4.3 Performance and Risk Analysis of Insurance Sector

Global life and non-life insurance sectors have grown mainly on the back of the momentum in the emerging markets. In Pakistan, the insurance industry's asset base has increased by 12.09 percent due to the accelerated economic activity, ease of structural constraints, aggressive marketing and sales (including bancassurance), increasing acceptance of Takaful products, wider use of technology, etc. These factors coupled with the low insurance penetration ratio may help sustain growth in the future.

Emerging markets driving global insurance growth …

Global life and non-life premiums have grown by 3 percent in 2017. Emerging markets, particularly emerging Asia, continue to provide growth opportunities for insurers.

In the non-life insurance sector, large natural catastrophe events in AEs (particularly in the US and Mexico) have drained capital out of the property and casualty insurance sector. There have been price increases in loss-affected segments/ regions where profitability was already strained (such as the motor segment). Emerging markets have witnessed non-life premium growth of 6 percent in 2017.

Global life insurance premiums have grown based on robust performance of savings products in emerging markets. However, profitability remains challenging due to the low interest rate environment, which is putting downward pressure in investment returns. In emerging markets, growth in premium is estimated to be at 17 percent in 2017.[215]

The insurance industry in Pakistan has expanded in CY17

Insurance, constituting 5.3 percent of total financial sector assets, is the second largest sector in the financial industry. Its asset base has registered an increase of 12.09 percent and the gross premium has grown by 12.18 percent during CY17[216]. (**Table 4.3.1**)

Table 4.3.1

Overview of Insurance Industry (as of December 31, 2017*)

	Life	Family Takaful	Non-Life	General Takaful	Total
	(PKR Million)				
Assets	1,007,123.6	22,640.2	179,611.9	2,403.2	1,211,778.8
Investments	787,923.8	13,233.7	89,013.3	534.8	890,705.6
Shareholders' Equity	15,365.6	1,526.3	85,955.8	914.9	103,762.6
Profitability	8,547.9	181.7	11,836.8	(185.7)	20,380.6
Gross Premium	185,298.0	9,576.3	74,340.5	1,472.4	270,687.3
Net Premium	183,130.8	1,632.5	41,651.6	529.5	226,944.4
Net Claims	76,745.1	1,090.1	21,146.1	575.0	99,556.3
	(Percent)				
Claims Ratio	41.91	66.77	50.77	108.59	43.9

*Estimated Figures

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

The accelerated economic activity, ease of structural constraints (such as allowing conventional insurers to transact window Takaful business, issuing relevant regulations to achieve uniformity, etc.),

215 Swiss Re's Global insurance review 2017 and outlook 2018 /19

216 The analysis is based on the data of 5 life insurers and 28 non-life insurers covering approximately 97 percent and 78 percent of the life and non-life insurance sectors, respectively. The analysis covers data up to period ending December 31 2017. Data for December 31, 2017 has been estimated, where necessary. The financial close for insurers is December of the corresponding year. All growth ratios are on year-on-year basis.

relatively low inflation and use of technology based distribution channels, among others, have facilitated the increase in assets and premiums for the insurance industry.

The insurance industry's profitability, while adequate, has declined due to subdued investment income - an outcome of low interest rate environment - and restructuring of a few general insurers. The industry maintains adequate equity to underwrite new policies.

In addition, the Takaful segment's asset base has increased by 15.09 percent to PKR 25 billion[217]. Overall, the segment has witnessed growth in gross premium by 7.61 percent to PKR 11 billion despite a decline in gross premiums for General Takaful.

Due to the overall improvement in the insurance industry, Pakistan's insurance penetration ratio has also improved slightly from 0.79 percent in 2016 to 0.82 percent in 2017.[218]

The life insurance sector has continued its growth momentum

Life insurance leads the industry with 83.11 percent share in total insurance assets and 68.45 percent share in gross premium. Its assets have increased by 13.43 percent to PKR 1,007.1 billion in CY17 (**Table 4.3.2**).

Investments constitute about 78.24 percent of total assets for the sector with majority of investments in government securities. The sector has further increased its investments in government securities by 15.44 percent to PKR 679.8 billion (total investments of PKR 787.9 billion) in CY17.

Table 4.3.2

Profile of Life Insurance

	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17*
	(PKR billion)				
Gross Premium	101.7	119.4	145.1	160.4	185.3
Net Premium	100.0	117.6	143.3	158.1	183.1
Net Investment Income	60.6	68.2	75.5	97.0	61.0
Net Claims	35.2	43.8	54.6	68.4	76.7
Expenses	34.9	35.4	40.3	43.4	50.1
Profitability	4.1	4.9	6.4	7.9	8.5
Assets	516.9	626.0	746.5	887.9	1,007.1
	(Percent)				
Capital to Assets	1.72	1.74	1.69	1.61	1.53
Claims Ratio	35.26	37.26	38.10	43.27	41.91
Combined Ratio	70.14	67.40	66.21	70.71	69.28
ROA	0.79	0.78	0.85	0.89	0.85

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

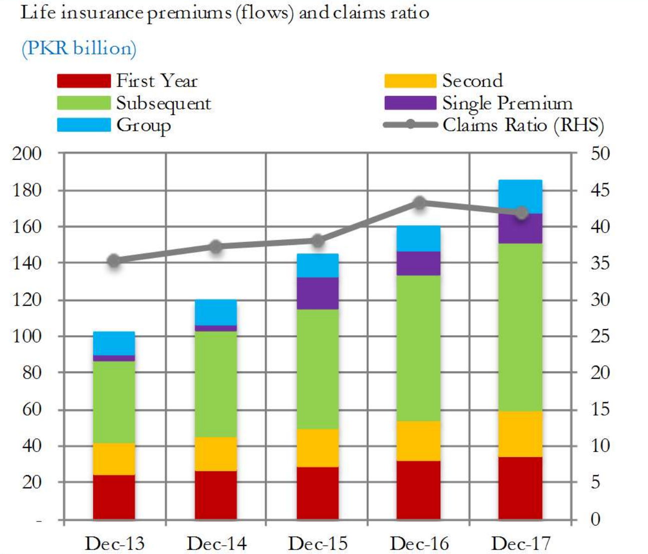
The growth in the life insurance sector can be observed in the increase in Gross Premium, which, in part, may be attributed to the increasing use of bancassurance, uptick in business underwritten by WTOs, new business underwritten for governments' health insurance programs, etc.

While Subsequent Year Renewals still forms the largest component of Gross Premiums, its share has slightly fallen to 49.11 percent. The share of Group Premiums in Gross Premiums has slightly risen from 8.55 percent to 9.82 percent for the year ended December 31, 2017. (**Figure 4.3.1**)

217 It may be noted that conventional insurers who have obtained authorization to conduct window takaful operations report the window takaful operations as a separate segment in their financial statements. Window takaful operations' data is included in the data for conventional insurers.
It may be noted that Window Takaful Operators (WTOs) have started to make an impact in the General Takaful segment: the WTOs' asset base has increased from PKR 4 billion as of December 31, 2016 to PKR 6.3 billion as of December 31, 2017.
218 SECP Annual Report 2017 has reported insurance penetration of 0.84 percent in 2015 and 0.91 percent in 2016. The difference is due to relative coverage of insurance companies.

Figure 4.3.1

Life insurance premiums have shown a steady growth

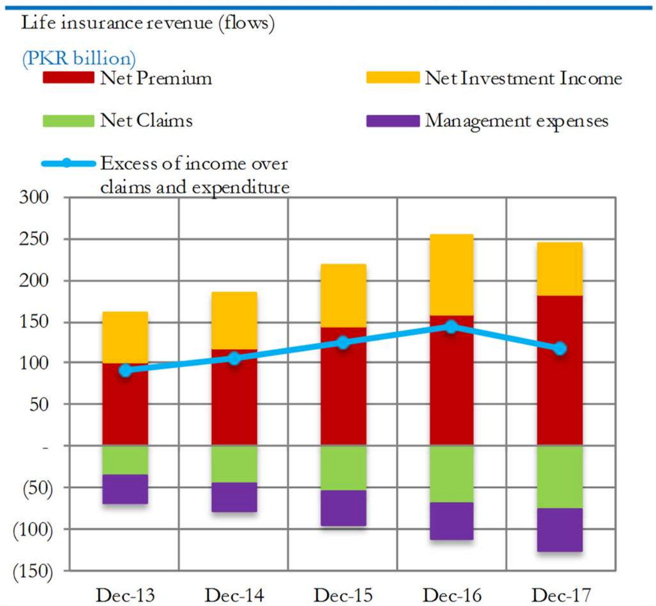


Source: Unaudited/Audited published financial statements of life insurance companies.

Despite the increase in premiums, the excess of income over claims and expenditures has decreased by 18.54 percent to PKR 117.2 billion for the year ended December 31, 2017 mainly due to a decrease in net investment income. (**Figure 4.3.2**)

Figure 4.3.2

Revenue has decreased due to lower net investment income



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

With regards to financial soundness, the Capital to Assets ratio has been declining since 2013 and the slide continues in CY17. This is due to relatively higher rise in assets over the years. (**Table 4.3.2**)

The Claims ratio, after consistently rising till 2016, has declined in 2017 due to a relatively larger percentage increase in premiums compared to claims. Further, the Combined Ratio has also observed a slight decline and remained far below 100 percent (69.28 percent for the year ended December 31, 2017) which implies that the Life Insurance Sector is still making a comfortable Underwriting Profit.

Despite witnessing an increase in the combined ratio in CY17, the non-life insurance sector indicators are relatively quiet sound …

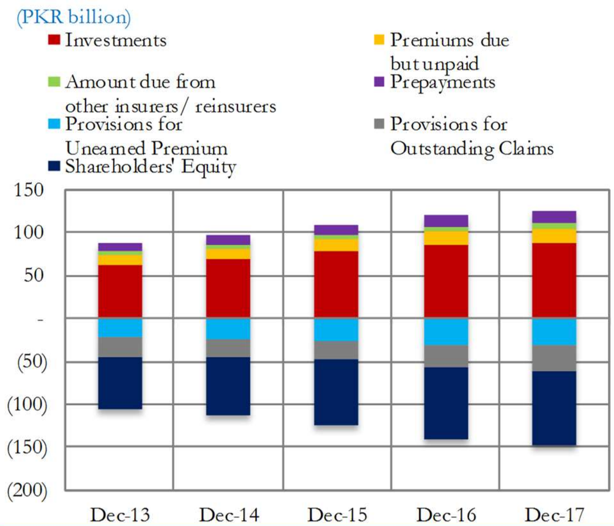
The assets of the non-life insurance sector increased by 4.75 percent to PKR 179.6 billion for the year ended December 31, 2017. Similarly, the sector's investments registered an increase of 4.64 percent to PKR 89 billion for the same period. Overall, the sector has a positive float (the money available for investing activities) which has generally been increasing over recent years which bodes well for the industry. (**Figure 4.3.3**)

Net Premiums have increased by 13.11 percent (YoY) to PKR 41.7 billion in CY17. The Motor segment still forms the largest segment of the portfolio (constituting around 43.9 percent of Net Premiums) provided by the non-life insurance sector despite a decrease in the overall share of Net Premiums as of December 31, 2017. The Health segment[219] has registered an increase of 27.46 percent to PKR 7.1 billion over the same period, increasing its overall share to 17.1 percent of Net Premiums. (**Figure 4.3.4**)

Figure 4.3.3

Assets of non-life insurance have shown a steady increase

Structure of non-life insurance

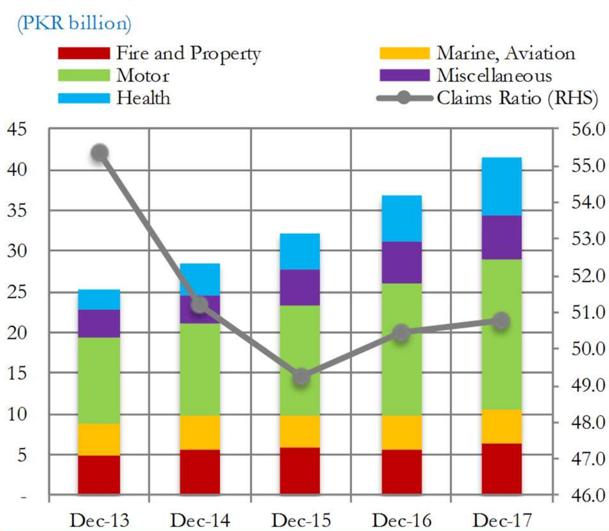


Source: Unaudited/Audited published financial statements of non-life insurance companies.

Figure 4.3.4

The Claims ratio has increased over the last two years

Non-life net premiums flows and claims ratio



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

However, Net Claims have shown a slightly larger increase; they have increased by 13.83 percent (YoY) to PKR 21.1 billion for the period ended December 31, 2017. The almost commensurate increase in Net Premiums and Net Claims have had a negligible effect on Underwriting Profits.

The sector has registered a decline in Profit before Tax of 26.61 percent to PKR 11.8 billion for the year ended December 31, 2017 mainly due to a steep decrease in Investment Income from PKR 11 billion in CY16 to PKR 5.7 billion in CY17 (a decline of 47.92 percent).

The non-life insurance sector, despite slight deterioration in indicators, is still quite sound. The decrease in Return on Investment (ROI) may be attributed to the long-term low interest rate environment and corrections in the capital market. The Capital to Assets ratio, despite fluctuations, has registered an increase over the last year. In addition, despite the increase in the Combined Ratio (from 82.08 percent to 85.3 percent for CY17), the sector still maintains a sizeable cushion for non-life insurers to register Underwriting Profits. (**Table 4.3.3**).

Table 4.3.3

Soundness of Non-Life Insurance

	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17*
	Percent				
Capital to Assets	12.63	13.33	12.98	12.48	12.91
Claims Ratio	55.34	51.22	49.24	50.45	50.77
Combined Ratio	88.48	83.61	80.57	82.08	85.30
Premium Retention	50.72	50.40	51.79	55.07	56.03
Return on Investment	5.76	6.36	5.77	8.43	6.57
ROA	3.28	4.21	5.58	4.46	4.65

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

*Estimated Figures

[219] The figures for health segment are underestimated as some insurers consolidate them under Miscellaneous Premiums.

The Takaful segment[220] has grown substantially …

The asset base of the Family Takaful segment increased by 16.47 percent to PKR 22.6 billion (YoY) as of December 31, 2017.

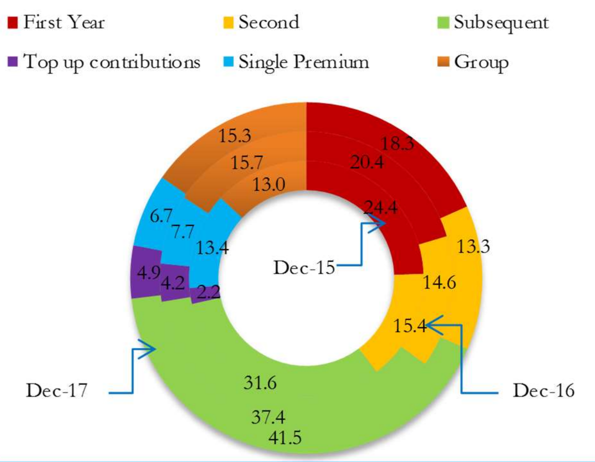
Gross Premium for the Family Takaful segment has increased by 10.42 percent to PKR 9.6 billion. The segment has successfully retained its customer base as Subsequent Year Renewals (under the Individual Family Takaful business segment) have seen a steady increase over the years; its share in Gross Premium has increased from 37.42 percent for the year ended December 31, 2016 to 41.5 percent for the year ended December 31, 2017. (**Figure 4.3.5**)

Figure 4.3.5

Subsequent year renewals have shown a significant increase

Family Takaful gross premiums (flows)

(percent)



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

The Family Takaful segment has also increased its profits for the year registering a 7.6 percent increase to PKR 181.7 million for the year ended December 31, 2017.

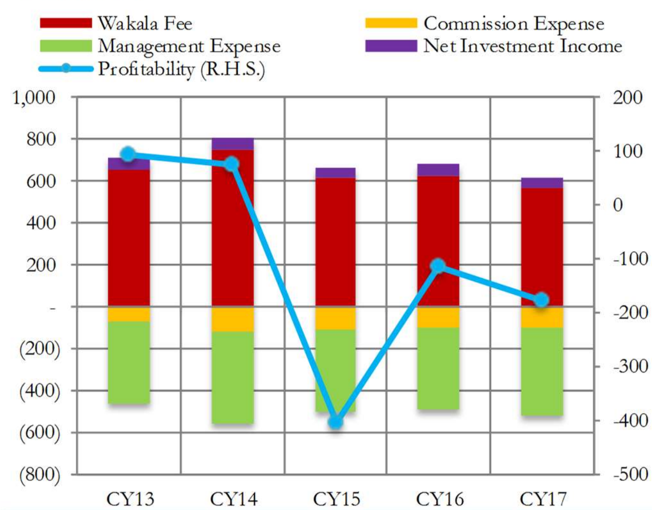
Notwithstanding an increase of 3.48 percent in the asset base of the General Takaful segment (to PKR 2.4 billion as of December 31, 2017), the General Takaful segment[221] has reported a Loss before Tax of PKR 176 million for the year ended December 31, 2017. This is due, in part, to a decrease in business underwritten by the takaful companies—reflected in the decreased Wakala fee—which may be attributed to increased competition from Window Takaful Operators (**Figure 4.3.6**).

Figure 4.3.6

The segment has been reporting losses for the last few years

General Takaful Profit and Loss (flow) items

(PKR million)



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

The segment has also witnessed a larger loss in Other Income of PKR 181.8 million for the year ended December 31, 2017 contributing to the increase in overall loss.

Most of the risks mentioned in previous publications still remain significant …

The insurance industry still faces concentration risk as a significant public sector player dominates the industry. While the concentration risk associated with the public life insurer can be gauged (it constitutes more than 60 percent of the entire insurance industry), nothing substantive can be stated about the recent financial health (including

220 Data for full-fledged takaful companies.

221 The data for 2016 and 2017 has been estimated.

the associated concentration risk) of the public non-life insurer as its financial information has not been publicly available for the last few years.

Besides the significant public insurers in the life and non-life sectors, there are a few systemically important private sector insurers in both of the sectors, which may contribute to systemic risk for the industry. To mitigate this risk, these systemically important insurers may be subject to enhanced supervision and regulation.

There is only one local reinsurer (which caters to the general insurance sector) in the industry, which may lead to increased **reinsurance risk**. Insurers mitigate this risk by utilizing the services of a diverse range of international reinsurers.

The increasing use of technology will lead to increased **cyber risks** for the industry, both as business clients of IT products and services, and as providers of financial protection against the risk of unexpected (contingent) loss. The industry may face data loss, data security, and technology failure. In order to mitigate these risks, some insurers are developing in-house IT systems to enable better decision making, meeting business challenges, enhancing controls, etc. Some other operational risks may emanate from human resources, regulatory challenges, etc.

The industry's reliance on investments (particularly in government instruments) makes it prone to **market risk** as adverse movement in interest rates or equity prices may affect their investment income.

Growth in the global insurance industry is likely to be sustained in 2018…

Global non-life premiums are expected to sustain growth at around 3 percent in 2018 and 2019[222]; it could be stronger depending on price increases.

Premium growth in emerging markets is expected to improve steadily from 6 percent in 2017 to around 7 percent in 2019. Assuming 2018 has average catastrophic losses, profits are expected to improve.

Global life premiums are expected to increase by 4 percent over the next two years based on robust performance of savings products in emerging markets. In emerging markets, life premiums are expected to grow at 12 percent in 2018. Given the global low interest environment, profitability may remain challenging in light of low investment returns.

Pakistan may witness sustained growth in the insurance industry in 2018…

Given the comfortable combined ratio and the net amount available for investing activities, coupled with low insurance penetration, the insurance industry is expected to maintain (if not, improve) its growth rate.

This growth impetus may gain momentum from the insurance needs surrounding the China-Pakistan Economic Corridor (CPEC) projects.

In addition, with the entrance of new Window Takaful Operators (WTOs) and operationalization of other recently established WTOs in the Takaful segment, it is expected that there will be an increase in premium (contribution) and asset growth. In addition, profitability, particularly for the Takaful sector, may increase in 2018 due to the influx of the recently established WTOs.

[222] Swiss Re's Global insurance review 2017 and outlook 2018 /19