# 6 Insurance

*The trend of improved premiums and strengthening of asset base prevailed in the insurance sector during the last two years which are reflected in comfortable stability indicators. Growth in gross premiums helped in improving asset base of life insurance, which now constitutes more than 80 percent of the overall insurance sector of Pakistan. This also resulted in an increase in insurance penetration in the country to 0.8 percent. Despite rise in management expenses, deceleration in net claims and growth in investment income improved the profitability of life insurance. The non-life insurance sub-sector and the takaful business, in general, are also growing. Growth in assets of insurance sector has remained consistent for the last two years.*

The insurance sector[144] has considerably prospered in recent years **(Figure 6.1).** Life insurance continues to dominate the sector with over 80 percent share as of H1CY15. Since H1CY13, the growth in life insurance has consistently remained around 21 percent (YoY). On the other hand, non-life insurance grew by only 6.2 percent (YoY) as of H1CY15 compared to 12 percent (YoY) as of H1CY14.

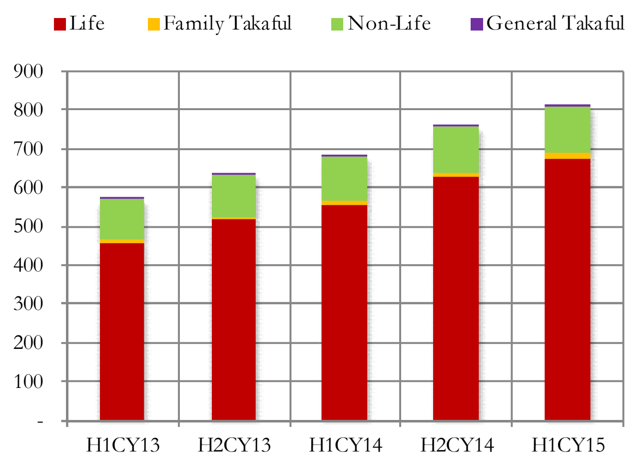
Family takaful grew by another 35.6 percent (YoY) in H1CY15 compared to 44 percent (YoY) in H1CY 14. Similarly, there was an increase of 29.3 percent (YoY) in general takaful business during H1CY15 (9.0 percent (YoY) growth in H1CY14). Overall, both family and general takaful business only comprised 1.9 percent of the total assets of the insurance sector in H1CY15 against 1.6 percent in H1CY14.

*…as gross premiums of conventional insurance sector have flourished*

During H1CY15, gross premiums of conventional insurance grew by PKR 18.3 billion (or 24.9 percent (YoY)) to reach PKR 91.8 billion as compared to an increase of PKR 9.5 billion (or 14.8 percent (YoY)) during H1CY14 **(Figure 6.2)**. Around two-third of these premiums were contributed by life insurance business. Gross premiums of life insurance grew by 32 percent, while that of non-life insurance increased by 11.8 percent for the half-year ended Jun-15.

**Figure 6.1**
**Steady growth in size of insurance sector**

Assets of insurance sector
(PKR billion)




Source: Unaudited/Audited published financial statements of life insurers, non-life insurers, family takaful and general takaful companies.

*Domestic sector fared well when compared with international emerging markets*

In comparison with other emerging markets and rest of the world, the domestic conventional insurance market performed reasonably well as the growth in

144 The analysis is based on the data of 5 life insurers and 22 non-life insurers covering 98 percent and 83 percent of the life and non-life insurance sectors, respectively. The analysis covers data up to half-year ending June 2015. The financial close for insurers is December of the corresponding year. All growth ratios are on year-on-year basis.

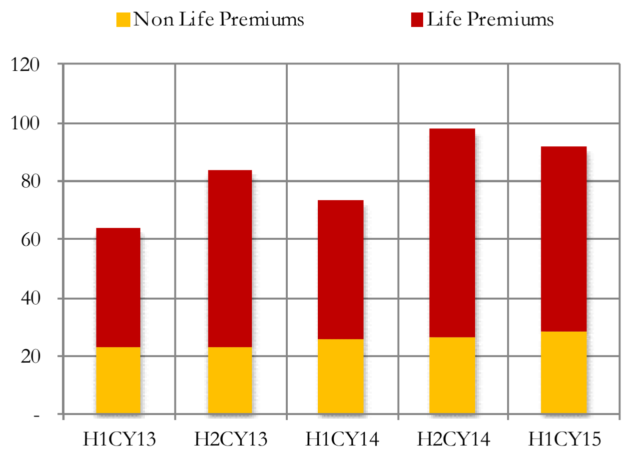
real premiums was well beyond other markets **(Table 6.1)**.

**Figure 6.2**

**Consistent rise in gross premiums of insurance sector**

Gross premiums (flows) of the insurance sector

(PKR billion)




Source: Unaudited/Audited published financial statements of life and non-life insurers.

### Table 6.1

Real Premium Growth Rates in 2014

| | Life | Non-life | Total |
|---|---|---|---|
| | | percent | |
| Advanced Countries | 3.8 | 1.8 | 2.9 |
| Emerging Countries | 6.9 | 8.0 | 7.4 |
| Pakistan | 12.7 | 18.0 | 16.6 |
| World | 4.3 | 2.9 | 3.7 |

Source: Swiss Re Sigma http://www.swissre.com/sigma/ and unaudited/audited published financial statements of insurance companies.

However, despite higher growth in the domestic sector, the insurance penetration still remained one of the lowest in the world. During CY14, the insurance penetration was 0.8 percent[145] which did manage to increase from 0.5 percent in CY13 and 0.3 percent in CY12[146]. As a result, Pakistan was ranked 80th among sample of countries.

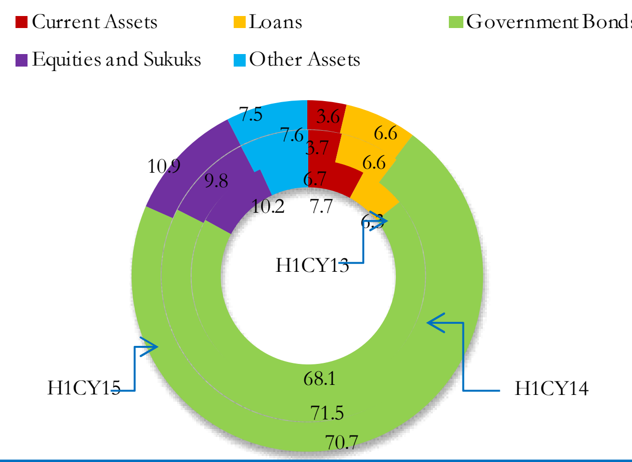
## Life Insurance

**Figure 6.3**

**Government securities continue to be the main investment avenue**

Structure of Life Insurance

(percent)




Source: Unaudited published financial statements of life insurance companies.

*Life insurance business continues to grow during last two years…*

The life insurance segment has performed well during the last two years in terms of strengthening of asset base and rising premiums. The asset base further increased by 21.5 percent (YoY) during H1CY15 as the companies kept on building investments largely in long-term risk free government securities funded by rising premiums and accumulated profits. As a result, 70.7 percent of assets of life insurance constituted of government securities while 10.9 percent of investments were made in other avenues such as listed shares, mutual funds and Sukuks **(Figure 6.3)**.

145 For further information, please see: http://www.swissre.com/

146 The Securities and Exchange Commission of Pakistan (SECP) has given different penetration ratios: 0.67 percent for 2011-12; 0.73 percent for 2012-13; and 0.77 percent for 2013-14. For further information, please see: http://www.secp.gov.pk/annualreport/2015/Annual-Report-2015.pdf

*Gross premiums significantly flourish…*

The gross premiums surged by 32 percent for the half year ending Jun-15 compared to 16.3 percent rise for the half year ending Jun-14. This was largely on account of attractive returns on unit-linked[147] policies and improved distribution channels including bancassurance[148].

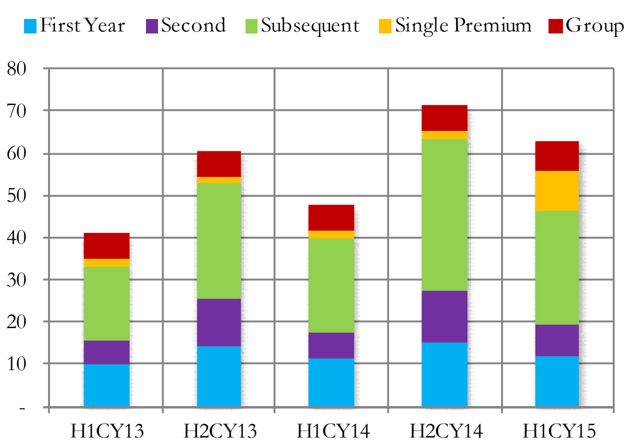
The first year premiums showed a growth of 7.5 percent for the half year ending in June 2015; however, its share in gross premiums declined to 19.4 percent from 23.8 percent in H1CY14. Similarly, although subsequent premium (beyond two years) grew by 22.3 percent in H1CY15 (YoY), its share in gross premiums declined in H1CY15.

**Figure 6.4**

**Life insurance premiums considerably grew**

Life insurance premiums (flows) and claims ratio

(PKR billion)




Source: Unaudited/ Audited published financial statements of life insurance companies.

This was due to a significant increase in single premiums which increased its share in gross premiums to 15.3 percent in H1CY15 from 3.8 percent in H1CY14. One major company's success of a single premium product with a bank partner, who has been very aggressive in its distribution strategy, has been the major reason for the rise.

Besides individual premiums, the group premiums also witnessed 15.3 percent growth in H1CY15, while its share declined to 11.4 percent owing to higher single premiums **(Figure 6.4)**.

*…while growth in net claims decelerated*

The net claims witnessed significantly lower growth in H1CY15; 13.1 percent compared to 26.3 percent in H1CY14. Much of the claims were on account of maturity (17.8 percent) and events of death (10.9 percent) of the insured. However, the share of claims incurred on account of surrender of policies also increased to 48.1 percent.

The common reasons for cancelation of policy by the insurers could be their inability to pay premiums or expecting less benefit out of it. However, the surrenders have also increased as investment-linked policy holders tended to book immediate profits from rising unit prices (possibly as the investments were mostly made in long term government securities whose prices increased as the interest rates declined).

Therefore, the down-side risk of unit-linked insurance products is very high as it might affect the profitability of the life insurance providers. However, the very same product has also increased the business of companies during the last few years.

*Higher investment returns also supported life insurance profitability…*

Besides improvements in core underwriting business, the life insurers also witnessed 14 percent return on investments as of H1CY15 **(Figure 6.5)**. Specifically, the return on government securities

[147] "Unit-linked" in relation to life insurance means individual life insurance contracts offering life insurance coverage coupled with saving component where the saving component is managed through operating unit-linked investment funds.

[148] Bancassurance is an alternate distribution channel to sell life insurance products through banks. This line of insurance business ensures wide coverage at lesser procurement cost.

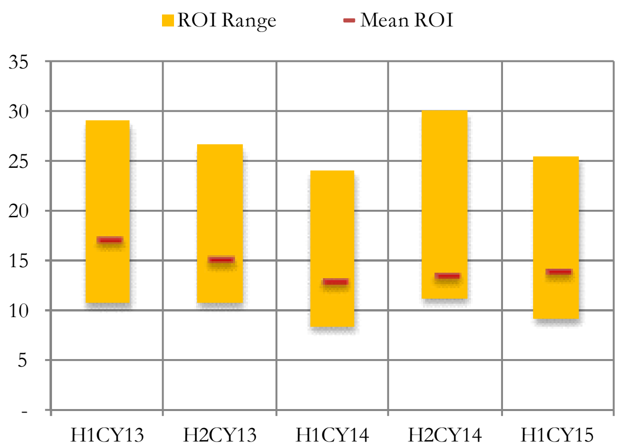
stood at 11.5 percent. Due to long-term nature of investments, life insurance is not faced with an immediate rollover risk. However, decline in government yields during the last two years has started to impact investment returns. As a result, insurers have moved some funds to more attractive yet riskier avenues of equity investments; the share of fixed securities and equities investments to total assets has increased from 9.8 percent in H1CY14 to 10.9 percent in H1CY15.

**Figure 6.5**

**Return on investments continues to support reveneues**

ROI of Life insurance companies

(percent)




Source: Unaudited/Audited published financial statements of life insurance companies.

*Overall profitability of life insurance considerably improved during the last two years…*

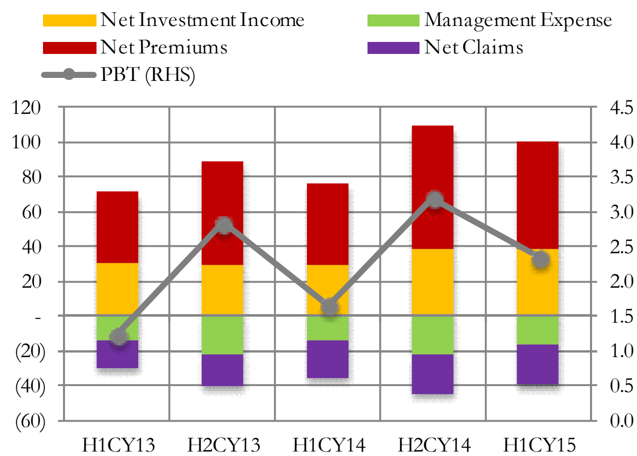
Given the aforementioned increase in premiums and investment income, and deceleration in claims, profitability of the life insurance segment significantly improved over the last two years. Profit before tax (PBT) has reached to PKR 2.4 billion (a surge of 42 percent (YoY)) during the half year ending Jun-15 compared with profits of PKR 1.7 billion (an increase of 33.9 percent (YoY)) during the half year ending Jun-14 **(Figure 6.6).** As a result, the ROA of the life segment also improved from 0.6 percent in H1CY14 to 0.7 percent in H1CY15.

**Figure 6.6**

**Life insurance profitability**

Life insurance profitability (flows)

(PKR billion)




Source: Unaudited/Audited published financial statements of life insurance companies.

**Table 6.2**

Soundness of Life Insurance

| | H1CY13 | H2CY13 | H1CY14 | H2CY14 | H1CY15 |
|---|---|---|---|---|---|
| | percent | | | | |
| Capital to Assets | 1.6 | 1.7 | 1.7 | 1.7 | 1.6 |
| Claims to Capital | 224.4 | 396.7 | 227.9 | 402.4 | 227.1 |
| Claims Ratio | 41.5 | 35.3 | 45.0 | 37.3 | 38.4 |
| Expense Ratio | 32.9 | 34.9 | 29.5 | 30.1 | 25.1 |
| Combined Ratio | 74.5 | 70.1 | 74.5 | 67.4 | 63.5 |
| Premium Retention | 98.0 | 98.3 | 98.2 | 98.5 | 98.6 |
| Return on Investment | 17.3 | 15.2 | 13.1 | 13.7 | 14.0 |
| ROA | 0.5 | 0.8 | 0.6 | 0.8 | 0.7 |

Source: Unaudited/Audited published financial statements of life insurance companies.

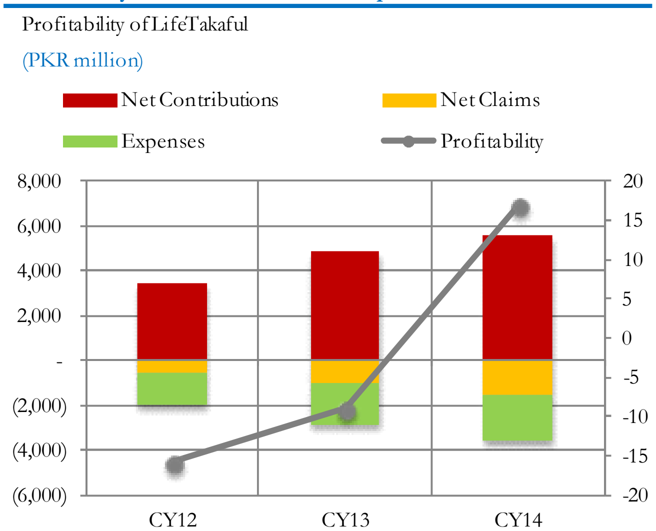
*Not surprisingly, the financial soundness indicators of life insurance remained stable…*

Solvency profile of the life insurance segment remains steady as claims to capital ratio slightly declined, while capital to assets ratio also minutely decreased as of H1CY15. Although, management expenses rose during the half year ending June 2015, the expense ratio improved on account of higher growth in gross premiums. By the same token, the claims ratio came down to 38.4 percent during the same period **(Table 6.2)**.

The life insurance segment carries concentration risk as it is dominated by a single public sector entity. The company can be categorized as "too big to fail" i.e. its financial distress can have systemic implications and may require government intervention. However, the risk of contagion spreading across other insurance segments might be limited; its subsidiary, a non-life insurer, has minimal market share in the non-life segment.

**Figure 6.7**

**Profitability of LifeTakaful business improved**




Source: Unaudited/Audited published financial statements of family takaful companies.

*Family takaful business shows promise…*

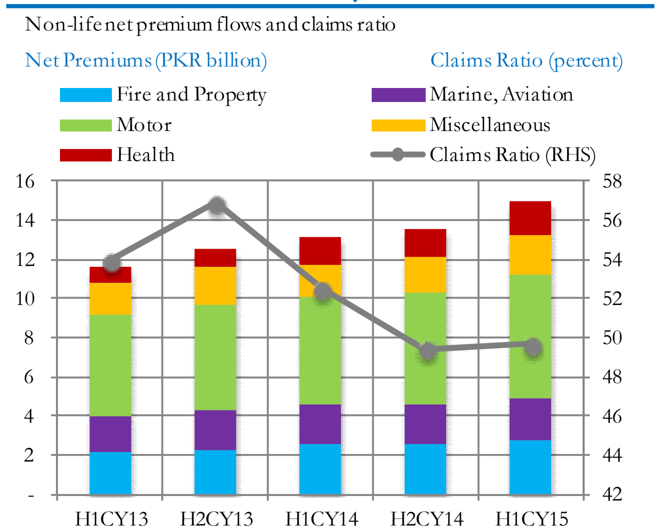
During CY14[149], family (life) takaful companies also witnessed improvements in gross contributions and asset buildup by 15.3 percent (YoY) and 37.6 percent (YoY), respectively **(Figure 6.7)**.

In the past, higher management expenses had significantly dented the profitability of family takaful companies. However, this trend changed in CY14 as family takaful business posted profit after continuous losses in CY12 and CY13. This was largely attributable to deceleration in expenses; 9.8 percent rise in CY14 compared to 29.2 percent increase in CY13. Overall, with improving share in insurance sector and opening of a number of family takaful windows of conventional life insurance companies, family takaful business shows a lot of promise in near future.

## Non-life Insurance[150]

**Figure 6.8**

**Non-life claims ratio remained steady**




Source: Unaudited/Audited published financial statements of non-life insurance companies.

*Non-life insurance business moves ahead…*

The non-life insurance segment witnessed an 11.8 percent (YoY) increase in gross premiums in H1CY15; while premium net of reinsurance registered an increase of 13.6 percent (YoY) with

[149] Analysis in this section is based on results up to CY14.

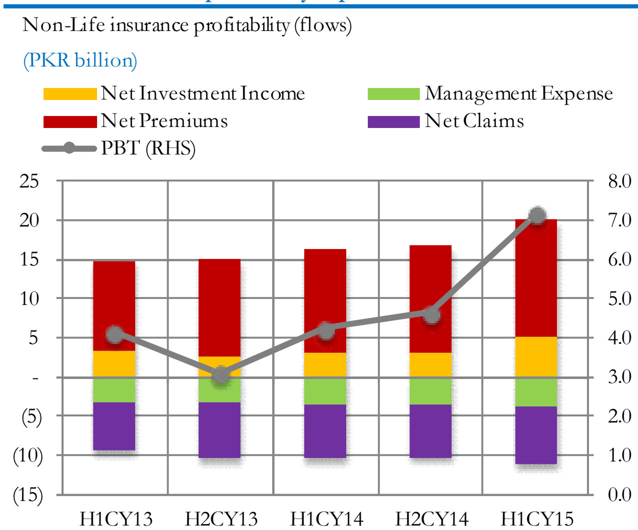
[150] The data covers more than 83% of the general insurance industry assets. The insurance industry data does not encompass National Insurance Company Limited which has not published its annual accounts since 2009.

motor vehicle and miscellaneous sub-sectors being the main drivers for growth in net premium. Meanwhile, the motor vehicle sub-sector remained the highest contributor towards premium accumulation with a share of 42 percent. **(Figure 6.8)**

During the same period, however, net claims increased by 7.5 percent (YoY). As the net premiums increased more rapidly than the net claims, there is an overall decrease in the claims ratio (49.7 percent as of H1CY15 against 52.5 percent as of H1CY14). This implies better underwriting performance by non-life insurers.

**Figure 6.9**

**Non-Life insurance profitability improved**




Source: Unaudited/Audited published financial statements of non-life insurance companies.

The profit of the non-life segment grew by 68.6 percent mainly due to an increase in investment income of 66.2 percent; investment income is also the main component of gross revenue at 58.6 percent. Overall, the Profit Margin has significantly increased to 40.1 percent. **(Figure 6.9)**

The financial soundness indicators show that the non-life insurance segment is relatively stable **(Table 6.3)**. The combined ratio indicates that the net premium underwritten is sufficient to cover the claims and expenses.

Improved earnings due to an increase in net premiums and investment income have led to an increase in ROA to 11.7 percent. Return on Investment has significantly increased to 16.6 percent as of H1CY15.

**Table 6.3**

Soundness of Non-Life Insurance

| | H1CY13 | H2CY13 | H1CY14 | H2CY14 | H1CY15 |
|---|---|---|---|---|---|
| | percent | | | | |
| Capital to Assets | 11.1 | 12.7 | 13.4 | 13.6 | 13.8 |
| Claims Ratio | 53.9 | 55.5 | 52.5 | 50.9 | 49.7 |
| Expense Ratio | 26.8 | 26.7 | 26.3 | 25.9 | 24.3 |
| Combined Ratio | 80.7 | 82.2 | 78.8 | 76.9 | 74.0 |
| Premium Retention | 50.6 | 52.0 | 51.3 | 51.5 | 52.1 |
| Return on Investment | 13.3 | 11.0 | 10.8 | 10.5 | 16.6 |
| ROA | 8.1 | 6.7 | 7.4 | 7.6 | 11.7 |

Source: Unaudited/Audited published financial statements of non-life insurance companies.

In order to improve financial soundness, the pubic non-life insurer needs to publish its financials to improve transparency. Pending litigation cases pertaining to the company also need to be speedily addressed to reduce systemic risk.

In order to expand the non-life insurance segment further, the government needs to allow private non-life insurers to provide general insurance coverage to public property; the Insurance Ordinance, 2000 provides that all insurance business relating to any public property or to any risk or liability pertaining to any public property, shall be placed with the pubic non-life insurer only and shall not be placed with any other insurer[151].

[151] Government urged to end NICL ‘monopoly’ at http://www.dawn.com/news/1183000 http://www.secp.gov.pk/corporatelaws/pdf/InsuranceOrdAmended-Nov2011.pdf

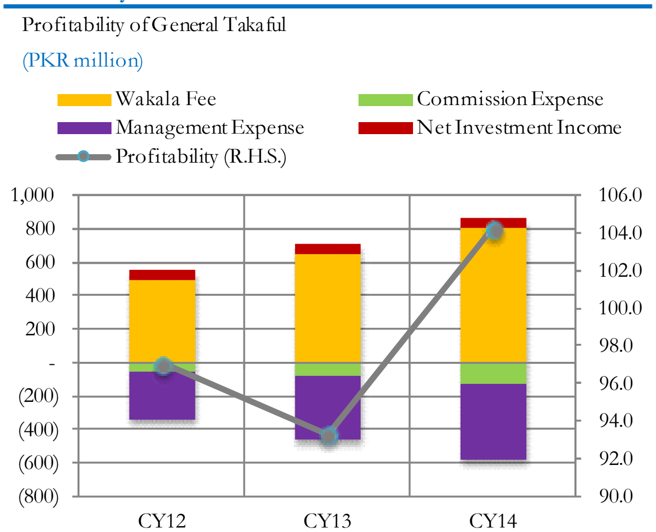
*General takaful asset base has significantly increased…*

General (non-life) takaful[152] only comprises 2 percent of the non-life insurance business but is expected to grow rapidly due to the entry of non-life (conventional) insurers into the general takaful segment. They are allowed to offer takaful services through dedicated windows under Takaful Rules 2012 as Window Takaful Operators. Accordingly, general takaful's asset base has increased by 29.3 percent as of H1CY15 (YoY).

The general takaful segment witnessed an increase in profitability by 11.8 percent (YoY) in the shareholder's fund, mainly due to an increase of 22.5 percent in Wakala fee; the increase in profitability was offset by increases in commission and management expense. **(Figure 6.10)**

**Figure 6.10**

**Profitability of General Takaful business increased**




Source: Unaudited/Audited published financial statements of general takaful companies.

However, the Participants' Takaful Fund (PTF)[153] of general takaful is still reporting losses; it reported losses of PKR 221 million for the year ended Dec-14.

*…potential for further growth in insurance sector*

Pakistan has a low insurance penetration rate which implies that there is a lot of potential for growth of the insurance industry.

The future for the insurance sector looks stable. CPEC and Iran-Pakistan gas pipeline can provide insurance companies an opportunity to underwrite related developmental projects. However, the government may consider allowing local insurers to underwrite such large developmental projects in conjunction with large international insurers. The withdrawal of reinsurers may also deter the government from allowing local insurers to underwrite large developmental projects on their own.

The lack of reinsurers has also contributed to increased concentration risk. This has been slightly mitigated by insurers establishing reinsurance contracts with international reinsurers. However, all insurers are mandated to offer 35 percent of their surplus business to Pakistan Reinsurance Company[154] in the form of cession; thus, limiting the business which can be reinsured with international reinsurers.

In order to strengthen the market infrastructure and the regulatory regime, SECP, the insurance industry regulator, is considering revising the insurance regulatory framework, establishing an insurance repository, issuing a Code of Corporate Governance for the Insurance Sector[155] etc.

SECP is also considering policies to promote micro insurance which may focus on lower capital requirements for dedicated micro insurance companies, introduction of minimum quota for

[152] Analysis in this section is based on results up to CY14.
[153] The Participants' Takaful Fund (PTF) is managed by the takaful operator; it is separate from the shareholders' fund.

[154] Pakistan Reinsurance Company Limited (PRCL) is a public sector company under the administrative control of the Ministry of Commerce.
[155] SECP has issued revised Code of Corporate Governance vide SRO 160(i)/2016 dated February 26, 2016.

micro insurance business, etc. Subsequently, insurers, including State Life, are looking to launch micro insurance products like micro insurance accidental cover and micro-health insurance, specifically catering to this segment.

In order to reduce systemic risk in the insurance industry, the issue of inadequately-capitalized insurers needs to be resolved. Inactive and active insurers which are inadequately capitalized may consider mergers to meet the provisions of the Insurance Ordinance, 2000 (which requires that paid-up capital should be PKR 300 million for non-life and PKR 500 million for life insurers, respectively). The issue of inadequately capitalized insurers will become more critical as the SECP intends to increase the minimum paid-up capital requirements to PKR 500 million and PKR 700 million for non-life and life insurers, respectively, by the year end 2017.

Pending litigation cases pertaining to various insurers also need to be expeditiously resolved.

Pakistan is also host to (at least) two global-systemically important insurers (G-SIIs); Allianz SE and AIG. However, due to their small marker share, Pakistan is not particularly susceptible to global market risks.

*…expect acceleration in growth of general takaful assets*

Recently, many conventional insurers have also been allowed to undertake takaful business as Window Takaful Operators under Takaful Rules, 2012. It is, therefore, expected that the larger insurers will enter the takaful segment to expand their business.

This may be disadvantageous for full-fledged takaful companies which have limited outreach; Window Takaful Operators will have greater outreach to expand their takaful business through their larger branch network and extensive agency arrangements (Bancassurance, mobiles, internet etc.) for distribution of their products.