Insurance and Reinsurance Industry Towards Stronger Capitalization

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PEFINDO is of the view that the Financial Services Authority (OJK)'s plans to raise the minimum capital requirements for insurers and reinsurers will enhance their capital structure, liquidity and promote the industry's overall growth and stability. The existing minimum capital regulation stated in POJK 67/2016 is considered insufficient in relation to the prevailing business risks faced by insurers and reinsurers. This is further evidenced by the challenges faced by numerous insurers and reinsurers in Indonesia in meeting the minimum paid-up capital and risk-based capital (RBC) ratio requirements in recent years, highlighting the need for capital strengthening.

OJK has outlined its plans to introduce new minimum capital regulations for insurance companies in two stages, scheduled for 2026 and 2028. Additionally, OJK intends to classify insurance companies based on their capital, which will determine the extent of their business operations. These capital regulations also will be categorized into two types: conventional and Sharia. For conventional insurers, the minimum capital requirement will increase from IDR 100 billion to IDR 500 billion in 2026 and further rise to IDR 1 trillion in 2028. Similarly, conventional reinsurers will see their minimum capital requirement escalate from IDR 200 billion to IDR 1 trillion by 2026, with a subsequent increment to IDR 2 trillion in 2028. As for Sharia insurers, their minimum capital will also experience an upward adjustment from IDR 50 billion to IDR 250 billion in 2026 and then reach IDR 500 billion in 2028. Likewise, Sharia re-insurers will witness their minimum capital raised from IDR 100 billion to IDR 500 billion in 2026, followed by a further increment to IDR 1 trillion in 2028.

Capital Adequacy in the Industry is High, but Varies Significantly Among Insurers

Indonesia's insurance and reinsurance industry has consistently demonstrated a robust RBC ratio. In the first quarter of 2023, the RBC ratio stood at 315.8% for the total general insurance and reinsurance industry, and 460.1% for the life insurance industry. These ratios significantly exceed the minimum regulatory requirement of 120%, reflecting the industry's strong position and capacity to handle risks. However, it is essential to note that RBC ratios can exhibit considerable variation among insurers and reinsurers operating within the industry. While high capitalization ratios generally denote stability and the ability to withstand potential risks, the variability in RBC ratios suggests differences in the capitalization strength among industry players.

Major participants in the industry, often backed by large conglomerates or banking groups, typically enjoy a more robust capital base compared to their counterparts. Their strong financial backing and resources contribute to their ability to fulfill regulatory requirements and navigate potential challenges. On the other hand, several independent insurers still have struggled to meet the minimum capital and RBC requirements in recent years, underscoring the necessity for capital reinforcement. According to OJK statistics, as of the first quarter of 2023, there were 78 general insurance companies, 60 life insurance companies, and eight reinsurance companies operating in Indonesia. In terms of paid-up capital, most insurers and reinsurers have not yet met the planned new minimum capital requirements proposed by OJK.

Table 1. Insurance and Reinsurance Industry Key Financial Figures

	General Insurance			Life Insurance			Reinsurance		
	1Q2023	FY2022	FY2021	1Q2023	FY2022	FY2021	1Q2023	FY2022	FY2021
[IDR Bn] Total Equity	74,348.9	72,529.8	67,740.2	103,977.0	102,943.6	55,867.6	7,084.6	6,584.1	7,474.8
[IDR Bn] Total Assets	199,930.5	196,751.7	183,232.5	586,203.1	585,858.0	589,807.8	35,236.0	33,810.7	29,709.9
[%] Equity / Total Assets	37.2	36.9	37.0	17.7	17.6	9.5	20.1	19.5	25.2
[%] Risk Based Capital	315.8	305.8	327.3	460.1	439.0	539.75	315.8	305.8	327.3
[IDR Bn] Technical Reserve	90,666.1	88,400.9	83,945.9	434,812.3	436,871.0	484,858.9	22,480.5	21,834.2	17,492.5
[IDR Bn] Net Written Premium	13,349.0	43,665.6	37,762.0	37,048.7	163,799.1	178,783.5	2,221.7	10,758.1	10,508.5
[%] Technical Reserve Ratio	169.8	202.4	222.3	293.4	266.7	271.2	253.0	203.0	166.5
[x] NWP/ Equity	71.8	60.2	55.7	142.5	159.1	320.0	125.4	163.4	140.6

Source: OJK Statistics

The reinsurance Industry Needs Capital Infusions to Boost Capacity

The reinsurance industry in Indonesia is facing a significant challenge due to relatively low equity levels. This limitation hampers their ability to take on substantial underwriting risks, resulting in heavy reliance on international reinsurance (retrocession). The constrained equity base directly impacts the retention capacity of the reinsurance sector, highlighting the current limitations in effectively handling more significant risks.

The largest reinsurer in Indonesia has total equity of only around IDR 2-3 trillion, significantly lower than few major general or life insurers in Indonesia, which have total equity ranging from IDR 10-15 trillion. This disparity in equity levels differs when comparing international insurers and reinsurers. At the multinational company level, as of the end of 2022, Munich Re and Swiss Re emerged as the world's largest reinsurers with equity of approximately USD 12-23 billion, while the largest insurers globally, like Allianz and AXA, possessed around USD 50-55 billion in equity.

The infusion of additional capital is expected to provide reinsurers with the necessary resources to take on greater underwriting risks and fulfill their role as reliable risk transfer partners. By increasing their capital base, reinsurers can also instill greater confidence among stakeholders, including customers and business partners. While capital increase is crucial, reinsurers must approach it with prudence and conduct thorough risk assessments. Evaluating risks and implementing effective risk management strategies will ensure the capital increase aligns with their risk profile.

Rating Implications of Higher Minimum Capital Requirement

The proposed increase in minimum capital requirements for the insurance and reinsurance industry carries significant implications for their capital structure and liquidity. The primary implication of higher minimum capital will result in more robust financial ratios, such as the RBC ratio, bolstering the Company's ability to fulfill its obligations in claim payments. Consequently, this will enhance the industry’s overall stability, and this development will have far-reaching effects on various aspects of the industry, instilling greater confidence among stakeholders. Furthermore, the increase in minimum capital will positively impact underwriting capacity, enabling them to position themselves better to underwrite more considerable sums insured.

Insurers and reinsurers that successfully reinforce their capital structure and surpass the new minimum capital regulations have the potential to receive higher ratings. However, it is essential to note that meeting the minimum capital requirements alone is not the sole determinant of an improvement in the insurer's financial strength rating. Ratings also consider factors such as fundamental business risks and the ability of insurers and reinsurers to underwrite higher-quality business in their portfolios. If a company can significantly improve its fundamental business aspects, including securing better-quality business, the possibility of a rating upgrade becomes more viable. The capital increase also holds relevance for implementing PSAK 74, which will be effective in 2025. PSAK 74 introduces changes in the accounting treatment, particularly revenue recognition for insurance contracts. By having a larger capital buffer, insurers will be better equipped to address potential corrections to key financial metrics that may arise due to the implementation of the new accounting standard.

On the other hand, for insurers and reinsurers that fail to meet the minimum capital requirements, the impact is still uncertain and will depend on the sanctions imposed by OJK. If the sanctions include business restrictions, reflecting on what occurred in the banking industry, it can negatively impact the insurer's financial strength rating. PEFINDO will remain vigilant in evaluating the preparedness and strategies of companies in meeting the newly proposed minimum capital requirements. Failure to take clear actions as the compliance deadline approaches can impact the revision of their ratings or outlook. In addition, the implementation of new minimum capital requirements in the banking industry has shown that there is a possibility of new large-scale foreign companies entering the market or the occurrence of mergers between insurers that fail to meet the minimum capital requirements. This potential development could reshape the insurance industry landscape and potentially impact the ratings of companies in the industry.

Capital Base is Still Far from New Minimum Requirements

PEFINDO acknowledges that the plan for stricter minimum capital regulations presents a significant challenge for national insurers and reinsurers, particularly players with lower capital profiles or slightly higher equity bases than existing regulatory standards. The implementation of the capital increase plan may compel small-capital players to explore alternative solutions to meet the requirements. This can include seeking collaborative efforts with other industry players or considering industry consolidation through mergers or even selling their companies entirely.

For insurers with substantial equity but low paid-up capital, they may consider reclassifying equity components into paid-up capital, in accordance with company policies and relevant regulations. Certain equity components, such as retained earnings, current year's profits, reserves, and additional paid-in capital, may be eligible for reclassification. However, it is important to note that not all equity components can be reclassified, such as undistributed dividends. Therefore, having equity above Rp 1 trillion does not automatically ensure insurers' readiness to meet the new proposed POJK requirements. Nonetheless, such insurers may find it relatively easier to meet the minimum capital requirement than those with a lower equity base.

The challenge of increasing capital goes beyond its direct impact on the financial sustainability of insurers and reinsurers. It also has implications for the reputation and trust of customers and the overall market perception. To address these challenges, insurers and reinsurers must take strategic steps to increase their paid-up capital. Implementing effective risk management strategies is also crucial to ensure that the capital increase aligns with the company's risk profile and supports long-term sustainability. PEFINDO's assessment indicates that a considerable number of insurers and reinsurers in our portfolio, approximately 90%, still need to increase their paid-up capital to comply with the proposed plan. This highlights the magnitude of the challenges that most players in the industry will face in meeting the new regulatory requirements.

Table 2. Published insurers and reinsurers ratings in PEFINDO portfolio

Ratings as of June 2023	Rating	Total Equity*	Paid-up Capital*
PT Asuransi Kredit Indonesia	$_{id}$AA+	12,332.3	400.0
PT Jasa Raharja	$_{id}$AAA	12,201.4	8,500.0
PT Asuransi Central Asia	$_{id}$AA-	6,945.2	100.0
PT BNI Life Insurance	$_{id}$AA+	5,792.5	300.7
PT Asuransi Sinar Mas	$_{id}$AA+	4,438.7	200.0
PT Reasuransi Indonesia Utama (Persero)	$_{id}$AA-	2,565.0	878.4
PT BRI Asuransi Indonesia	$_{id}$AA	1,570.8	311.5
PT Asuransi Jiwa Inhealth Indonesia	$_{id}$AA	1,481.3	1,000.0
PT Asuransi Umum BCA	$_{id}$AA	1,111.4	195.0
PT Asuransi Bangun Askrida	$_{id}$A	977.1	319.0
PT Asuransi Jiwa Taspen	$_{id}$A-	603.1	300.0
PT Asuransi Tri Pakarta	$_{id}$A	549.9	105.0
PT Reasuransi Syariah Indonesia	$_{id}$A	361.4	200.0
PT Asuransi Perisai Listrik Nasional	$_{id}$BBB+	328.1	235.3
PT Asuransi Sahabat Artha Proteksi	$_{id}$BBB	214.3	195.3
PT Asuransi Bhakti Bhayangkara	$_{id}$BBB	122.7	48.3

**as of December 2022, in IDR billion*