5.3. Insurance and Takaful Companies

*Insurance industry's asset growth remained modest as of September 30 2019. Profitability witnessed a decline owing to an increase in claims and net fair value losses (on financial assets) in case of life sector and a fall in net investment income for the non-life sector. Though the claims ratio for the life sector inched up, yet it remained within reasonable bounds. The Takaful segment's growth was quite significant with Window Takaful Operators (**WTOs**) becoming significant players in the segment. Due to COVID-19 pandemic, the industry might experience challenges in writing new business and could witness further rise in claims and a decline in net investment income, going forward.*

Profitability in the Pakistan insurance industry has declined in September 2019 …

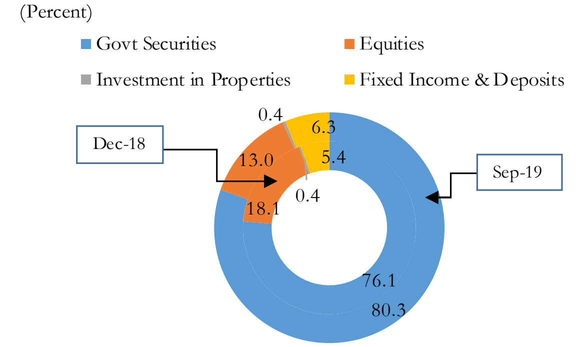
Overall, the industry witnessed a decline in profitability (Profit before Tax) from PKR 15.9 billion for the period ended September 30, 2018 to PKR 14.5 billion for the period ended September 30, 2019[254]. This was due to a substantial increase in net claims and net fair value losses (for the life sector) for the period indicating a slight weakening in its core business. In addition, the decline in net investment income for the non-life sector, contributed to the decrease in profitability.

Life Sector

Asset base of Life Insurance Sector increased…

The life insurance sector's asset base increased by 4.9 percent to PKR 1,266 billion as of September 30, 2019 from PKR 1,207 billion as of December 31, 2018. Investments by the sector increased by 5.2 percent in 2019 from PKR 994 billion as of December 31, 2018. There was a significant rise in equity of the sector, which increased from PKR 21.9 billion as of December 31, 2018 to PKR 25.3 billion as of September 30, 2019, mainly driven by a surge in unappropriated profits of the dominant public life insurer **(Chart 5.3.1).**

Chart 5.3.1: Life Sector Investments & Properties



Source: Audited/ Unaudited financial statements

Net Claims for the Life Insurance sector climbed substantially…

The growth in Net Claims in life sector during the period under review outpaced the growth in Net Premiums. While Net Premium for the sector grew by 3.4 percent to PKR 120.9 billion for the period ended September 30, 2019, the Net Claims increased by 21.4 percent to PKR 72.4 billion for the same period.

With the rise in Net Claims, the Claims ratio edged up to 59.9 percent in September 2019, as compared to 51.0 percent in September 2018. However, the "Expense Ratio" declined from 27.9 percent to 26.1 percent over the corresponding period, mainly due to a decrease in commission to agents on first year premiums by the public life insurer. In addition, "Return on Investments" increased, in part, due to rise in interest rates

[254] The analysis is based on the data of 5 life insurers and 28 non-life insurers covering approximately 97 percent and 83 percent of the life and non-life insurance sectors' assets, respectively. The analysis covers data up to period ending September 30, 2019. Data has been estimated, where necessary. The financial close for insurers is December of the corresponding year. All growth ratios for flow items are on year-on-year basis.

during the period. **(Table 5.3.1)**

Table 5.3.1: Soundness of Life Insurance

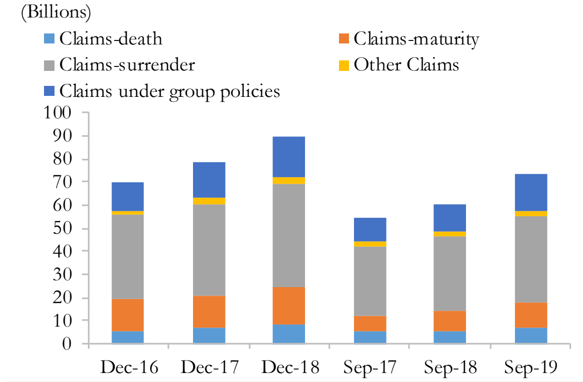
	Dec-17	Dec-18	Sep-17*	Sep-18*	Sep-19*
			Percent		
Claims Ratio	41.9	43.8	48.9	51.0	59.9
Capital to Assets	1.4	1.8	1.6	1.6	2.0
Return on Investment	8.4	8.0	8.6	8.3	9.3
Return on Equity	70.1	45.8	64.7	41.5	30.6

Source: Unaudited/Audited published financial statements of life insurance companies and IAP data.
*Annualized Figures

The increase in Net Premiums was subdued (3.4 percent) as there was a decline in First Year Premiums under Individual Life policies. It was a strategic restructuring of the business segment by the public insurer to restrict entry into new contracts so as to curtail the renewal expense in the future. However, it was mitigated by an increase in Group Premiums. The operationalization of the Prime Minister's National Health Program also led to a substantial increase (70 percent increase) in Gross Premiums for the Health segment (to PKR 6.5 billion) of the public life insurer.

The main contributors to the increase in Net Claims were Surrender Claims and Group Claims. During the period under review, there was an increase in interest rates, which might have encouraged policyholders to seek better rates by surrendering their existing policies (before maturity), thus leading to an increase in Surrender Claims. In addition, the volatile financial market conditions could have led to a reduction in value of unit-linked policies (with significant investments in equities) prompting the policyholders to surrender their policies and seek other higher-yielding policies or investment avenues. **(Chart 5.3.2)**

Chart 5.3.2: Gross Claims for Life Sector



Source: Audited/ Unaudited financial statements

The retention ratio for the life sector - at 98.5 percent for the period ended September 30, 2019 - is comfortable compared to the retention ratios of life insurance sectors in Brazil, India, Russia, and South Africa, which range from 94.6 percent to 99.5 percent in recent years[255].

Overall, while the increase in Claims ratio is slightly worrisome, the sector possesses sufficient cushion to register profits in its core business activities.

Investment income provided support to overall profitability …

The overall profitability (i.e. Profit before Tax) of the sector registered a slight increase of 0.7 percent reaching to PKR 5.8 billion for the period ending September 30, 2019. It was mainly because of rise in investment income, which increased by PKR 14.6 billion to reach the level of PKR 72.6 billion by end September 30, 2019. However, in terms of components, the return on investment was quite diverse.

In case of equities investment, while dividend income increased by 5.4 percent (from PKR 6.5 billion for September 2018 to PKR 6.8 billion for September 2019), the Net realized losses (mainly from sale of financial assets) and Net fair value losses (on financial assets) registered yearly increases of PKR 8.3 billion and PKR 23.9 billion,

[255] OECD Stats

respectively. The cushion, however, was provided by the fixed income segment, as investment income from government and fixed income securities increased from PKR 51 billion as of September 2018 to PKR 64.4 billion as of September 2019 – a 26.1 percent YoY increase. This rise was attributable to the higher interest rates prevailing during the period.

Non-Life Sector

… while drop in investment income declined the profitability of the non-life sector …

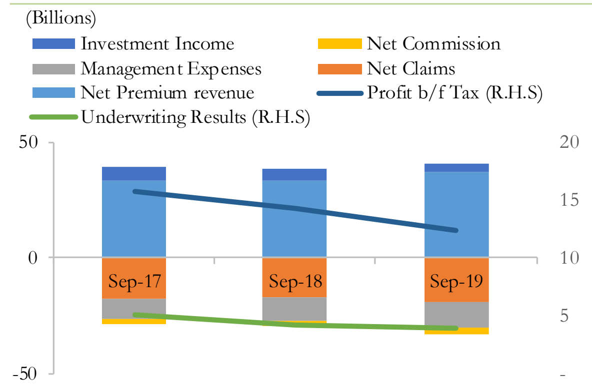
The asset base of the non-life sector increased to PKR 208.8 billion as of September 30, 2019 from PKR 197.2 billion as of December 31, 2018. However, the sector registered a (YoY) decline in profitability of 14.3 percent to PKR 8.6 billion for the period ended September 30, 2019. This was mainly due to a decrease in Investment Income from PKR 5.3 billion in September 2018 to 4.1 billion in September 2019 largely due to the volatile domestic financial markets.

Further, the non-life sector divested 1.2 percent of its investments bringing the level down to PKR 96.6 billion as of September 30, 2019 from PKR 97.7 billion as of December 31, 2018. In addition, there was a structural change in the sector's investment portfolio as the sector divested 13.2 percent (PKR 7 billion) of its investment in equities and increased its investment in fixed income securities (PKR 4.9 billion) and deposits (PKR 0.4 billion). In wake of the rising interest rates during 2018-19, fixed income securities and deposits were offering higher returns. The non-life sector might have been motivated to make their portfolio more risk-averse since these securities offered attractive (and relatively less volatile) returns.

…and increase in expenses lowered the underwriting performance…

Further, expenses (Net Claims, Management Expense, and Commission Expense) grew at a faster rate than Net Premiums, resulting in a decline of 8.6 percent (to PKR 3.9 billion) in underwriting performance for the period ended September 30, 2019. **(Chart 5.3.3)**

Chart 5.3.3: Profit and Loss Items for Non-Life Sector

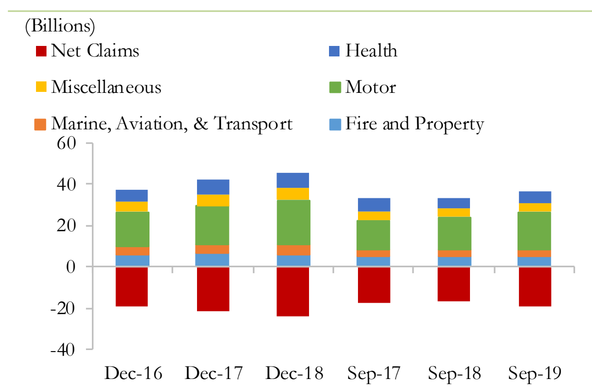


Source: Audited/ Unaudited financial statements and IAP data

…lower net premiums and higher claims increased the combined ratio…

Non-life Premiums positively correlate with economic activity. Consequently, the weakened economic growth led to a subdued increase in Premiums. The Motor and Health segments, primarily, drove the rise in Net Premiums. On the other hand, the increase in Net Claims was mainly driven by the Health segment, which increased by 45.5 percent over the year to PKR 4.4 billion for the period ended September 30, 2019. Health Claims increased, in part, due to medical expense inflation. **(Chart 5.3.4)**

Chart 5.3.4: Net Premiums and Claims for Non-Life Sector



Source: Audited/ Unaudited financial statements and IAP data

The Premium Retention ratio for the non-life sector (at 51.2 percent) is lower than the retention ratios of non-life insurance sectors in Brazil, India, Russia, and South Africa which range from 66.8 percent to 89.2 percent in recent years[256]. This may be, in part, due to the lower capacity of the domestic insurance industry to cover local risks.

Overall, the Combined ratio increased from 87.4 percent in 2018 to 89.5 percent in 2019. This is slightly concerning as the ratio has been consistently increasing over the past few years, resulting in a deteriorating underwriting performance. In addition, the annualized ROA for the sector declined to 5.6 percent for the period ended September 30, 2019. **(Table 5.3.2)**

Table 5.3.2: Soundness of Non-Life Insurance

	Dec-16	Dec-17	Dec-18	Sep-17*	Sep-18*	Sep-19*
				Percent		
Paid-up Capital to Asset	12.9	13.3	13.3	12.3	13.0	12.6
Claims Ratio	50.5	51.0	51.9	52.8	50.2	51.3
Combined Ratio	81.9	89.0	88.9	85.1	87.4	89.5
Premium Retention	51.6	55.2	54.3	53.2	52.0	51.2
Return on Assets	10.0	6.8	6.3	7.4	6.5	5.6

Source: Unaudited/Audited published financial statements of non-life insurance companies and IAP data.
*Annualized, Estimated Figures

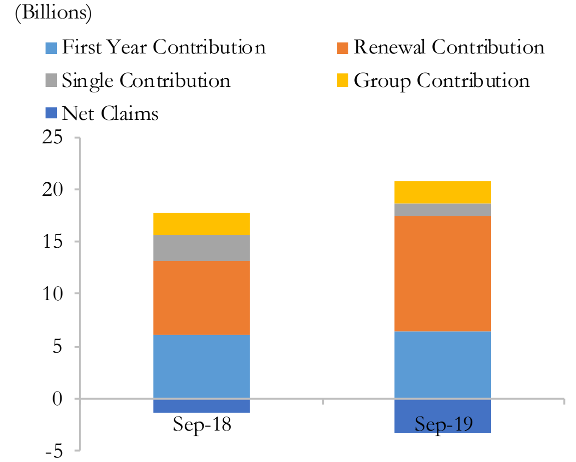
Family Takaful Segment

*Growth in Family Takaful (**FT**) segment has been spurred by Window Takaful Operators (**WTOs**)[257]…*

The FT segment's asset base has increased to PKR 53.0 billion as of September 30, 2019 with Window Takaful Operators (**WTOs**) accounting for almost half of all the assets for the segment. This is in contrast to the previous year where WTOs accounted for about one-third of all assets for the segment.

Net Contributions for the FT segment increased by 16.2 percent (YoY) to PKR 14.4 billion for the period ended September 30, 2019. In terms of Net Contributions, WTOs constitute 84.5 percent of the market share. **(Chart 5.3.5)**

Chart 5.3.5: Gross Contributions & Claims for Family Takaful Segment



Source: Audited/ Unaudited financial statements and IAP data

The overall Claims ratio for the segment was 23 percent for September 2019. The low Claims ratio was due to the new operators, which were yet to experience claims due to long-term nature of FT product life cycle. As they mature, it is expected that more claims could be exercised over the coming years. In contrast, full-fledged Takaful companies registered a Claims ratio of 47.6 percent for the same period.

General Takaful Segment

The General Takaful segment witnessed significant growth in Contributions …

The asset base of the General Takaful (**GT**) segment stands at PKR 7.2 billion (including WTO's assets of PKR 4.5 billion) as of September 30, 2019. [258]

The GT segment received Gross Contribution worth PKR 8.9 billion for the period ended September 30, 2019, which was 28.4 percent

[256] OECD Stats
[257] This section covers both WTOs and full-fledged Takaful companies. In the rest of the chapter, WTOs operating in the Family Takaful segment are included in the consolidated financials of the associated conventional insurers.

[258] This section covers both WTOs and full-fledged Takaful companies. In the rest of the chapter, WTOs operating in the General Takaful segment are included in the consolidated financials of the associated conventional insurers.
Due to unavailability of data, one full-fledged General Takaful company has been excluded from the analysis.

higher than last year. The market share of WTOs, based on Gross Contribution, slightly decreased to 85.3 percent in September 2019 from 89.1 percent in September 2018, mainly due to extraordinary growth in Gross Written Contributions by one full-fledged Takaful Company. However, there was room for substantial growth as the segment had a small base and the general populace could be more receptive to Takaful products **(Table 5.3.3)**

Table 5.3.3: Overview of General Takaful Segment*

	Sep-18	Sep-19	YoY Change
	PKR billions		*Percent*
Gross Contribution Revenue			
Window Takaful Operators	6.2	7.6	23.0
Full-Fledged Takaful Companie	0.8	1.3	73.1
Total	7.0	8.9	28.4
Net Contribution Revenue			
Window Takaful Operators	3.9	4.9	25.1
Full-Fledged Takaful Companie	0.2	0.6	181.4
Total	4.2	5.5	32.7
Net Claims			
Window Takaful Operators	2.1	3.0	44.5
Full-Fledged Takaful Companie	0.2	0.4	102.7
Total	2.3	3.4	49.8
Profit before tax			
Window Takaful Operators	0.5	0.7	
Full-Fledged Takaful Companie	(0.0)	(0.2)	
Total	0.4	0.5	

Source: IAP data and unaudited financial statements of General Takaful companies and WTOs.
*Estimated Figures

The pace of growth of Net Contributions for the GT segment was slightly higher than the gross contributions. They increased by 32.7 percent (YoY) to PKR 5.5 billion as of September 30, 2019.

…as well as in net Claims

The Net Claims increased by PKR 1.1 billion (increase of 49.8 percent) to PKR 3.4 billion for the period ended September 30, 2019. This resulted in an increase in Claims Ratio for the GT segment to 62.5 percent in September 2019 from 55.3 percent in September 2018. Substantial increase in claims (YoY increase of PKR 0.2 billion or 330.9 percent) registered by one full-fledged Takaful company was partly responsible for this. The claims mainly emanated from the Motor and Health segments.

Nevertheless, the GT segment's profitability improved …

Overall, the GT segment registered a profit before tax of PKR 0.5 billion for the period ended September 30, 2019, up from PKR 0.4 billion for the period ended September 30, 2018.

Reinsurance Sector

The public reinsurer displayed a strong performance …

Pakistan's reinsurance sector constitutes one full-fledged non-life reinsurer. Despite witnessing a YoY decline of 25 percent in Investment Income for the period ended September 30, 2019, the reinsurer registered a sturdy underwriting performance. This indicates the resilience of the company's core business. Profitability for the reinsurer improved to PKR 2.3 billion for the period ended September 30, 2019 from PKR 1.3 billion during the corresponding period last year. **(Table 5.3.4)**

Table 5.3.4: Snapshot of reinsurance company

	Dec-16	Dec-17	Dec-18	Sep-18	Sep-19	growth
	PKR billions					
Equity	12.3	10.5	9.9	10.8	10.2	-5.8%
Investment	13.4	9.2	8.6	8.8	7.6	-13.4%
Total Assets	26.0	24.3	24.8	25.4	32.4	27.4%
Gross Premium	8.8	8.0	10.7	7.3	12.6	71.9%
Net Premium	5.8	5.0	5.5	4.0	6.6	62.1%
Net Claims	3.3	3.7	3.0	2.2	3.6	67.4%
Underwriting Result	0.5	(0.7)	0.6	0.6	1.2	97.6%
Profit Before Tax	1.4	2.9	1.7	1.3	2.3	67.1%
	Percent					
Claims Ratio	**57.50**	**74.71**	**54.76**	**53.25**	**55.01**	

Source: Unaudited/Audited published financial statements of reinsurance company.

The asset base of the company expanded to PKR 32.4 billion as of September 30, 2019 from PKR 25.4 billion as of September 30, 2018, mainly due to rise in insurance/reinsurance receivables. The reinsurer decreased its investments by 13.4 percent as of September 30, 2019.

The Claims ratio for the company slightly increased from 54.8 percent in 2018 to 55 percent in 2019, which was still at a comfortable level.

Conclusion

Increasing public awareness could improve the low penetration levels…

The low insurance penetration in the country (less than 1.0 percent of GDP) emerges from lack of awareness and education regarding the benefits and importance of the insurance as well as the religious concerns of the populace. In contrast, insurance penetration in India, Russia, Brazil, and South Africa is 3.6 percent, 1.4 percent, 3.1 percent, and 13.9 percent, respectively, in recent years.[259] Accordingly, public awareness campaigns are necessary to educate the masses regarding the importance of savings and insurance to increase our insurance penetration.

…interconnectedness between the capital markets and insurance industry remained significant…

The performance of the stock market has a direct bearing on the profitability of the insurance sector. As mentioned earlier, the weak stock performance for the period ended September 30, 2019 resulted in decline in some components of the overall investment income for the life and non-life sectors. However, to mitigate investment risk, the insurers try to diversify their investment portfolios and continuously monitor developments in the financial markets.

…and so does the concentration risk…

The insurance industry in Pakistan was exposed to concentration risk. In terms of asset size, although the dominant public life insurer's market share had gone down, it constituted more than 60 percent of the industry. The top five life insurers—in terms of asset size—comprised more than 99 percent of total assets and total Gross Premiums of life sector, respectively. In case of non-life sector, the top five insurers—in terms of asset size—constituted more than 68 percent of total assets and 65 percent of total Gross Premiums. The concentration of the non-life sector would be even higher if the public non-life insurer was included in the analysis.

Besides, the insurers were exposed to a variety of other risks…

In 2019, the tighter macroeconomic conditions resulted in weaker economic activities that, in turn, affected the business environment for the insurance industry (economic risks). Consequently, in recent years, insurers have adopted a cautious approach to preserve their business segments and expand into new segments. They have utilized new channels including Takaful operations, micro-insurance, technology-based distribution channels, etc.

In addition, natural catastrophes and climate change events could lead to increasing disruptions in life and economic activities (insurance risks). Insurers try to mitigate these risks by developing comprehensive risk management frameworks, which include implementation of underwriting strategies, adequate reinsurance coverage, etc.

Insurers that do not meet the solvency and capital adequacy requirements have been dissuaded from entering in to new contracts of business. The industry is gradually consolidating.

Moreover, the ongoing issue of imposition of provincial sales taxes (and other taxes) on insurance business and on the commission of insurance agents is another challenge facing the insurance industry.

[259] OECD Stats

…and the regulatory requirements increased…

While stringent regulations are necessary for the protection of consumers, they could also curtail the efficiency in the insurance sector. The insurance industry is currently implementing IFRS-17 on Insurance Contracts. This may enhance transparency, but it will also significantly change the way insurers currently value and report their insurance contracts.

In addition, the SECP - the insurance regulator - undertook the following initiatives and policy reforms during the year:

- Review of bancassurance regulatory framework – currently underway
- Undertook the issue of exemption of sales tax from health and life insurance with provincial tax authorities
- National Financial Inclusion Strategy (**NFIS**) on insurance
- General Takaful accounting regulations
- Proposed amendments to Motor Vehicles Act, 1939.

Growing use of digital channels exposes the sector to cyber security risks…

Digitization is seeping through the insurance industry. Insurance providers have digitized their consumer interaction and delivery channels. This has set their organizations up for easier interactions, more personalized products and experiences, and greater operational efficiencies. However, the risks of cyber threats with the increasing use of digital channels cannot be ignored. Therefore, insurance providers along with regulators are taking policy initiatives to mitigate these risks. The SECP is currently working on formulating a cybersecurity framework for the insurance sector.