General insurance: moderate industry growth supported by retail segment expansion

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PEFINDO is of the view that the general insurance industry risk profile is moderate with a stable outlook. We project the industry to grow moderately by around 7%-9% in the next 12-18 months, supported by low insurance penetration at merely around 2.5%-3% due to large untapped potential, Indonesia's large population, high consumption and growing middle class, as well as improving market awareness. Low penetration indicates the potential of untapped business, but also reflects a lack of insurance literacy in communities. Soft economic conditions with stagnant economic growth at 4.9%-5.1% are a major factor that may affect the performance of general insurance in Indonesia, in addition to the lack of a prevention culture amid high catastrophic risks due to the country's natural conditions.

In terms of segmentation, we are of the view that potential growth may come particularly from the retail segment, which accounts for only around 20% of total general insurance business. The corporate segment dominates as most general insurance products were initially tailored to cater to corporate client needs such as commercial property, engineering, and marine cargo. The corporate segment also led to larger premium generation for general insurers due to higher sums insured. However, tight competition combined with the lower margin in corporate segments has forced general insurers to innovate and expand the retail segment. Retail offers better underwriting results given the lower claims potential and risks spread over a large number of policyholders. This is also in line with the financial services regulator's (OJK) aspiration to support micro insurance with simple products and reach middle to low-end customers.

With competition rising and margins under continued pressure, we are of the view that insurers are in need of product innovation for stability and sustainable growth. Innovation will intersect with digitalization as insurers seek more cost effective ways to acquire, reach and interact with customers, which in Indonesia are rapidly becoming more mobile and smartphone savvy. While most consumers in the region like to use more traditional distribution channels, such as branches and insurance agents, 2019 should be a year of continued experimentation with innovation. While soft economic conditions challenge insurers, rising individual wealth and an aging population create opportunities for insurers to introduce new products.

We are of the view that the leading general insurers could benefit from partnerships with Insurtechs in developing their digital channels and products. Insurtechs are technology-led companies that enter the insurance sector, taking advantage of new technologies to provide coverage to a more digitally savvy customer base.

Insurtechs benefit from the achievements of financial technology (fintech) companies, as new financial technologies also allow insurer product ranges to be expanded, alternative sales channels to be created and additional groups of clients to be reached. Insurtechs can therefore play an important role in these hitherto underdeveloped insurance markets by offering simple, innovative and needs-based products digitally, and thereby developing new markets.

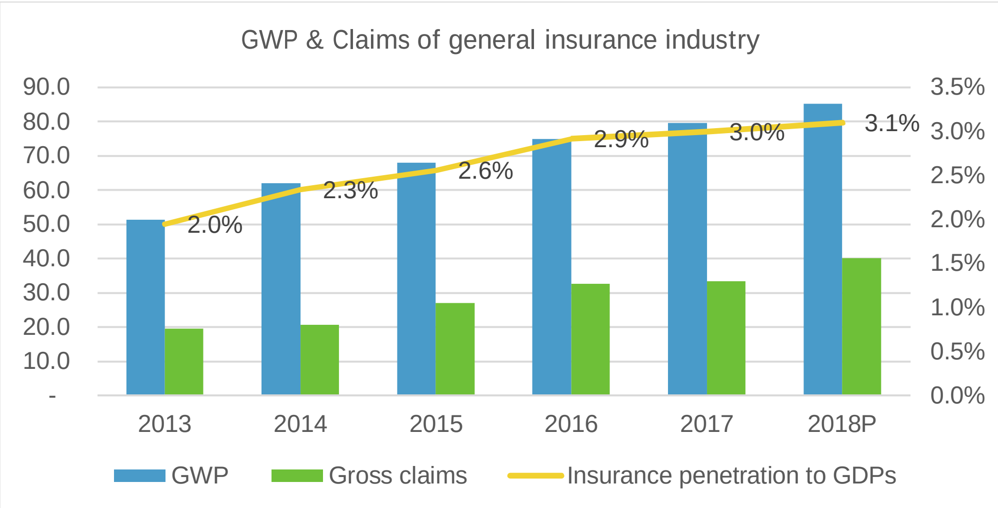
Particularly in emerging countries such as Indonesia with a rapid smartphone density, Insurtechs can provide an additional boost to premium growth, particularly in some retail products with relatively low premiums and sums insured, such as personal accident, health, or travel insurance, by utilizing smartphones for new policies and claim processes. However, as insurers become more digital and use more open IT architecture, the cyber risks grow substantially. While firms rush ahead to innovate, they will also need to keep pace with mechanisms to protect against cyber-attacks within their systems and their partner systems.

Overview of latest market conditions

General insurance business growth in the past few years is moderate, booking total gross written premiums (GWP) of IDR43.4 trillion as of 1H2018, or growing by 15.9% year-on-year (YoY) from IDR37.5 trillion in 1H2017. During 2012-2017, the industry saw an average 11.6% compound annual growth rate (CAGR) in terms of GWP. In 2017, however, premium growth eased to 6.7%, the lowest in more than five years. The sluggish performance of the marine hull, aviation, and energy sectors was a key factor that led to lower premium generation. The regulatory landscape has also affected industry growth, to some extent. Over the last two years, the pace of regulation to has increased significantly – the single presence policy, commission limits, domestic reinsurance requirements, as well as tariffs and capital requirements. Our expectation is this pace will not slow in the near future and we will see a continued OJK focus on the sector as it matures.

In terms of general insurer compliance to regulations, on February 13, 2018 the OJK imposed sanctions in the form of business activity restrictions on PT Asuransi Recapital as it could not meet the lowest solvency level by 100% from the minimum risk-based capital required by regulation. This resulted in it being prohibited from conducting any new insurance coverage activities for all insurance business lines until it solved the problems that caused the sanctions. It is also obliged to settle its due financial obligations. In 2017, the OJK revoked the licenses of two general insurers - PT Fairfax Insurance Indonesia at its own request due to the single presence policy regulation, and PT Asuransi Raya due to claim settlement violation.

Graph 1: GWP and claims of general insurance industry (in IDR trillion)



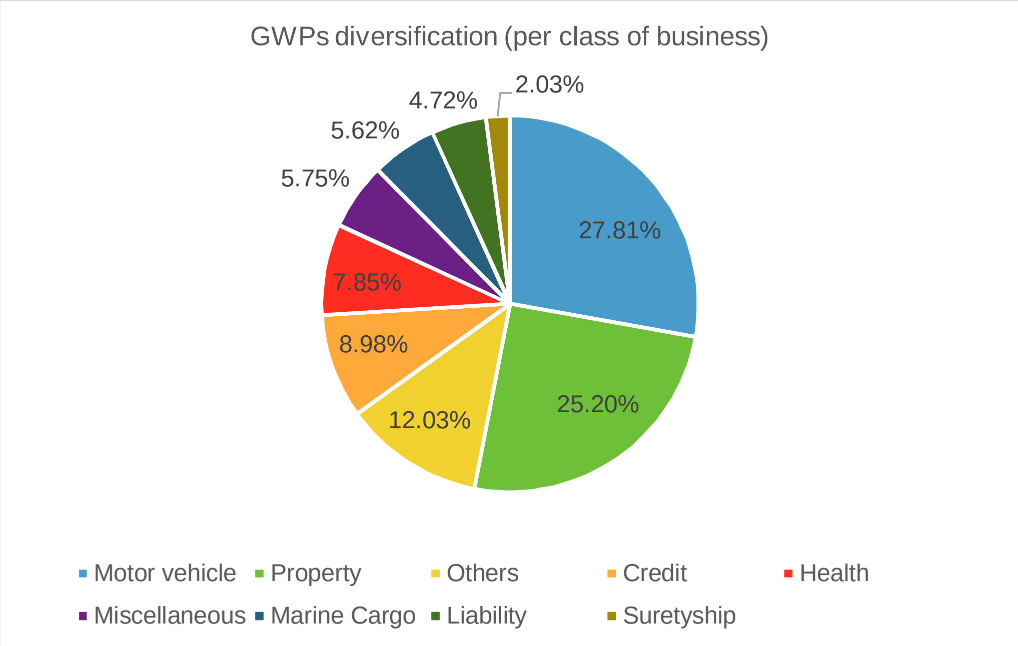
Source: OJK's insurance statistics, 2018P: PEFINDO's projection

Property and motor vehicles to remain largest contributors

Positive growth in the general insurance industry GWP was mainly derived from property and motor vehicle insurance, the largest GWP contributors among other class of businesses. Motor vehicle insurance, as the industry's highest GWP contributor at 27.8% as of 1H2018, grew by 9.0% YoY, mainly due to increasing sales of both cars and motorcycles in 1H2018. PEFINDO is of the view that premium revenue will continue to be derived from the major lines, such as motor vehicles, houses, and commercial property. We expect GWP contributors will remain similar to 1H2018's diversification profile, with property and motor vehicles contributing 53%-55% to premium revenue, followed by credit insurance at 8%-10%, and health at 7%-9%.

Despite the potential growth, we expect insurers to face challenges in 2019 where property and motor vehicle growth could be curbed by potential delayed property and motor vehicles purchase amid the political year, and higher lending rates amid the increasing interest rate environment. Given the current rupiah depreciation that can potentially linked with increasing automotive prices, we expect that there could be additional pressure on growth from motor vehicle insurance if car ownership does not grow as fast as expected. As in the health insurance segment, general insurers are facing competition from the national insurance scheme (BPJS Kesehatan). Growing infrastructure projects also have potential growth which should generate demand for related insurance services such as engineering. In 2019, the engineering and marine cargo sectors are also expected to benefit from OJK's new regulations on engineering fees that could ease the pressure on profit margins, and the requirement to use national general insurers for the export of certain products could boost marine cargo premium generation.

Graph 2. GWP diversification (per class of business)



Source: Asosiasi Asuransi Umum Indonesia (AAUI), as of June 30, 2018

Financial highlights expected to remain sound

PEFINDO notes that general insurance players generally maintain stable operating performances and sound balance sheets with good quality investments, contributing to the stable outlook for the sector. The industry maintained a healthy loss ratio of 38%-52% during the years under review. The combined ratio (loss, expense, and commission) also remained stable at below 100%, which shows insurers booked positive underwriting results. We expect the industry to maintain the combined ratio at 85%-93% in the next two years.

The capitalization of the general insurance industry is moderate, supported by moderate business growth, low dividend payments, and a conservative investment profile. However, PEFINDO is of the view that these factors are partly offset by the modest size of its overall equity, which leaves insurers more vulnerable to single event losses and with a limited capacity to capture high-sum risks.

The majority of general insurers maintain a conservative investment policy, as they focus more on liquidity to fulfill potential claims in the short term and reciprocal business from the banks as their business counterparties. Some 35% of general insurer investments are placed in time deposit, and the rest exposed to marketable securities, including mutual funds, government bonds, corporate bonds, and stocks. The new OJK regulation requiring a minimum placement in government bonds and securities (state-owned infrastructure bonds and mutual funds with government securities as the underlying) of 20% has affected investment composition, with placement in government bonds gradually increasing to IDR9.3 trillion as of 1H2018 from IDR2.8 trillion as of FY2015. With the moderate yield offered by government bonds and capital market volatility, we are of the view that insurers have altered their investment strategies to increase yields and be adequately compensated for increased risks to the portfolio. Market volatility, if it continues, may also dampen the returns and profitability of general insurers in 2019, in our opinion.

Constraining rating factors include general insurer exposure to catastrophe risks due to Indonesia's natural conditions. Insurers use reinsurance to manage catastrophe exposure, placing more than half of their property reinsurance with reinsurers of high credit quality. But, there is some portion of reinsurance provided by reinsurers that has low credit quality by international standards.

Stable outlook for PEFINDO's rated portfolio

As of October 31, 2018, PEFINDO published the financial strength ratings of 10 general insurance companies, and they span from $_{id}$AA+ to $_{id}$BBB in the rating scale. The outlook for all rated general insurers is stable. The industry is supported by a sound regulatory framework as well as the expectation of improvement in economic conditions in the near to medium term. We expect general insurers will maintain their sound underwriting profile to bolster profitability, despite volatile investment results. We also expect insurers to maintain combined ratios below 100% amid a still softer market in the medium term and tight competition in the industry.

Graph 3: Rated Indonesian general insurers (in IDR billion)

Company	Rating / outlook	GWP	Assets	RBC	Combined ratio	ROAA
Asuransi Sinar Mas	AA+/stable	22,409.0	31,271.1	443.8%	51.6%	2.3%
Asuransi Kredit Indonesia (Persero)	AA+/stable	3,699.8	12,106.2	746.2%	92.8%	6.2%
Asuransi Umum BCA	AA/stable	801.1	1,430.5	235.0%	90.9%	4.9%
Asuransi Bangun Askrida	A+/stable	3,112.4	2,703.3	213.8%	89.1%	6.7%
Asuransi Central Asia	A+/stable	2,794.9	8,918.7	183.3%	105.0%	4.4%
Asuransi Bringin Sejahtera Arthamakmur	A/stable	1,262.2	2,213.4	339.0%	74.8%	5.7%
Asuransi Tri Pakarta	A-/stable	655.3	1,393.4	211.6%	94.6%	2.1%
Asuransi Tugu Kresna Pratama	BBB+/stable	210.0	803.5	216.8%	83.9%	1.4%
Asuransi Binagriya Upakara	BBB+/stable	138.3	390.7	369.4%	89.8%	6.5%
Asuransi Bhakti Bhayangkara	BBB/stable	73.8	179.2	375.5%	100.0%	1.5%

Source: PEFINDO's database and published financial statement (as of December 31, 2017), rating database as of October 31, 2018

GWP (gross written premium); RBC (risk based capital); ROAA (return on average assets)