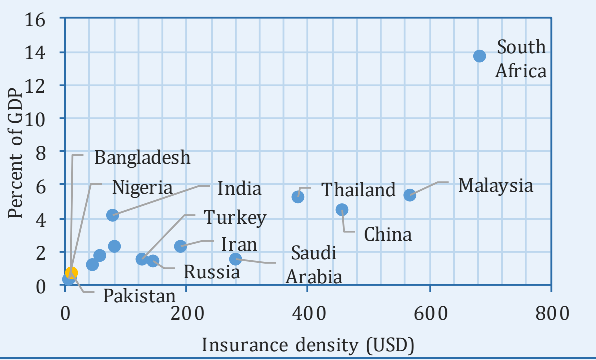
Chapter 6.3: Insurance and Takaful Companies

In 2021, insurance premiums for both the life and non-life sectors increased following a resumption of economic activities. Gross premiums for life registered a significant jump due to a doubling of group premiums as the national health insurance program expanded. With more health insurance policies being underwritten, claims for life also increased resulting in an overall increasing claims ratio. Nevertheless, the life sector posted higher profits on the back of increase in premiums. In the non-life sector, fire and property damage premiums drove the increase in non-life gross premiums, however, non-life claims did not register a significant increase as fire and property witnessed significant decline vis-à-vis the one-off spike in claims during the previous year caused by the urban flooding in the southern parts of the country. Accordingly, the profitability of the non-life sector posted appreciable increase in CY21. Despite a few insurers not meeting the solvency requirements in CY20, solvency indicators have improved for the insurance industry in CY21. Overall solvency indicators remain at a comfortable level. Given the challenging macroeconomic environment at both global and domestic front, growth and performance of the insurance sector will remain dependent upon the emerging macro financial conditions and business activity in the economy.

Pakistan lags behind peer countries in terms of insurance penetration…

Pakistan's insurance penetration[152] compared to some of its peer countries remained low at less than 1 percent of GDP. Similar was the case with Insurance density[153] which stood at USD 10 premium per capita in 2020. (**Chart 6.3.1**)

Chart 6.3.1: Country-wise Insurance Penetration and Density in 2020



Source: Swiss Re

While Pakistan's insurance premiums have grown in recent years (compound annual growth rate over last 3 years=10.1 percent), the small base means that growth of even 10 percent does not have a significant impact on insurance penetration in the country. Growth in the industry is inhibited by multiple factors including the country's low savings rate, religious sentiments, relatively lower returns offered by some insurance products, lack of awareness of insurance benefits, among other issues.

Overall Industry Snapshot

In the wake of the economic recovery from the pandemic, the insurance industry posted steady growth in CY21 …

In the second year of the pandemic, both advanced and emerging economies adapted to COVID-19. Pakistan performed relatively better in coping with the pandemic, and there was strong resumption in economic activities during CY21 amid spells of surge in infections. Accordingly, the insurance industry revenues posted decent growth and the overall asset base

[152] Insurance penetration is used as an indicator of insurance sector development in a country and is calculated as the ratio of insurance premiums to GDP.
[153] Insurance density is another indicator of insurance sector development of a country; it is calculated as ratio of total insurance premiums to the whole population of a given country.

increased by 11.0 percent to PKR 2,143 billion in CY21[154].

A few major players dominate the insurance industry, indicating the great potential for new players to explore the untapped potential ...

The insurance sector of Pakistan comprises of 10 life insurers and family Takaful companies, 30 active non-life insurers and general Takaful companies, and one reinsurer[155]. Life insurance and family Takaful companies (which have long-term business horizons) hold higher market share of around 84 percent in terms of assets in Dec-21.

The industry in terms of relative market share of players remained concentrated. The public sector enterprises (**PSEs**) i.e. two public life insurers, the large public non-life insurer, and the sole reinsurer contribute a major share of the industry. The dominant public sector life insurer constituted more than 50 percent of the insurance industry (in terms of assets). In a similar vein, the top five non-life insurers (including the public non-life insurer) made up about 70 percent of the non-life and General Takaful sector's assets. This high market concentration in the context of low insurance penetration and density represents the untapped potential of the industry, which can be explored by new and existing players. Besides improving the access to insurance products and services, there is also a need on the part of policymakers and industry to raise awareness about the importance of insurance in the country through extensive financial literacy campaigns.

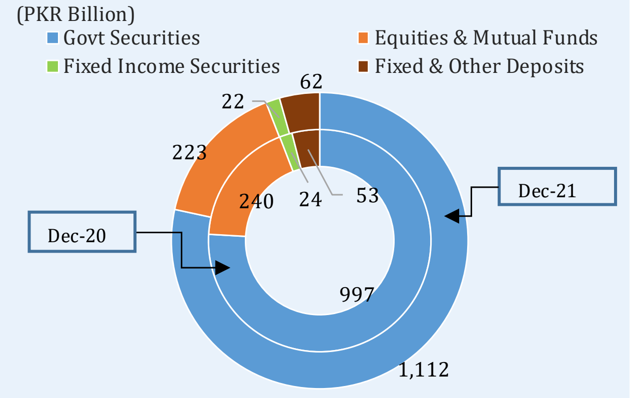
Life Insurance

The asset base of the life insurance sector grew at a slower pace in CY21...

Compared to last year's strong growth in the asset base of life insurance sector (14.7 percent in CY20), the asset base in CY21 grew at slower rate of 11.3 percent to PKR 1,805 billion in CY21.

Investment portfolio increased by 8.0 percent to PKR 1,418 billion in CY21. In the wake of increase in interest rates due to tightening in monetary policy towards the end of the year, life insurers increased their investments in government securities by PKR 114 billion and decreased their investments in equities and mutual funds by PKR 17 billion. (**Chart 6.3.2**)

Chart 6.3.2: Life Sector Investments



Source: Unaudited/ audited accounts of insurers

Group premiums drove the growth in gross premiums ...

Furthermore, with the gradual resumption of economic activities, there was an uptick of 20.3 percent in first year premium (against a 0.4 percent decrease in first year premium in CY20).

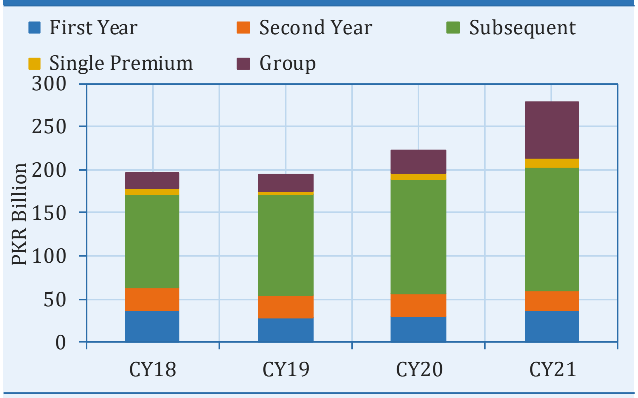
Overall, gross premium posted a strong growth of 25.0 percent to PKR 278 billion mainly due to increase in group premiums. Group premiums

[154] The analysis in the chapter is based on the data of 6 life insurers and 24 non-life insurers covering approximately 100 percent and 82 percent of the life and non-life insurance sectors' assets, respectively. The analysis also covers the two Family Takaful companies, the two active General Takaful companies, and the sole reinsurer, thus, covering the entire insurance industry. The analysis covers data up to period ending December 31, 2021. The financial close for insurers is December of the corresponding year. All growth ratios for flow items are on YoY basis.

[155] This assessment covers all the active insurance firms.

increased from PKR 26 billion to PKR 64 billion in CY21 as the national-level health insurance program took off. After the initial success shown by the provincial-level Social Health Program Initiative in previous years, the Sehat Sahulat Program was implemented where health insurance policies were underwritten on national-level through the dominant public life insurer. (**Chart 6.3.3**)

Chart 6.3.3: Gross Premiums for Life Sector

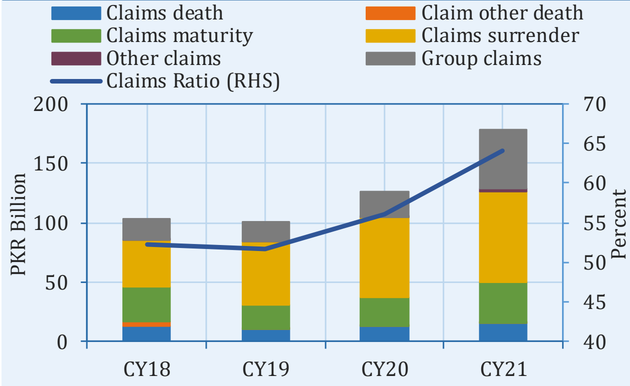


Source: Unaudited/ audited accounts of insurers

On the back of the increase in group premiums (mostly pertaining to health insurance business), group claims increased from PKR 22 billion to PKR 50 billion in CY21. This 132.0 percent increase was mostly expected as need-based individuals began utilizing their health policies to avail medical facilities. Overall, gross claims increased by PKR 53 billion to PKR 179 billion in CY21. (**Chart 6.3.4**)

In addition, during the second year of the pandemic, death claims showed a significant increase of 25.8 percent (against an increase of 20.7 percent in CY20). The increase in gross claims was also in line with increase in the insurance business.

Chart 6.3.4: Gross Claims for Life Sector

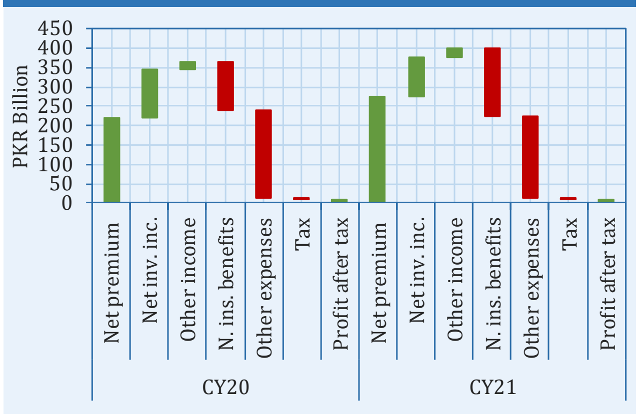


Source: Unaudited/ audited accounts of insurers

Consequently, profitability of the life insurance sector increased appreciably ...

The after tax profit of the sector increased by 8.9 percent to PKR 9.5 billion on the back of a spike in net premium revenue and a slight decline in other expenses. (**Chart 6.3.5**)

Chart 6.3.5: Earnings Components for Life



Source: Audited/ unaudited financial statements of insurers

Expenses declined over the reviewed year as there was a decline in net change in insurance liabilities. However, given the substantial increase in business underwritten, acquisition costs increased by 16.3 percent to PKR 40 billion in CY21, which slightly blunted the overall fall in expenses.[156] With the decline in expenses, key efficiency ratio i.e. expense ratio also improved.[157]

Net investment income decreased by 18.6 percent (PKR 23 billion) to PKR 103 billion over the year due to net fair value losses. A steeper

[156] Acquisition cost is cost incurred in obtaining and recording policies.

[157] Management expense to net premium ratio

decline in investment income was partially mitigated by an increase of PKR 4 billion in dividend income mainly due to the release of dividends by the banking sector in CY21. Initially, these dividends were put on hold for a significant period of CY20 due to the temporary restriction on distribution of dividends imposed by SBP.

Life insurers maintained most of their investments in government securities so as to ensure consistent flow of revenues and build reserves to meet their longer-term business commitments and asset-liability management (**ALM**) strategies. Though this policy led to an interim moderation in ROI as interest rates remained low during most of CY21.

Considering their longer investment horizons, which provides them opportunities to structure a diversified investment portfolio and maximize returns, life insurers have the capacity to provide long-term finance[158] for projects and contribute to faster economic growth, greater welfare, shared prosperity and enduring stability[159]. In Pakistan, the life insurance sector, however, has limited long-term avenues for investments due to a number of reasons including the limited scope and scale of capital market and dearth of long-term products.

Table 6.3.1: Soundness of Life Insurance

Description	Dec-18	Dec-19	Dec-20	Dec-21
	Percent			
Claims Ratio	52.2	51.8	56.1	64.1
Expense Ratio	26.3	26.0	22.9	21.6
Equity to Assets	2.0	1.9	2.1	2.2
Return on Investments	5.7	10.4	10.6	7.7
Return on Equity	41.1	31.7	40.9	36.6
Return on Assets	0.7	0.6	0.8	0.8

Source: Unaudited/ audited accounts of insurers

With the rise in health insurance policies under group claims, the claims ratio[160] for the sector began to rise but it still remained contained. On the other hand, the ROE with a slight contraction remained at comfortably high level. (**Table 6.3.1**)

Soundness indicators like the claims ratio indicated that the pricing remained significantly favorable for the insurance firms. The high margin also reflected the ample prospects for new players to enter the market and explore the untapped potential of the sector and infuse efficiency therein.

Non-Life Insurance

Non-life insurers increased their asset base mainly on the back of investments in equity securities …

In terms of assets, non-life insurers and general Takaful companies constitute only 11.7 percent of the overall insurance industry. However, given the various barriers to entry in the sector such as the difference in the minimum paid-up capital requirements (PKR 700 million for life and PKR 500 million for non-life insurers[161]), there are around 30 active non-life insurers (including general Takaful companies) compared to 10 active life insurers (including family Takaful companies).

The non-life insurance sector increased its asset base by PKR 13 billion to PKR 246 billion in CY21 (against PKR 23 billion increase in CY20) on the back of increases in investments, cash & bank, and reinsurance recoveries, among others.[162]

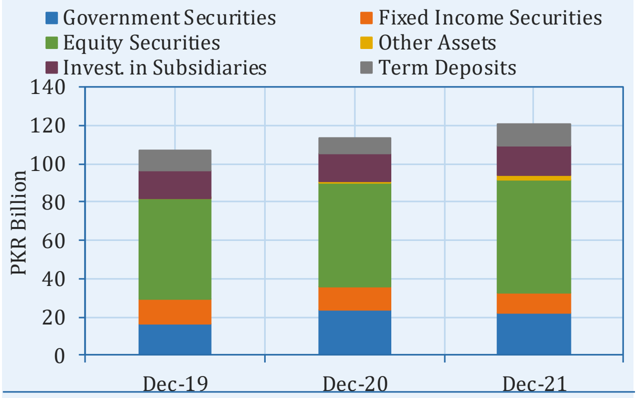
Investments increased by PKR 7 billion to PKR 121 billion in CY21 as non-life insurers increased their investments in equity securities and term deposits by PKR 5 billion and PKR 3 billion, respectively. Equity securities

158 World Bank Blogs – Which financial intermediaries provide long-term finance? (Accessed on April 15, 2022)
159 Caprio Jr, G., & Demirgü-Kunt, A. (1998). The role of long-term finance: theory and evidence. *The World Bank Research Observer*, *13*(2), 171-189
Demirgüç-Kunt, A., & Maksimovic, V. (1998). Law, finance, and firm growth. *The journal of finance*, *53*(6), 2107-2137
160 Net claims to net premium ratio

161 See SECP's Insurance Companies – Pre-Requisites and Guidebook on Incorporation, Registration & Licensing for Insurance companies, Takaful operators, Insurance brokers, surveyors & third party administrators. (Accessed on April 15, 2022)
162 Investments, cash and cash equivalents, and reinsurance recoveries increased by PKR 7.2 billion, PKR 2.4 billion and PKR 1.7 billion, respectively.

constituted 49.2 percent of the total investments & properties portfolio in CY21 (48.1 percent in CY20). Meanwhile, insurers divested their investments in government and fixed income securities worth PKR 3 billion. This may be due, in part, to the low interest rate environment that prevailed during most of CY21 as insurers sought higher returns to boost their investment income. However, the rise in the policy rate towards the end of the year may have revived the interest in government securities (**Chart 6.3.6**).

Chart 6.3.6: Non-Life Investments



Source: Unaudited/ audited accounts of insurers

The investments to assets ratio at 49.3 percent (49.0 percent in CY20) seems to be towards the lower end as most assets of insurers are generally expected to be part of the investment portfolio to support earnings.

Shareholders' equity continued to finance a substantial part of the non-life sector's asset base …

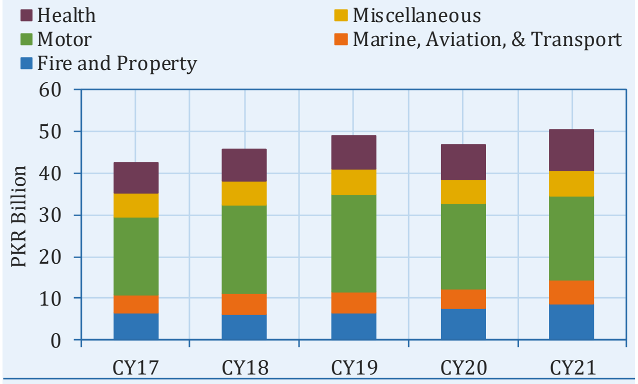
On the funding side, retained earnings and provisions increased by PKR 6 billion and PKR 3 billion to PKR 40 billion and PKR 87 billion in CY21, respectively. During the pandemic, profitability for the non-life sector declined only slightly during CY20 and then rose appreciably in CY21. Overall, equity increased by 8.4 percent over CY21 to PKR 106 billion, which came to 43.0 percent of the asset base.

The provision for unearned premium to gross premium ratio declined from 43.4 percent to 42.2 percent in CY21. Since it remained slightly higher than the indicative 'guideline' of 40 percent, there is a need to monitor the situation to ensure adequate coverage of underwritten risks [163]

Fire and property damage mainly contributed to the increase in gross premiums …

After a witnessing a slight 2.8 percent increase in gross premium and 4.5 percent dip in gross and net premiums during last year, these premiums increased by 10.2 percent (to PKR 103 billion) and 7.4 percent (to PKR 50 billion) in CY21, respectively, due to a broad-based resumption of economic activities (**Chart 6.3.7**).

Chart 6.3.7: Net Premiums for Non-Life Sector



Source: Unaudited/ audited accounts of insurers

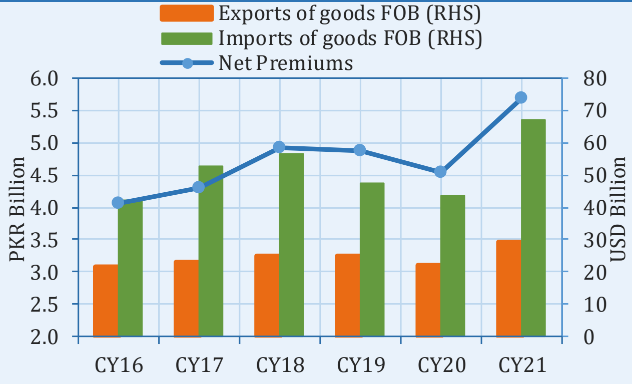
Fire and property damage premium followed by motor premium were the main drivers of growth in gross premiums. This was different from net premiums where marine, aviation, and transport premiums followed by health premiums illustrated the largest absolute increases. The difference in the drivers of growth for gross and net premiums was due to the difference in the opening and closing balances of unearned premium provision and reinsurance expense for different business lines.

The jump in foreign trade of goods led to a corresponding jump in net premiums for

[163] The 40 percent indicative 'guideline' assumes that 20 percent of the premium is used for expenses and the remaining 80 percent covers the risk over the year. Since policies are on average assumed to be halfway through their life, the ratio comes to 40 percent of gross premium.

marine, aviation, and transport business in CY21 (**Chart 6.3.8**).

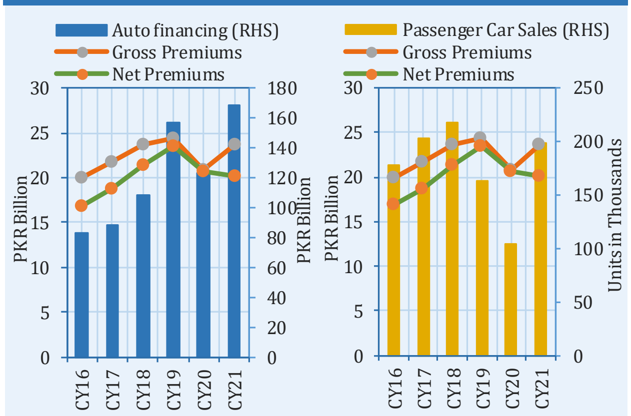
Chart 6.3.8: Trade in goods against Marine, Aviation and Transport Premiums



Source: SBP and Unaudited/ audited accounts of insurers

On the other hand, net motor premiums – the largest segment with market share of 40.0 percent in premiums - slightly declined by 2.2 percent in CY21 despite an increase of 13.6 percent in gross motor premiums. Gross premium increased in line with banks' auto financing as SBP's Prudential Regulations requires lending banks to ensure that vehicles (under auto financing) are properly insured and growth in the sale of automobiles during the year .[164] As noted earlier, the difference between the gross and net premiums was due to the larger reinsurance expense in CY21 (**Chart 6.3.9**).

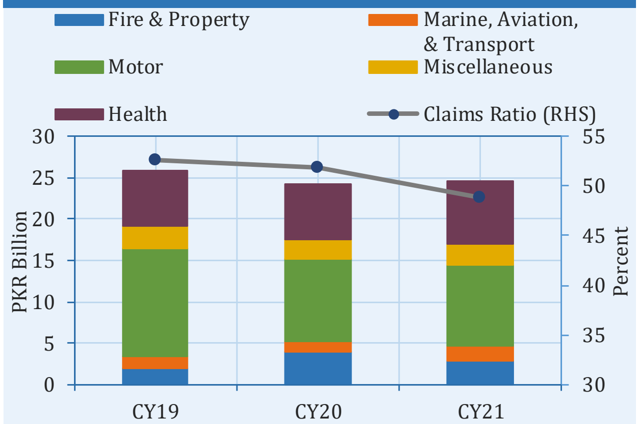
Chart 6.3.9: Passenger Cars Sales, Auto Finance & Motor Insurance



Source: SBP and Unaudited/ audited accounts of insurers

Due to the appreciable growth in premiums with net claims remaining stable compared to the previous year, the overall claims ratio declined from 51.8 percent in CY20 to 48.8 percent in CY21 (**Chart 6.3.10**).

Chart 6.3.10: Net Claims and Claims Ratio



Source: Unaudited/ audited accounts of insurers

With the decline in net motor premiums, there was a corresponding decline of 1.9 percent in motor claims. On the other hand, marine, aviation and transport claims increased in line with their associated premiums.

However, fire and property claims declined significantly in CY21 (despite an increase in associated premiums) as there was a one-off spike in CY20 when torrential rain caused urban flooding in the southern parts of the country particularly Karachi, which caused significant damage to the region's infrastructure.

Consequently, profitability for the non-life sector improved significantly during the year...

The increase in net premiums vis-à-vis stable net claims led to a boost in underwriting results for the non-life sector, which increased by 61.9 percent to PKR 6 billion in CY21. While management expenses increased only slightly, the recalibration of the investment portfolio and the increase in dividend income led to a spike of 23.7 percent in investment income to PKR 10 billion in CY21.

[164] See SBP Prudential Regulations for Consumer Financing

Accordingly, the after-tax profit of the non-life sector posted a healthy increase of 36.2 percent during CY21 to PKR 13 billion (PKR 10 billion in CY20).

Table 6.3.2: Soundness of Non-Life Insurance

Description	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21*
			Percent		
Capital to Assets	12.6	12.6	11.8	10.9	10.5
Claims Ratio	51.4	52.0	52.6	51.8	48.8
Combined Ratio	89.1	88.6	91.0	92.3	88.1
Premium Retention	55.1	54.4	54.0	50.1	48.9
Return on Assets	6.7	6.5	6.6	5.9	7.7

Source: Unaudited/ audited accounts of insurers.
*Estimated Figures

Moreover, the financial performance and soundness indicators also improved as return on assets (ROA) increased from 5.9 percent to 7.7 percent in CY21 while the combined ratio[165] declined from 92.3 percent to 88.1 percent in CY21 (**Table 6.3.2**).

General Takaful

*Underwriting results showed improvement for Dedicated Takaful Operators (**DTOs**) in the general Takaful segment...*

The general Takaful segment[166] consists of three DTOs and around 20 Window Takaful Operators (**WTOs**).

Table 6.3.3: Snapshot of Dedicated General Takaful Operators

Description	Dec-18	Dec-19	Dec-20	Dec-21	growth
		PKR million			Percent
Equity	899	911	819	1,248	52.4
Investment	810	951	1,203	1,355	12.7
Total Assets	2,290	2,834	3,615	5,669	56.8
Gross Premium	1,054	1,733	2,208	3,252	47.3
Net Premium	338	834	1,172	1,584	35.1
Net Claims	309	568	872	1,177	35.0
Underwriting Results	7	-7	39	65	69.1
Surplus before tax (PTF)	16	38	82	94	13.6
		Percent			
Claims Ratio	91.6	68.1	74.4	74.3	

Source: Unaudited/ Audited accounts of General DTOs

On a standalone basis, the two full-fledged active general Takaful operators increased their asset base by PKR 2.1 billion to PKR 5.7 billion at the end of CY21 (growth of 56.8 percent). It seemed that DTOs were benefitting from the acceptability and support of the faith-sensitive segments of society (**Table 6.3.3**).

Nevertheless, DTOs still constituted only 2.3 percent of assets of the consolidated non-life and general Takaful sector in CY21 (up from 1.5 percent in CY20).

The DTOs' investment portfolio mainly comprised equity securities (including mutual funds), fixed income securities (Sukuk), and term deposits. As was the case with the conventional non-life sector, due to the prolonged low interest rate environment during the year, DTOs shifted towards equity securities increasing their share in the investment portfolio from 20.7 percent to 31.4 percent in CY21. The share of debt securities and term deposits stood at 27.8 percent and 40.8 percent, respectively.

Net contributions and net claims for the DTOs increased by PKR 0.4 billion and PKR 0.3 billion to PKR 1.6 billion and PKR 1.2 billion, respectively.

Consequently, in CY21, Surplus for the Participants' Takaful Fund (**PTF**) increased from PKR 82.4 million to PKR 93.6 million. Moreover, profitability for the Shareholders' Fund (**SHF**) posted strong growth from PKR 35.4 million to PKR 159.8 million in CY21, as there was a surge in Wakala Fee.

Family Takaful

[165] Net claims and expenses to net premium ratio
[166] This section covers the two active full-fledged General Takaful companies/ Dedicated Takaful Operators only, as the new business of one dedicated General Takaful Company has been ceased. The performance of Window Takaful Operators (WTOs) of non-life insurers has been discussed on a consolidated basis under the non-life section.

Wakala fee helped sustain profitability for DTOs in the family Takaful segment...

The family Takaful segment is comprised of two DTOs and seven Window Takaful Operators WTOs.[167]

These DTOs in family Takaful increased their asset base by 6.7 percent to PKR 39.4 billion in CY21.

After a slight dip in CY20, the DTOs posted healthy gains of 22.8 percent to register gross contribution of 12.0 billion in CY21. While all the components registered healthy growth, the increase of 20.2 percent in first year contribution reflected that the DTOs attracted significant new business while growth of 9.2 percent and 32.8 percent in subsequent year and group contributions, respectively, indicated the sustainability of their operations.

However, the higher increase in net claims compared to that of net contributions (30.0 percent against 16.4 percent) pointed to slightly subdued underwriting results for the DTOs.

Consequently, surplus (before tax) for the PTF fell from PKR 0.3 billion to PKR 0.1 billion in CY21. Nevertheless, profit (before tax) for the SHF remained somewhat stable at PKR 0.3 billion in CY21 as the substantial increase in acquisition expenses was matched by a similar increase in Wakala fee.

Table 6.3.4: Soundness of Dedicated Family Takaful Operators

Description	Dec-18	Dec-19	Dec-20	Dec-21
		Percent		
ROA	0.7	0.5	0.9	0.7
ROE	10.5	7.6	16.2	13.8
Claims Ratio	43.6	50.2	55.6	62.1
Expense Ratio	26.9	30.6	31.6	31.3
Contribution Retention	95.4	95.1	94.9	89.9

Source: Unaudited/ Audited accounts of Dedicated Family Takaful Operators

Claims ratio for the family DTOs increased due to an increase in surrender and maturity claims.

Despite a decline in profitability indicators, they remained at comfortable level. (**Table 6.3.4**)

Reinsurance

The sole reinsurer in the industry witnessed significant growth in its gross premiums during the year ...

There is one non-life reinsurer in the industry. Besides reinsuring the private sector's non-life insurance business, this sole non-life reinsurer also underwrites (as reinsurer) the business of a public non-life insurer. It is important to note that to cover its own risk, the reinsurer maintained reinsurance arrangements with some of the largest global insurers such as Hannover Re, Partner Re and Lloyd's Syndicate

The company improved its performance significantly in CY21. Its gross revenue from public sector business increased from PKR 10.3 billion to PKR 13.5 billion, whereas the overall gross premiums increased by PKR 4.1 billion to PKR 21.0 billion while net claims declined by PKR 0.1 billion to PKR 3.8 billion leading to an underwriting profit of PKR 1.7 billion in CY21 (PKR 0.8 billion in CY20). Accordingly, profitability of the reinsurer increased from PKR 2.0 billion in CY20 to PKR 3.6 billion in CY21.

Solvency indicators remained at a comfortable level on an overall basis ...

The favorable pricing (which can be gauged by the claims and expense ratio) and conservative investment allocation decisions (most investments in government securities for life and blue chip equity securities for non-life) by most insurers contributed to the financial stability of the industry.

As per latest available data, the life sector on an aggregate basis had solvency ratio of around one in CY20 (which is the regulatory requirement).

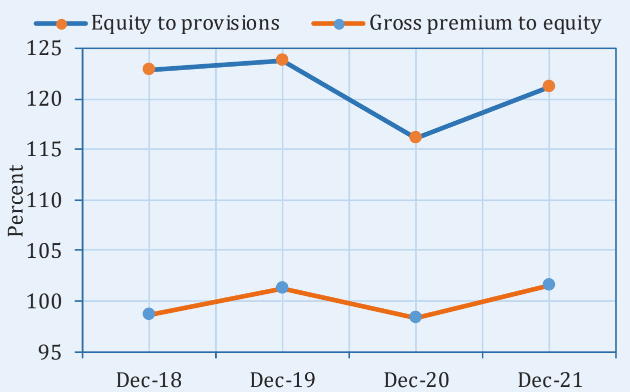
The solvency position of non-life insurance sector improved during CY21. The solvency

[167] This section cover the two full-fledged Family Takaful companies only. The performance of the WTOs of life insurers has been discussed on a consolidated basis under the life section.

indicators remained at comfortable levels on an aggregate basis as gross premium was around 1 times to equity with a slight dip in CY20 at the onset of the pandemic (**Chart 6.3.11**).

Out of the thirty active non-life insurers, only two insurers were not meeting the solvency ratio benchmark in CY20 (two insurers in CY19) out of which, one firm became solvent subsequently. The other deficient firm has a relatively small market share and sponsors of the firm were also striving to inject equity to meet the margin requirement.

Chart 6.3.11: Solvency indicators for Non-Life sector



Source: Unaudited/ audited accounts of insurers

Insurers operating in Pakistan generally have 'traditional' business models – with sufficient loss absorbency capacity, favorable pricing and low leverage utilization – indicating that they have adequate financial standing and are less likely to become a source of systemic risk.

It is important to note that due to the unique nature of insurance business i.e. inverted production cycles[168], longer-term investment horizons (especially for life insurers), built in checks and buffers (e.g. penalties on premature withdrawals), contained interconnectivity and low potential to create contagion effects in the financial system, insurers in general do not significantly contribute to systemic risk in the financial system.

However, since a few insurers operating in Pakistan dominate the market and they have systemic importance for the economy, enhanced supervision and regulation of these entities remains important.

Outlook

Going forward, growth in life premiums partly depends on the sustainability of the national health insurance program while macro financial conditions will be important for the performane of non-life insurers …

Growth and performance of the insurance sector will remain dependent upon the level of business activities in the context of emerging macroeconomic conditions, dynamics of global commodity prices, and geo-strategic and political situation in the country.

Given the country's geopolitical situation and fiscal constraints, the sustainability of the national health insurance program which is underwritten by a leading insurer, will be a key determinant of growth in group premiums for life insurance sector.

In addition, Pakistan's macro financial conditions especially the level of economic activity and future trade scenario and growth in car sales and auto financing will remain important for the growth of marine, aviation, transport, and motor premiums.

[168] Inverted production cycle indicate that policyholders pay premiums upfront and contractual payments by the insurer are made only if and when an insured incident takes place.