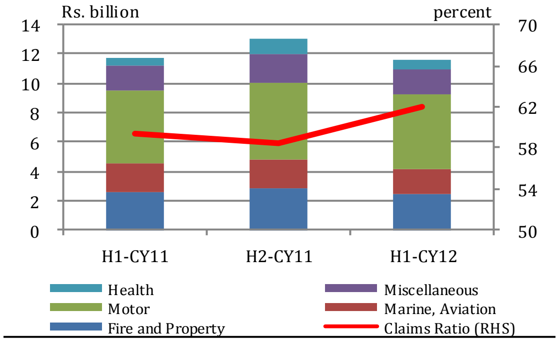


Figure 7.10

ROI of Nonlife insurance companies (percent)

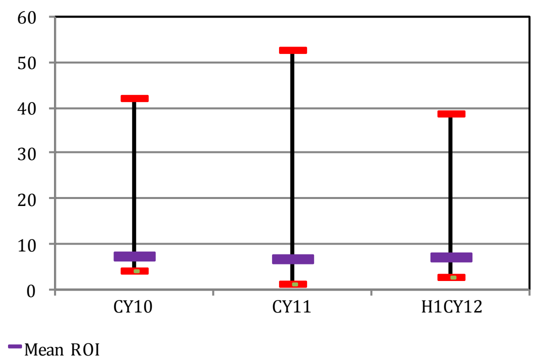
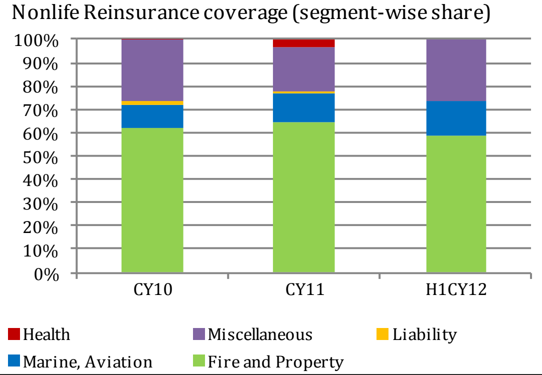


Figure 7.11

Nonlife Reinsurance coverage (segment-wise share)



insurance continued to attract higher premium and increased by another 30 percent during the period under review, thus limiting decline in overall net premiums (**Figure 7.9**).

Globally, the nonlife reinsurance market has re-emerged from depressed premium growth especially in crisis-hit advanced economies and its performance improved since 2009. However, with the increased catastrophe in the last few years the cost of reinsurance seems to have increased. In case of Pakistan, flood, torrential rains, security concerns, prevailing economic conditions and other unforeseen events have forced the general insurers to limit the risk in fire, marine and miscellaneous items through reinsurance. The industry draws major portion of GPW from these categories, however in wake of the prevailing risks, major part of the GPW is passed on to the reinsurers, which actually squeezed the net premium to almost 50 percent of the GPW by the industry (**Figure 7.10**). Meanwhile, with a rather limited and relatively expensive reinsurance of auto business, the nonlife insurance providers preferred to keep risk in this segment, which made auto insurance the major contributor towards net premium revenues for the nonlife providers.

During H1-CY12 net claims expense remained almost at the level of corresponding period of the last year. Auto claims formed major part of the claims expense, an outcome of increasing auto theft. Auto claims have actually been on the rise for last few years and as a result, insurance companies have become selective in auto insurance business. This also reflected in the fact that despite substantial increase in auto sales (sum of local and imported vehicles), the motor insurance coverage has not picked up. Additionally banks, which are the main business source for insurance companies, also shed a substantial amount of auto financing over the last four years (**Figure 7.11**). With almost stagnant claims expense and a decline of 1.1 percent in net premiums, the claims ratio saw a marginal increase of 20bps during H1-CY12.

Like life insurance business, investments form the major part of the non-life insurance assets base. However, unlike life insurance, investment mix mainly constitutes equities, mutual funds, and investment in associates. Analysis of trend shows that size of investment has seen a marginal change over the last three years. However, with a surge in the stock market indices, healthy performance shown by the blue chips and stable stream income from the money market mutual funds, investment income surged YoY by 74 percent to PKR 2.5 billion in H1-CY12.

Figure 7.12

Consumer finance and insurance premiums (Rs. billion)

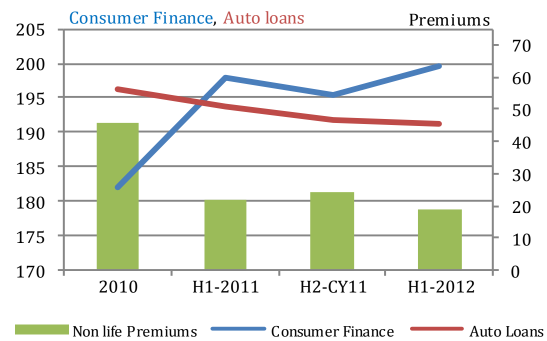


Figure 7.13

Profitability of Nonlife Companies

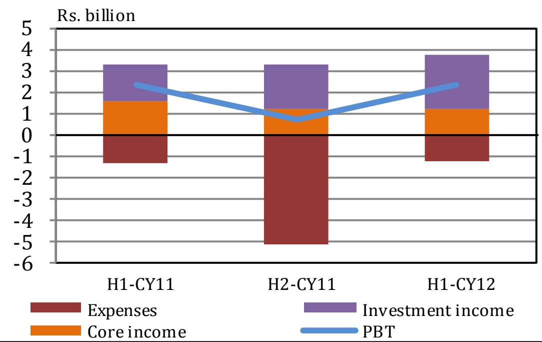


Table 7.3

Soundness of Non-Life Insurance Companies

	2009	2010	2011	H1-CY12
Capital to Assets	57.8	47.9	52.8	52.6
Claims Ratio	62.4	68.1	58.9	62.1
Expense Ratio	23.5	27.1	27.1	26.4
Combined Ratio	85.9	95.2	86.0	88.5
Premium Retention	59.4	54.8	52.7	51.9
Return on Inv.	7.4	6.6	6.8	9.3
ROA	4.1	3.0	2.7	3.9

Table 7.4

Profile of Reinsurance (Rs. billion)

	2010	H1-CY11	2011	H1-CY12
Equity	6.4	5.9	6.4	5.9
Investments	4.7	4.8	5.8	5.2
Gr. Premiums	6.6	2.4	6.9	3.1
Premiums	2.9	1.6	3.5	2.1
Net Claims	1.7	0.9	2	1.0
Expenses	0.3	0.5	0.4	0.6
Profits	0.5	0.4	0.8	0.6
Assets	12.5	10.9	12.9	12.5

The distribution of investment income for the nonlife companies witnessed an upward shift in yields during the first half CY12 (**Figure 7.12**). Not only a high concentration of companies earned more than the average ROI of 9 percent for the nonlife industry, the spreads between the companies' earnings also reduced indicating a rather even playing field for the nonlife providers.[80]

The general insurance industry registered an appreciable improvement in profitability over H1-CY12 thanks to healthy improvement in returns on investment and other non-core activities. The PAT of the industry improved by 100 percent to PKR 3.2 billion and while ROA improved by 270 bps to 5.5 percent.

The underwriting performance of the non-life sector deteriorated during the period under review due to a rather stagnant net premium revenues and rising underwriting expenses, which kept a check on the core income. During H1-CY12, the core income decelerated by 17 percent (**Figure 7.13**), which reflected an increase in claims and expense ratios. On the other hand, improved premium retention facilitated companies in reducing the cost of claims (**Table 7.3**). However, recovery in stock market index and improved corporate performance boosted the share of investment income and overall profitability of the sector.

Reinsurance:

Assets of Reinsurance reduced owing to decline in investments

The improvements in the gross premiums of the non-life insurance providers and subsequent declining premium retention had a direct bearing on the premium accumulation of the local non-life reinsurance company. The half-yearly gross premiums improved to Rs. 3.1 billion during H1-CY12 as against Rs. 2.4 billion in H1-CY11. Moreover, a reduction in the claims ratio to 47.6 percent also improved the profitability of the company to Rs. 0.6 billion (**Table 7.4**).

However, the asset size of the company declined by 3.1 percent during H1-CY12 as stock of investment were reduced owing to a

[80] We have assumed spread as the difference between the maximum and minimum ROI among the nonlife providers.

partial liquidation of its investments mainly for payment of dividends to the shareholders, which led to a decline in retained earnings and equity of the reinsurance company.