General Insurance Outlook: Stable in Challenging Environment

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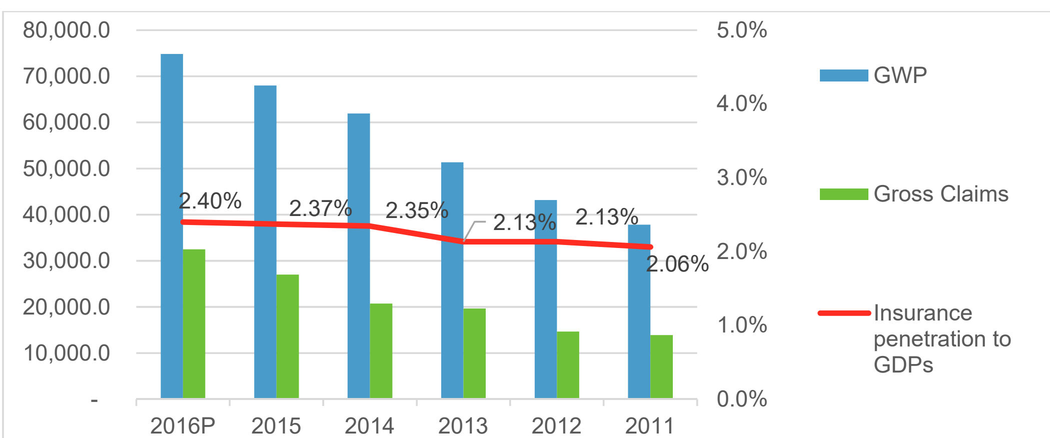
The outlook of the general insurance industry in Indonesia is stable in the near to medium term. However, insurers went through a challenging year in 2015, illustrated by premium growth easing to 9.8% in 2015, the lowest in more than five years. Slower economic growth and subdued consumer sentiment played major roles in the underperformance of general insurance, with the industry in Indonesia showing an average 15.8% year-on-year compound annual growth rate (CAGR) for 2011-2015 in terms of gross written premiums (GWP), and 24.1% in terms of total assets.

The sluggish performance of the automotive and property sectors was a key factor that led to lower premium generation. These two segments used to be the backbone of the general insurance business, contributing about 60% to total gross premiums. Declining automotive sales have suppressed the acquisition of premium revenue for the motor vehicles segment, while weakening demand for property has significantly pushed down premium generation for the property segment. We expect this to persist in the next 12 months, as consumer spending will remain moderate and will need some time to recover.

The insurance regulatory framework has changed significantly over the past two years. The Insurance Industry Law issued in 2014 focuses on risk management policy and good corporate governance. The Financial Services Authority (OJK) also released supporting regulations, including domestic reinsurance requirements, tariff and commission arrangements for several classes of business, and investment placement policy. The more stringent regulatory framework has forced insurers to improve their modeling capabilities, data quality, and data governance, as well as the level of detail provided by their reporting systems. This, in our view, is positive for the establishment of a resilient and sustainable insurance industry in the medium to long term.

Graph 1: GWP and Claims of General Insurance Industry



Source: OJK's insurance statistics, 2016P: PEFINDO's projection

GWP and Gross claims in IDR billion

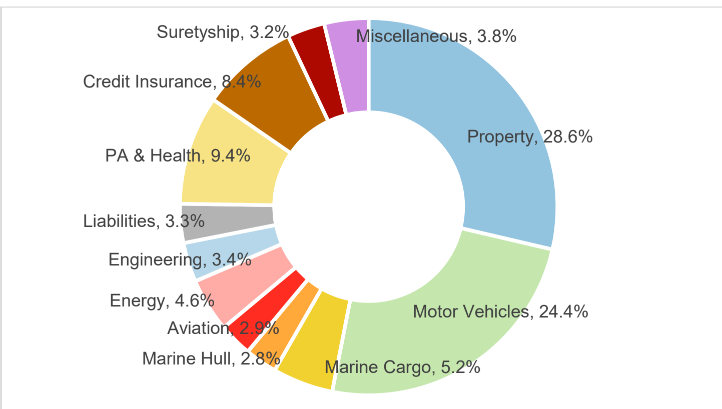
Growth Projection Will Remain Above GDP Levels

Although economic growth will remain soft in 2016, with PEFINDO's gross domestic product (GDP) growth forecast at 5.1%, we project the general insurance industry to book steady premium growth at 8%-10% over the next two years. This growth will be backed by a low penetration rate, good earnings performance, and adequate capitalization of general insurance companies.

Although insurance penetration (total insurance GWP to GDP) in Indonesia has increased steadily from 1.9% in 2010 to 2.3% in 2015, it remains among the lowest compared to other ASEAN countries such as Thailand (4.7%), Malaysia (4.9%), and Singapore (6.5%). More established markets, such as Korea and Japan, have a penetration rate above 6.0%. This gives an indication of the large untapped potential. As such, PEFINDO is of the view that insurance penetration could reach or surpass the 2.5% benchmark set over the medium term, although it may take a while to reach 4.0%.

PEFINDO is of the view that premium revenue will be derived from the major lines, such as motor vehicles, houses, and commercial property. Potential premiums will come from the engineering segment, in line with the government's priority on infrastructure projects. The contribution from the credit insurance segment is expected to increase following a lower Bank Indonesia benchmark rate that will boost credit growth in 2H2016, in our opinion. On the other hand, the energy segment is projected to remain modest, affected by low oil prices weighing on corporate investment spending. The lower GDP contribution from the mining sector also led to the low potential for premium generation from the energy segment. We expect GWP contributors will remain similar to the 2015 diversification profile, with property and motor vehicles contributing 57%-60% to premium revenue followed by health and personal accident at 10%-12%.

Table 2. GWPs Diversification (per class of businesses)



Source: Asosiasi Asuransi Umum Indonesia (AAUI), as of June 30, 2016

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 49%-52% during the years under review. The combined ratio (loss, expense, and commission) also remained stable at below 100%, which shows that insurers booked positive underwriting results. We expect the industry to maintain the combined ratio at 90%-93% in the next two years.

The capitalization of the general insurance industry is considered moderate, with all general insurance companies maintaining a risk-based capital (RBC) of above 120%. Industry capitalization is 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. About 50% of general insurers' investments are placed in time deposits, and the rest exposed to marketable securities, including government bonds, mutual funds, and stocks. The new OJK regulation requiring a minimum placement in government bonds will slightly change this investment composition. Investment in government bonds increased by 56% to IDR4.4 trillion at the end of May 2016, up from IDR2.8 trillion at the end of December 2015. However, as the low interest rate environment continues, insurers must retool their investment strategies to increase yields and be adequately compensated for increased risks to the portfolio. Market volatility, if it continues, may dampen the returns and profitability of general insurers in 2016, in our opinion.

Nevertheless, the constraining rating factors include the general insurers' 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 that are of high credit quality. Still, there is some portion of reinsurance provided by reinsurers that have low credit quality by international standards.

Retail Segment Will Continue to Grow

Tight competition, combined with the lower margin in the corporate segments, pressures general insurers to innovate their business and expand the retail segment. Retail offers better underwriting results given the lower claims potential and that risks are spread over a large number of policyholders. This is also in line with the OJK's aspiration to support micro insurance with simple products and reach middle- to low-end customers. However, the challenge ahead is that insurance literacy is still quite low among most of Indonesia's population.

A key factor to reach mass customers is to enhance IT infrastructure to support business operations, in our opinion. More advanced IT systems have changed the way consumers engage with insurers, putting the onus on carriers to develop digital distribution strategies that improve consumer experience and provide comprehensive support. To improve capital efficiency and profitability, and prepare for more digital-focused competition, insurers must overcome legacy insurance technology with investment in tools that enhance underwriting and innovate distribution. While the slowing growth rate of the economy and the low interest rate environment challenges insurers, rising individual wealth and an aging population create opportunities for insurers to introduce new products.

Stable Outlook for PEFINDO's Rated Portfolio

PEFINDO has published the financial strength ratings of 12 general insurance companies, and they span from $_{id}$AAA 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. In addition, we expect insurers to maintain combined ratios below 100% amid a still softer market in the medium term and tight competition in the industry.

Table 3: Rated Indonesian General Insurers (in IDR billion)

Company	Rating / Outlook	GWP	Assets	RBC	Combined Ratio	ROAA
Jasa Raharja (Persero)	AAA/Stable	4,003.90	10,772.3	603.9%	67.5%	22.2%
Asuransi Jasa Indonesia (Persero)	AA/Stable	4,845.10	11,376.1	162.9%	86.0%	3.5%
Asuransi Kredit Indonesia (Persero)	AA/Stable	2,677.30	9,980.5	605.0%	75.2%	10.0%
Asuransi Umum BCA	AA-/Stable	440.7	898.6	344.4%	96.7%	5.6%
Reasuransi Internasional Indonesia	AA-/Stable	3,132.70	4,387.4	310.4%	89.8%	5.5%
Asuransi Central Asia	A+/Stable	2,979.40	7,552.8	173.2%	106.9%	2.2%
Asuransi Bangun Askrida	A+/Stable	2,179.10	2,075.2	214.4%	86.8%	9.1%
Jasa Raharja Putera	A+/Stable	907.1	1,564.4	281.3%	90.9%	7.2%
Maskapai Reasuransi Indonesia Tbk	A+/Stable	1,075.30	1,438.7	230.2%	81.2%	10.1%
Asuransi Bringin Sejahtera Arthamakmur	A-/Stable	234.8	1,733.3	306.7%	43.6%	4.4%
Asuransi Binagriya Upakara	BBB+/Stable	130.8	374.6	343.2%	92.2%	6.7%
Asuransi Umum Bumiputera Muda	BBB/Stable	426.7	655.2	152.3%	115.3%	1.4%

Source: PEFINDO's database and published financial statement (as of December 31, 2015), Rating database as of July 1, 2016

GWP (Gross Written Premium); RBC (Risk Based Capital); ROAA (Return on Average Assets)

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