Insurance Sector Report 2021

"RISING INTEREST RATES; A LIFELINE FOR LIFE INSURERS"

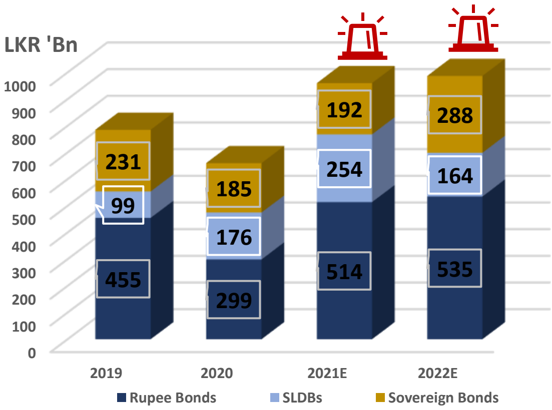
First Capital Research - Jun 2021

Insurance industry in Sri Lanka is still at an early stage of the life cycle despite the growth momentum in recent times. The industry can be segregated into Life Insurance and Non-Life Insurance and as per IRCSL and CBSL, 27 Insurance companies are operating in the country as of 31st Dec 2020. Under section 53 of the regulation of Insurance Industry (Amendment) Act No.3 of 2011, it was made compulsory to segregate composite Insurance companies to the two categories of Insurance on or before Feb 2015. Almost all of the composites separated their Life and Non-Life businesses into two separate companies, except for Sri Lanka Insurance and MBSL Insurance Company Limited. We project Life Insurance to show a strong growth in Gross Written Premium (GWP) and to appear lucrative over Non-Life business.

Potential upward trend in interest rates to have a triple effect on the Life Insurers

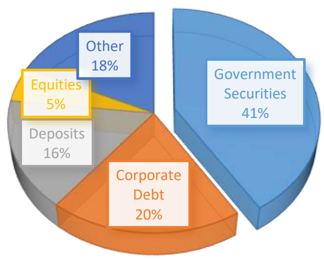
We expect revival in private credit and heightened Govt. borrowing to mount pressure on bond yields from 2H2021E resulting in nearly 50bps upwards shift.

Total Rupee and USD Bond obligations spike in 2021E



However, Life Insurers are expected to benefit from rising interest rates due to the higher investment returns as asset allocation in Life Insurance is skewed towards fixed income earning assets. Govt. securities represents the main investment due to the regulatory requirement to invest minimum of 30% of the life fund assets. Balance of the fund after investing minimum 30% can be invested in other investments, subjected to a particular threshold.

Investment of Life Insurance Fund as at 2Q2020

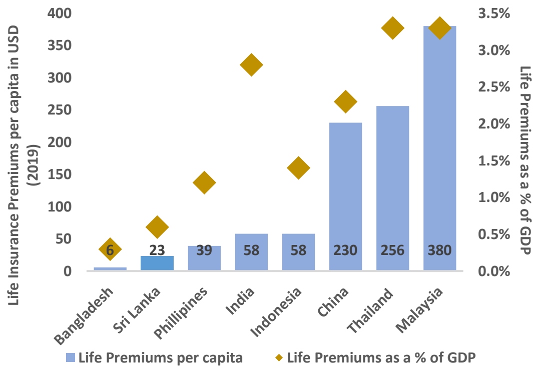


Insurance companies which own larger Life Insurance funds are expected to benefit from rising interest rates due to potentially lower transfer to Insurance contract liabilities. During the last 07 years change in Insurance Contract Liabilities has shown a negative correlation with the 05 Yr Avg. T bond rate. Ceylinco Insurance PLC having the largest Insurance fund among the Listed Life Insurance sector players are expected to benefit from rising interest rates due to possible surplus gains. Moreover, escalation in interest rates are expected to improve Insurers' Risk Based Capital ratios through improved earnings.

COVID-19; A blessing in disguise for Life Insurance sector

In the midst of the COVID-19 pandemic, Life Insurers have seen higher demand as the pandemic caused more people to reconsider Health Insurance needs coupled with Life Insurance. We believe that increased awareness in post-pandemic to augur well with low penetration in Sri Lanka. Being a country largely characterized by the collectivism and dependency where the need for a Life Insurance is yet to realized, industry in Sri Lanka still remains underpenetrated compared to regional peers. Among Asian countries, Sri Lanka is expected to clock a growth of 20% in 2021 as Sri Lanka's Insurance market is still one of the least developed in the region. Growth in Asian region is expected to be a further sweetener for Sri Lanka's growth trajectory.

Low Life Insurance penetration in Sri Lanka to leave room for further upside



Historical data shows that Life Insurance GWP indicates a positive correlation with real GDP growth. However, even though Sri Lanka recorded a negative GDP growth of 3.6% in 2020, Gross Written Premium has grown even higher at 16.0%YoY. Sri Lanka's GDP is estimated to grow at 3.2% in 2021E and 3.8% in 2022E and we expect a recovery in GDP growth to provide a strong impetus for Life Insurance industry thriving the demand for Life Insurance in coming years.

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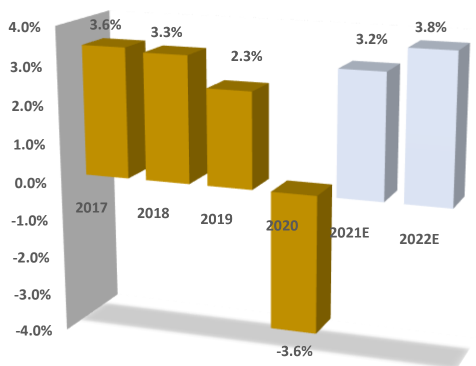
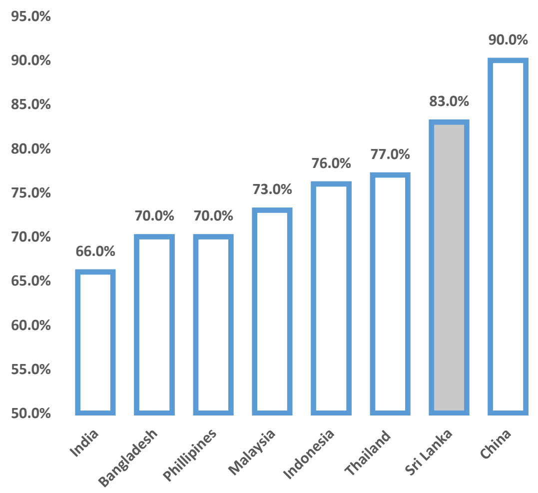


Moreover, the S curve drawn between GDP per capita and Life Insurance penetration demonstrates the interrelationship between per capita income of a country and the extent of its' Insurance penetration. Sri Lanka is currently ranked at a considerably low position in the S Curve due to low per capita income and low penetration. However, with the country aiming to reach an annual per capita income of USD 5,000 by 2025, the premium per capita as a % of GDP per capita is expected to reach a higher position in the curve in the medium term.

We also believe that demographical changes in Sri Lanka are further conducive for Life Insurance business. Non-communicable diseases (NCDs) have shown an increasing trend and currently accounts for 83% of total deaths. In line with this, people have become more aware of risks of NCDs and looking for health/life covers which augurs well with the Life Insurance industry growth.

NCDs as a percentage of total deaths

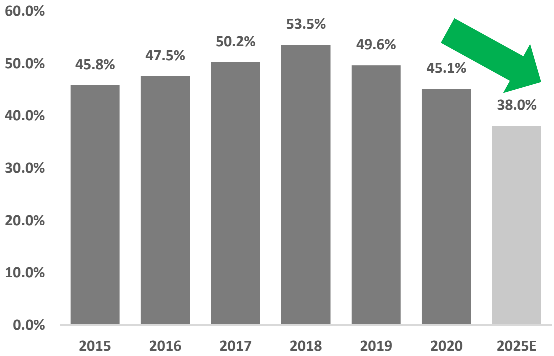


Accordingly, in light of above factors, Life Insurance GWP is expected to grow at a CAGR of 18% during 2020-23E.

Technology driven new normal; A game changer in post COVID Era

With the wake of COVID-19, Life Insurance companies in Sri Lanka have introduced various technological platforms which has led to an emergence of alternative distribution channels recently. As insurers have moved to make use of alternative distribution channels, Life GWP per agent has seen an increasing trend in Sri Lanka during the recent past. Digitization has also led to a decline in expense ratio of the Life Insurance industry. We expect that Sri Lanka has further potential to reduce the expense ratio up to 38% by 2025E with the use of technology which is currently at 45%.

Expense Ratio of Life Insurance sector in Sri Lanka



In conclusion, potential upward trend in interest rates is expected to have a positive effect on the Life Insurers. Additionally, increased demand for health and Life Insurance, together with increased industry efforts to offer digitalized access and solutions have culminated in the Life Insurance sector finding positive growth through the ongoing Covid-19 pandemic.

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