| Chapter 7 | Insurance Sector |
|---|---|

*During H1-CY13, steady growth in premiums continued to strengthen asset base of the insurance sector. The life insurance business attracted 17.4 percent higher gross premiums on account of higher retention and improved coverage of new life business. Similarly, the nonlife gross premiums showed a healthy growth of 16.6 percent owing to some improvement in economic activity and revival of auto finance business. In terms of performance, the profitability of the insurance industry surged at the back of higher returns from booming stock market, which generally improved the soundness indictors of the industry.*

**Figure 7.1**

Steady growth in size of insurance industry

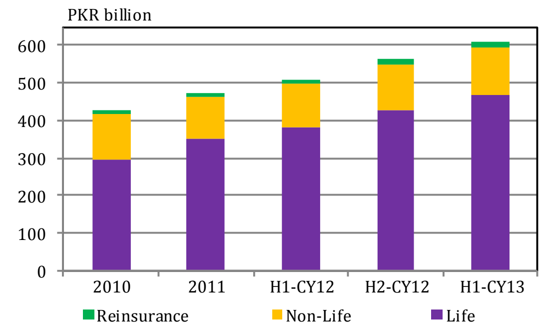



**Figure 7.2**

Insurance gross premium flows

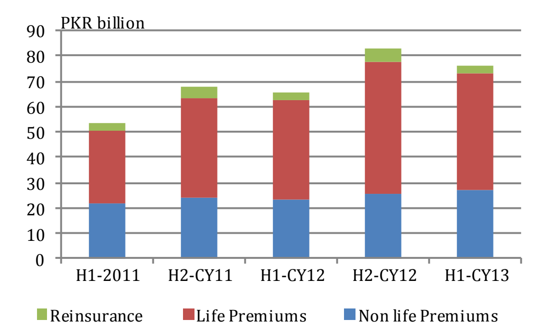
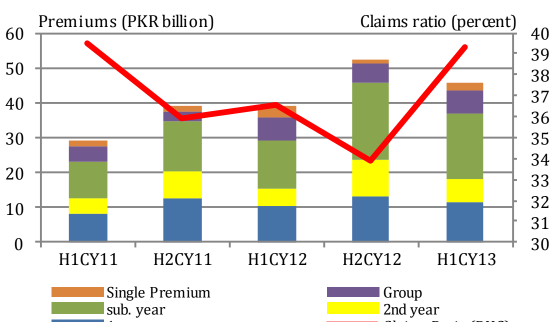



**Figure 7.3**

Life insurance premiums and claims ratio (flows)




### *Asset base of insurance further strengthened as life industry bolsters*

The life insurance sector registered a healthy growth of 9.6 percent at the back of steady premium flows (**Figure 7.1**). The trend of life insurance as a major contributor towards the buildup of sector's assets[68] maintained during H1-CY13. The growth in life industry's assets supported insurance sector cross PKR 600 billion mark. The sector also witnessed a hefty 16.8 percent growth in gross premium accumulation with equally impressive growth in both life and nonlife businesses (**Figure 7.2**). In addition to offering innovative and attractive products, the asset base also increased due to gradual increase in real income of the prospective policyholders[69]. Furthermore, revival of auto finance and risk coverage for security related concerns contributed towards buildup of premiums.

Improved performance of the insurance sector reflected in healthy growth in earnings. The pre-tax profits improved by 73 percent (YoY) to PKR 7.2 billion with a major jump witnessed in the nonlife earnings[70]. Declining claims ratio coupled with robust capital gains and dividends from booming stock market surged profitability of the nonlife companies. Meanwhile, earnings of the life industry witnessed a moderate growth amid increase in the claims ratio and higher underwriting / management expenses.

## Life Insurance

### *Improved life premiums compromised by worsening claims ratio*

The basis for life insurance coverage has been indemnification towards financial losses arising from consequences of death, illness and physical impairment. Apart from conventional policies offered by the life insurance industry of the country, the robust growth in recent years has been largely on account of unconventional unit-

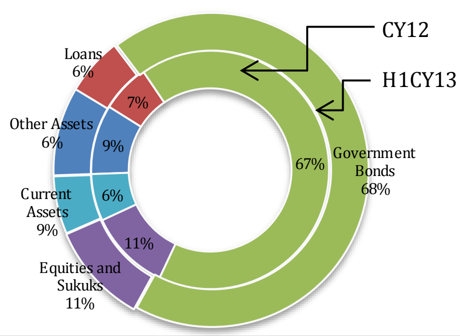
[68] Life insurance, nonlife insurance and reinsurance
[69] Increase in real income is because of declining inflation rate.
[70] The high profitability of the nonlife companies is solely due to large numbers of service providers (36) than the life insurance (9) as of end H1-CY13.

linked products and improved coverage of takaful - Shariah compliant insurance. During H1-CY13, the assets of conventional life insurance companies grew by 9.5 percent; while the family takaful companies witnessed 22 percent growth. Rising demand from prospective policyholders and growing financial business, particularly the Islamic banking complemented the increase in Takaful premiums.

During H1-CY13, the gross life insurance premiums witnessed a robust increase of 17.4 percent (YoY). The family takaful business witnessed yearly 38.9 percent growth in gross contributions as against growth of 16.3 percent in premiums accumulated under conventional means. As a result, the share of takaful business inched up to 5.5 percent of total industry premiums.

**Figure 7.4**

Structure of Life insurance (percent of assets)

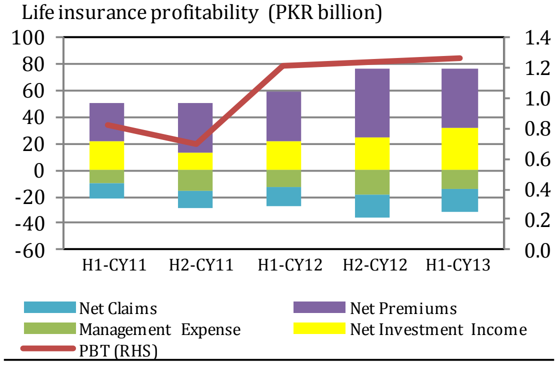



The retention of policyholders – a measure of trust; remained instrumental for growth in premiums. The second year and subsequent premiums witnessed a combined growth of 33.8 percent (YoY) thereby increasing its share to 55.6 percent. Similarly, the premiums from new coverage also increased by 12.2 percent, indicative of improved penetration (**Figure 7.3**). Meanwhile, the claims ratio also worsened to 39.3 percent during the period against 36.6 percent in H1-CY12. Much of the increase in claims was witnessed in case of death and surrenders. However, despite a rise in the claims ratio, 8 out of 9 companies witnessed underwriting surplus[71].

Given the very nature of life insurance business consisting of long-term insurance contracts, much of the assets were placed in long-term government securities. In fact, the life insurance is the second largest investor in government bonds after the banking sector. During H1-CY13, the share of government bonds in total assets inched up to 68 percent, an increase of 1 percent over corresponding period last year (**Figure 7.4**)

**Figure 7.5**

Life insurance profitability (PKR billion)




The profitability of the life insurance increased by 4.1 percent to PKR 1.26 billion during H1-CY13 (**Figure 7.5**). This modest improvement was mainly contributed by increase in investment income, which further enhanced the ROI to 17.1 percent. This remarkable improvement, despite a declining interest rate scenario on government bonds, resulted from gains on sale of investments and higher returns on investment in equities. However, increase in expense including reinsurance cost and net claims kept the growth in net income and overall profitability under check. As such the ROA of the sector deteriorated over the period under review.

[71] Underwriting surplus is the excess of net premiums after deducting expenses of net claims, underwriting expenses and commission to other companies / agents.

| **Table 7.1: Soundness of Life Insurance Companies** | | | | |
|---|---|---|---|---|
| (Percent) | CY11 | H1CY12 | H2CY12 | H1CY13 |
| Capital to Assets | 2.1 | 1.9 | 2.0 | 1.9 |
| Claims to Capital | 336.5 | 365.4 | 401.7 | 387.0 |
| Claims Ratio | 37.1 | 36.1 | 35.1 | 39.3 |
| Expense Ratio | 38.5 | 32.6 | 35.3 | 32.1 |
| Combined Ratio | 75.6 | 68.7 | 70.4 | 71.4 |
| Premium Retention | 96.9 | 97.1 | 98.1 | 97.8 |
| Return on Inv. | 13.2 | 14.0 | 14.2 | 17.1 |
| ROA | 0.4 | 0.3 | 0.9 | 0.5 |

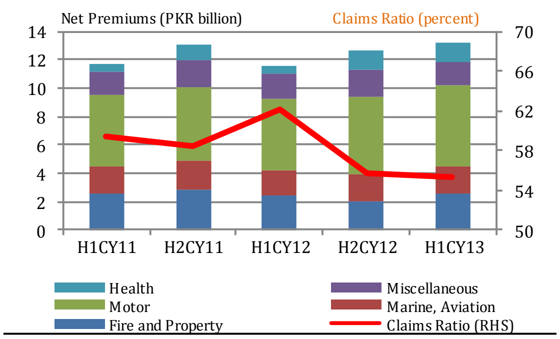
The financial soundness of the life industry highlighted mixed results (**Table 7.1**). The capital adequacy as measured by capital to assets ratio deteriorated marginally as growth in equity was moderate by deceleration in returns. The life insurance providers succeeded in limiting the expense ratio; however, the combined ratio increased due to an increase in the claims ratio. The life business in its present form is almost fully retained by the companies themselves (lack of reinsurance) which may stress the capital of the life insurance companies in face of any adverse shock.

**Nonlife Insurance**

***Nonlife benefited from Lower claims ratio and bullish equity market returns***

**Figure 7.6**

Non-life net premiums and claims ratio




Backed by revival in consumer finance, specifically auto loans and some improvements in economic activity as measured by the LSM index, the nonlife insurance business gathered momentum during H1-CY13. It witnessed a healthy 16.6 percent (YoY) increase in gross premiums; while premiums net of reinsurance registered a strong growth of 11.4 percent. Much of this improvement occurred due to surge in health insurance business that saw 100 percent increase during the period (**Figure 7.6**). Meanwhile, the motor insurance remained the highest contributor towards premium accumulation as its share increased to 43 percent.

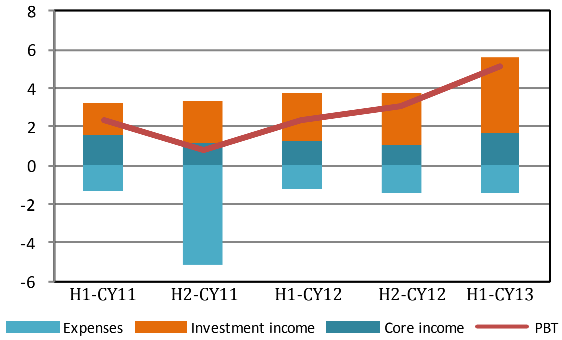
In addition to improvements in premiums, the absolute claims remained almost at the level of corresponding period last year that reduced the claims ratio to 55.3 percent. The dip largely resulted from higher reinsurance coverage on nonlife business. Within the claim categories, the health insurance related claims remained high at 89.2 percent indicating a risky venture for the companies and posing technical risk in terms of mispricing of health premiums. Similarly, the motor and marine business also faced higher claims ratio of 57.9 percent and 51.8 percent respectively that also reduced the underwriting income and in fact, ten companies posted underwriting losses. However, investment income provided for improved profits and strengthened capital adequacy.

| **Table 7.2: Soundness of Non-Life Insurance Companies** | | | | |
|---|---|---|---|---|
| (Perxent) | CY11 | H1CY12 | H2CY12 | H1CY13 |
| Capital to Assets | 52.8 | 52.6 | 50.7 | 49.5 |
| Claims Ratio | 58.9 | 62.1 | 55.6 | 55.3 |
| Expense Ratio | 27.1 | 10.4 | 13.5 | 13.3 |
| Combined Ratio | 86.0 | 72.5 | 69.1 | 68.6 |
| Premium Retention | 52.7 | 51.9 | 49.5 | 48.9 |
| Return on Inv. | 6.8 | 9.3 | 9.8 | 13.2 |
| ROA | 2.7 | 3.9 | 4.9 | 4.0 |

The salient feature of the performance of the nonlife insurance has been the robust growth in its profitability. During H1-CY13, the earning of non life insurance surged by 118 percent (YoY) to PKR 5.1 billion, that doubled the ROA to 8.2 percent (**Table 7.2**). Nonlife companies witnessed a vigorous growth in profitability owing to healthy returns on equity market investments and mutual funds. Furthermore, the dividend income and profits on bank deposits also contributed to significant growth of profitability (**Figure 7.7**).

**Figure 7.7**

Profitability of Nonlife Companies (PKR billion)




The soundness indicators of nonlife service providers exhibited relatively steady position. Improved earnings during the year boosted the equity base of the non-life business, which improved the capital to assets ratio by 40 bps. Meanwhile with a reduction in claims ratio, the expense ratio also reduced to 68.6 percent.

## Reinsurance

### *Asset base decline and yet profits rise*

The nonlife reinsurance witnessed a 9.3 percent decline in the asset base during H1-CY13 largely for settlement of amounts due to other insurers and dividend payout during the period under review. The company distributed PKR 900 million annual cash dividend for CY12 to its shareholders which reduced the equity of the company through partial liquidation of investments that shrunk by 4.7 percent. However, the gross premiums did improve by 9.7 percent (YoY) on account of healthy growth in nonlife business.

The operating performance of the company observed improvement during H1-CY13 as company posted 33 percent higher earnings (YoY) basis. Though underwriting income declined due to increase in claims and premium related expenses, profits of the company surged at the back of healthy returns on investments that led to increase in ROA to 10.4 percent in H1-CY13 compared to 9.4 percent in H1-CY12 (**Table 7.3**).

**Table 7.3: Profile of Reinsurance** (PKR billion)

| | CY11 | H1CY12 | H2CY12 | H1CY13 |
|---|---|---|---|---|
| Equity | 6.4 | 5.9 | 6.3 | 6.0 |
| Investments | 5.8 | 5.2 | 6.4 | 6.1 |
| Gr. Premiums | 6.9 | 3.1 | 5.1 | 3.4 |
| Net. Premiums | 3.5 | 2.1 | 2.1 | 2.2 |
| Net Claims | 2 | 1.0 | 1.0 | 1.1 |
| Expenses | 0.4 | 0.6 | 0.6 | 0.7 |
| Profits | 0.8 | 0.6 | 0.6 | 0.8 |
| Assets | 12.9 | 12.5 | 16.1 | 14.6 |