

RAM

RATINGS

CREDIT RATING RATIONALE

CLAIMS-PAYING ABILITY – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad

Co-operative Insurance Company Ltd - Rating Review

Claims-Paying Ability Ratings: BB [reaffirmed]

Rating Outlook:
Stable [reaffirmed]

Strength:

- Geographically dispersed branch network

Weaknesses:

- Small stature
- Hefty overheads
- Weak reserving

Principal Activities:
Provision of general and life insurance

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Summary

RAM Ratings Lanka has reaffirmed the BB claims-paying ability rating of Co-operative Insurance Company Limited ("CICL" or "the Company"), with a stable outlook. The rating is premised on the Company's moderate competitive position, extensive distribution network and moderate underwriting standards. On the other hand, the rating is pressured by hefty overheads and inadequate reserving in the general-insurance business.

CICL is a small composite insurer in an industry where the 2 largest players command about 57% of the sector's gross written premiums ("GWPs"). Leveraging on the distribution networks of other co-operative societies, the Company was able to sustain its above-average premium growth in FYE 31 December 2008 ("FY Dec 2008"). CICL's overall premiums augmented 67.52% to LKR 653.45 million, resulting in a 1.12% share of the market as at the same date (end-FY Dec 2007: 0.75%). The growth was mainly driven by the motor insurance sub-class, which charted an unprecedented 97.97% year-on-year ("y-o-y") expansion in 2008.

While expanding its premiums, we note that CICL's overall claims ratio for general insurance increased from 46.80% to 58.98% in FY Dec 2008, owing to the high claims experience in the motor sub-class. Nonetheless, it was still better than the industry average of 64.92%. We note that the Company has been facing an increasing trend in claims in the motor sub-class, which may become a concern. However, for now we have taken into account the management's measures to arrest this rising trend. In the context of life insurance, RAM Ratings Lanka considers CICL's life insurance fund to be moderate owing to its benign claims ratio and lapse rates.

In the meantime, CICL has maintained its conservative investment strategy by investing about 79% of its funds in government securities. The high interest rate environment in 2008 aided the Company to increase its investment income from LKR 45.93 million to LKR 102.50 million y-o-y. Meanwhile, we note that the Company's reserving levels in general insurance also weakened in FY Dec 2008, pressured by escalating overheads. All said, CICL's pre-tax profit augmented 70.42% to LKR 53.17 million in FY Dec 2008 (FY Dec 2007: LKR 31.20 million). However, the core business performance is considered weak due to its heavy overheads.

Elsewhere, the Company reported solvency ratios of 1.10 and 1.13 times in the life and general segments, respectively, as at end-FY Dec 2008. However, RAM Ratings Lanka's independent calculation of CICL's ratio (excluding the fixed deposit placed with a registered finance company or RFC) revealed a marginal shortfall. Nonetheless, subsequently, the management has taken remedial action.

On a more positive note, the Company's capital adequacy has improved after capital infusions. This had followed the Insurance Board of Sri Lanka's ("IBSL") provisional direction to increase an insurance company's paid-up capital to LKR 500 million (or LKR 250 million for each class of business) by end-2009. This regulation is expected to be mandatory with effect from FY Dec 2009. As at end-March 2009, CICL's paid-up capital amounted to LKR 251.23 million. Nonetheless, the shareholders of CICL have agreed to meet the regulatory requirement via the issuance of new shares and a dividend-reinvestment plan. RAM Ratings Lanka will monitor the Company in this regard and inability to meet this requirement may exert pressure on CICL's ratings.

Outlook

The stable outlook on the rating is premised on our expectation that CICL's life underwriting results are maintained at current levels while its general insurance claims ratios remain better than the industry's.

The rating may be revised upwards if the Company can demonstrate sustained premium growth that allows it to adequately support its overheads while improving its reserving levels. Concurrently, CICL will need to maintain its claims ratio at better-than-industry levels.

On the other hand, the rating could come under pressure if CICL's claims and expense ratios rise, its exclusive tie-ups with other co-operative societies are disrupted, or large players also venture into the Company's more niche market segments. Regulatory contraventions can also exert downward pressure on its rating.

Corporate Profile

Established in late 1999, CICL is a relatively new player and comes under the regulatory ambit of the IBSL. The Company is principally involved in the provision of both general and life insurance coverage. Approximately 80% of the Company's business is driven by the general segment. Over the past few years, CICL has expanded its branch network; it now has 35 branches and 74 service centres.

Established by co-operative societies and unions under the concept of mutual insurance, most of CICL's policy holders are members of these co-operative societies. CICL is an active member of the International Co-operative and Mutual Insurance Federation ("ICMIF"), which is based in the United Kingdom and has 120 members in 65 countries. The Company is also a member of the Asia and Oceania Association. In 2008 and 2009, CICL won the international quality summit awards in the gold and platinum categories, respectively, at the International BID Quality Convention.

Small player

**Co-operative
concept**

Ownership Structure and Financial Flexibility

The major shareholders of CICL are co-operative societies and co-operative rural banks (refer to Table 1). As the shareholders are also profit-oriented financial institutions, they require regular dividends to justify their investments. While we acknowledge their capital injections over the last few years as tangible evidence of support, we are unable to assess the financial flexibility of these shareholders or their ability and/or willingness to infuse capital during a stressed scenario.

Table 1: Major shareholders of CICL

Shareholders	end-June 2009
Institutional Shareholders	99.15%
Individual shareholders	0.85%
Total	100.00%

CICL has to comply with the first stage of the regulator's minimum capital requirement of LKR 250 million per business by end-2009; as at end-March 2009, the Company's paid-up capital stood at LKR 251.23 million. We note that the Company's shareholders intend to meet this requirement via dividend reinvestments and share issues. RAM Ratings Lanka will closely monitor the developments in this area.

Competitive Position

Although CICL has a small presence in the insurance industry, RAM Ratings Lanka considers its competitive position to be moderate given its widespread distribution network.

The distinct competitive advantage that the Company has over the other insurance players is its access to co-operative societies' branch networks. As CICL is a co-operative establishment, it is able to tie up with these co-operative societies to sell its policies, which the other insurance players have little access to. To generate business, CICL utilises about 74 Co-operative societies throughout the country as service centres, in addition to its agents and brokers. Through this arrangement, CICL is able to approach its target market, i.e. rural and semi-urban consumers. The Company had extended its reach by adding 29 service centres and a branch during the review period, bringing the count to 74 service centres and 35 branches in total.

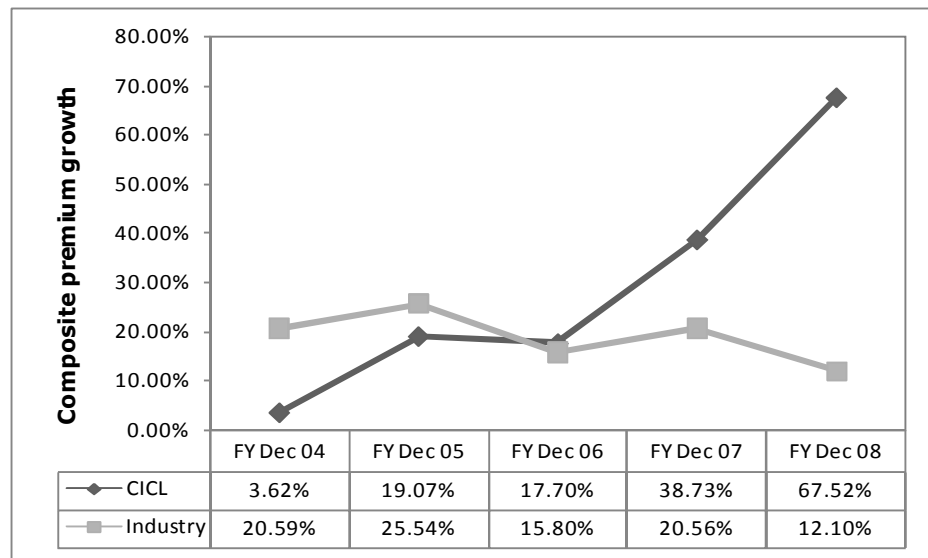
Given CICL's enlarged distribution network, the Company was able to maintain its above-average premium growth in FY Dec 2008. That said, the Company's brokers and agents are significant contributors to its premium growth. CICL's composite premiums surged 67.52% y-o-y to LKR 653.45 million in FY Dec 2008 (FY Dec 2007: LKR 390.08 million) (refer to Chart 1). Accordingly, the Company had augmented its composite market share from 0.75% to 1.12%.

Overall moderate competitive position

Wider branch network

Above-average premium growth

Chart 1: CICL’s composite premium growth vs the industry



Motor segment drove premium growth

The Company’s GWPs in general insurance charted an unprecedented 79.95% growth in FY Dec 2008. This was underpinned by the motor sub-class, where the premiums leapt 97.97% to LKR 378.76 million as at end-FY Dec 2008. Consequently, CICL’s share of the motor segment enlarged from 1.12% to 2.02% as at the same date. This improvement had been brought about by the combination of its broader network coverage and tie-ups with other financial institutions. Furthermore, the introduction of on-site assessment for its motor policies had assisted the advancement in gross premiums. Overall, CICL’s share of the general insurance market increased to 1.51% as at end-FY Dec 2008 (end-FY Dec 2007: 0.93%) (refer to Table 2).

Table 2: Market shares of CICL by product

Category	FY-Dec-04	FY-Dec-05	FY-Dec-06	FY-Dec-07	FY-Dec-08
Motor	1.16%	0.88%	0.81%	1.12%	2.02%
Fire	0.42%	0.55%	0.51%	0.53%	0.58%
Marine	0.33%	0.34%	0.42%	0.42%	0.66%
Miscellaneous	2.09%	0.89%	1.11%	0.90%	1.25%
Total	0.99%	0.79%	0.80%	0.93%	1.51%

Weak competitive position in life insurance

In the life-insurance arena, CICL’s competitive position is deemed weak due to its miniscule market share. That said, we note that the Company has aggressively sought to expand its premiums in life insurance. As a result, its long-term business premiums jumped 30.49% y-o-y (or LKR 30.61 million). Concurrently, its market share edged up from 0.48% to 0.55%. Despite this, the Company still ranks 10th in the industry out of 13 players (where Janashakthi Insurance PLC and National Insurance Company Ltd are considered a single entity). Given CICL’s current position, RAM Ratings Lanka opines that the Company will be challenged to sustain its growth momentum.

Management & Strategies

CICL’s senior management team continues to be led by Mr TMS Nanayakkara, the managing director (“MD”). Mr Nanayakkara is an attorney and the former chairman of the National Insurance Corporation. The senior management of CICL comprises 5 key individuals (refer to corporate information).

Main objective

CICL continues to pursue its objective of offering a range of insurance services to the rural masses. In this context, the Company is focused on enlarging its branch network by increasing the number of its service centres to 100 over the next 3 years. Apart from this, the Company also aims to augment its presence in life insurance. In this regard, the management has introduced 2 new products and will be implementing a new sales strategy.

Internally, the management is exploring opportunities to gain greater efficiency by improving its expense ratio. An external consultancy firm has been engaged to analyse CICL's overheads and to recommend possible areas for improvement.

MIS still in developing stage

Elsewhere, we note that the Company has not aggressively expanded its medical insurance products due to system limitations. RAM Ratings Lanka views this cautious approach positively. In the context of the Company's management information system ("MIS"), it is still in the nascent stage and hence hinders effective decision-making.

Corporate Governance and Risk Management

CICL's board comprise 13 directors, including its former MD who is now its only independent non-executive director. The board convenes on a monthly basis to review the performance of the Company against its budgets. In addition, the board keeps abreast of regulatory issues and developments.

Sub-committees

Meanwhile, the board is supported by 4 committees: audit, remuneration, fund management and purchasing. The Company's external audits are carried out by *Messer PE Mathews & Company*. Meanwhile, CICL has appointed *Messer Ernst & Young* to carry out the internal audit on a quarterly basis.

Underwriting Quality and Risk Exposure

General Insurance

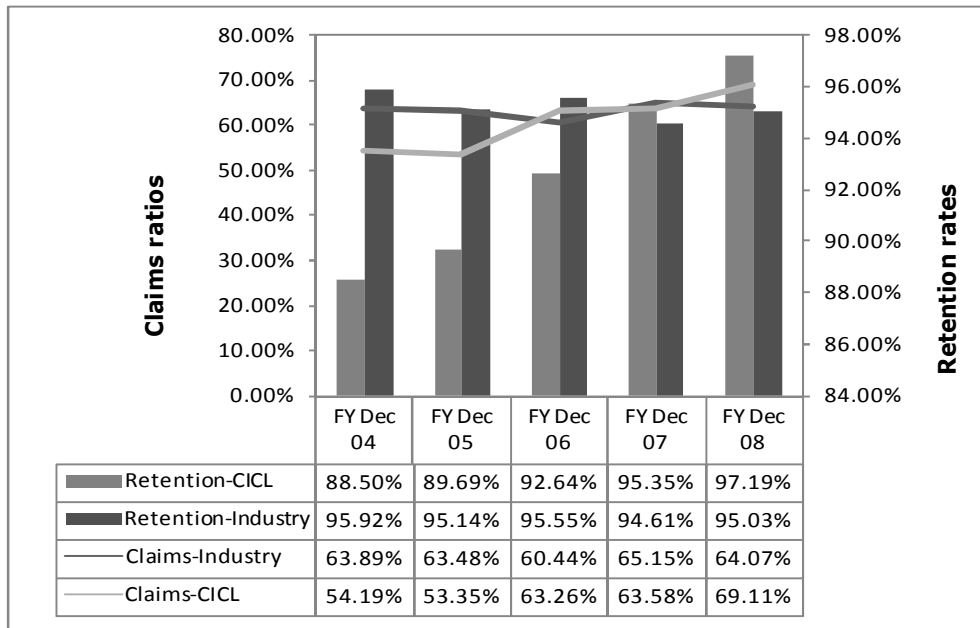
Moderate underwriting standards

RAM Ratings Lanka considers CICL's underwriting standards to be moderate given its better-than-industry claims record. In FY Dec 2008, CICL's overall claims ratio weakened but remained within the industry parameters. The escalation in claims had resulted from heftier claims in the motor sub-class. We note the rising trend in motor claims with some concern. However, we have also considered the management's efforts to curtail this emerging trend. Should claims rise unabated, however, this could exert downward pressure on CICL's rating.

Even though the gross premiums in the motor sub-class had almost doubled, CICL's general insurance portfolio and retention rates remained broadly unchanged during the review period. Nonetheless, the rapid rise in the motor sub-class was followed by a 125% spike in claims. As a result, the claims ratio of the motor sub-class climbed up from 63.58% as at end-FY Dec 2007 to 69.11% as at end-FY Dec 2008 (industry: 64.07%) (refer to Chart 2). In view of the escalation in claims for this segment, the management has placed "excesses"¹ on the policies. RAM Ratings Lanka will monitor the relevant developments in this regard.

¹ Amount to be borne by the policy holder if it is below the specified sum. This clause is utilised to discourage low-value, high-frequency claims.

Chart 2: Claims and retention rates of CICL vs the industry



Higher-than-industry claims ratio in marine sub-class

In the context of the marine segment, RAM Ratings Lanka expects CICL’s exposure to increase as fishing boats are to be mandatorily covered by such insurance. However, the Company has shied away from this sub-class due to the high risks involved. Nonetheless, CICL’s underwriting results in this segment remain abysmal due to inadequate market share; the Company only had 676 policies in force as at end-FY Dec 2008. The Company will therefore be challenged to ease its claims ratio in this segment.

Limited exposure to medical segment

With regard to the fire and miscellaneous segments, CICL continues to maintain better-than-industry claims ratios (refer to Table 3). A factor that aids CICL in containing claims in the miscellaneous class is its limited exposure (less than 5%) to health insurance. This trend is expected to remain unaltered in the foreseeable future.

Table 3: Claims and retention rates of CICL vs the industry (by product)

Segment	FY Dec 2007		FY Dec 2008	
	CICL	Industry	CICL	Industry
Fire-claims ratio	48.86%	84.79%	65.75%	73.20%
Fire-retention rates	52.24%	24.06%	51.92%	12.64%
Marine-Claims ratio	383.77%	30.34%	164.56%	35.56%
Marine-retention rates	46.89%	39.73%	56.80%	36.13%
Miscellaneous-claims ratio	-6.33%	63.94%	17.88%	71.85%
Miscellaneous-retention rates	92.84%	70.46%	95.44%	67.62%
Overall claims ratio	46.80%	64.95%	58.98%	64.92%
Overall retention rates	89.12%	73.54%	92.68%	70.49%

Life Insurance

Moderate life underwriting standards

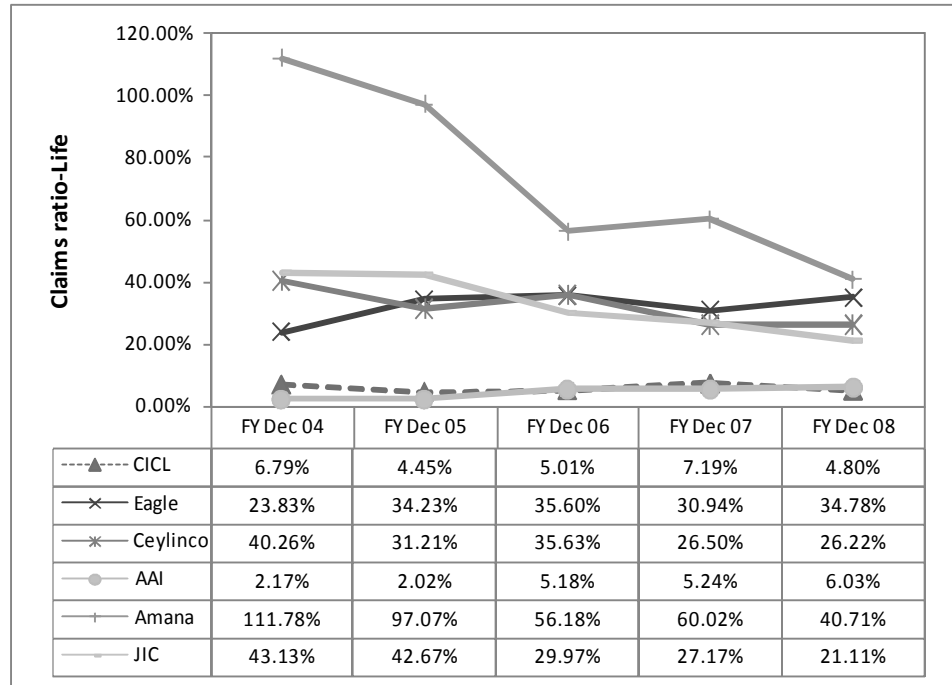
RAM Ratings Lanka considers CICL’s life-insurance business to be moderate owing to its benign claims ratio and lapse rates. However, the Company’s claims ratio is expected to increase as its life portfolio matures.

Better than peers claims ratio

As CICL is only a decade old, it has been able to maintain better claims ratio than its peers (refer to Chart 3). The Company was able to reduce its claims ratio in FY Dec 2008, as the amount of claims reduced by LKR 1.27 million while

earned premiums increased LKR 22.20 million y-o-y. CICL’s claims ratio stood at 4.80% as at end-FY Dec 2008 (end-FY Dec 2007: 7.19%); this ratio is likely to rise as its policies mature.

Chart 3: CICL’s life claims ratio vs the industry



Source: Published annual reports of the industry players

Note: Eagle = Eagle Insurance PLC; Ceylinco = Ceylinco Insurance PLC; AAI = Asian Alliance Insurance PLC; Amana = Amana Takaful PLC; JIC = Janashakthi Insurance PLC.

Our analysis of policy holders’ claims reveals that 80.64% were due to death, disability and hospitalisation while 10.04% were on account of surrenders. The balance was split among other claims (refer to Table 4).

Table 4: Analysis of CICL’s life claims

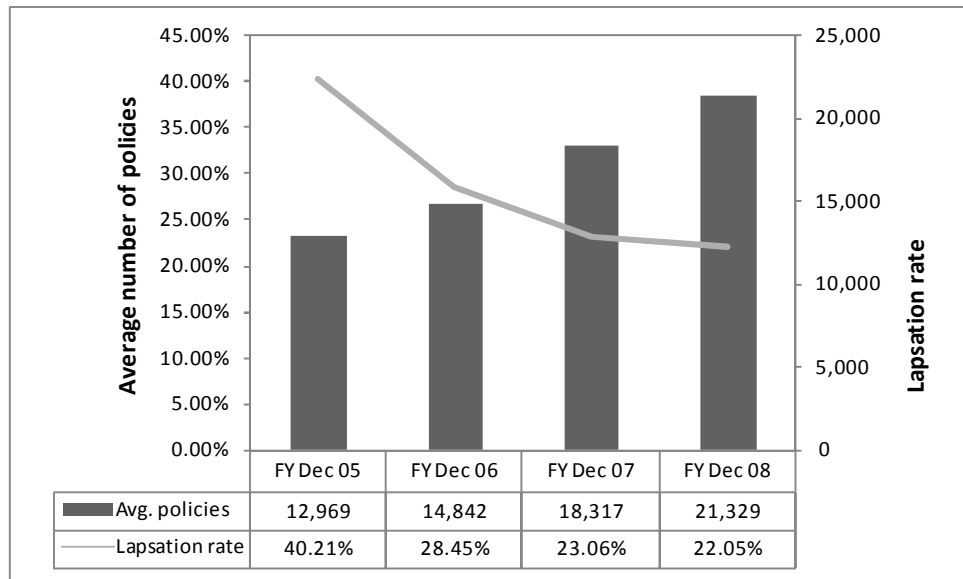
Claims category	FY Dec 06	FY Dec 07	FY Dec 08
Death,disability and hospitalization	89.85%	84.30%	80.64%
Policy surrenders	7.62%	9.96%	10.04%
Policy maturity	0.00%	0.00%	2.48%
Pension benefits	1.81%	5.45%	3.62%
Critical illness and others	0.72%	0.29%	3.22%
Total	100.00%	100.00%	100.00%

CICL’s lapse ratio (the number of policies lapsed during the year divided by the average number of policies for that year) came up to 22.05% as at end-FY Dec 2008 (refer to Chart 4). This compares well against the industry’s estimated 51%. The Company has been able to keep its policy lapses in check as it follows up on the collection of premiums. In addition, the Company encourages its policy holders to keep track of their premium payments via a manual premium register.

Meanwhile, Hannover Re (Rated A+ by Standard & Poor’s) is still the principal reinsurer for CICL, and continues providing technical support in terms of underwriting criteria and pricing.

Better-than-industry lapse ratio

Chart 4: CICL’s policy lapsation ratio



Investment Portfolio

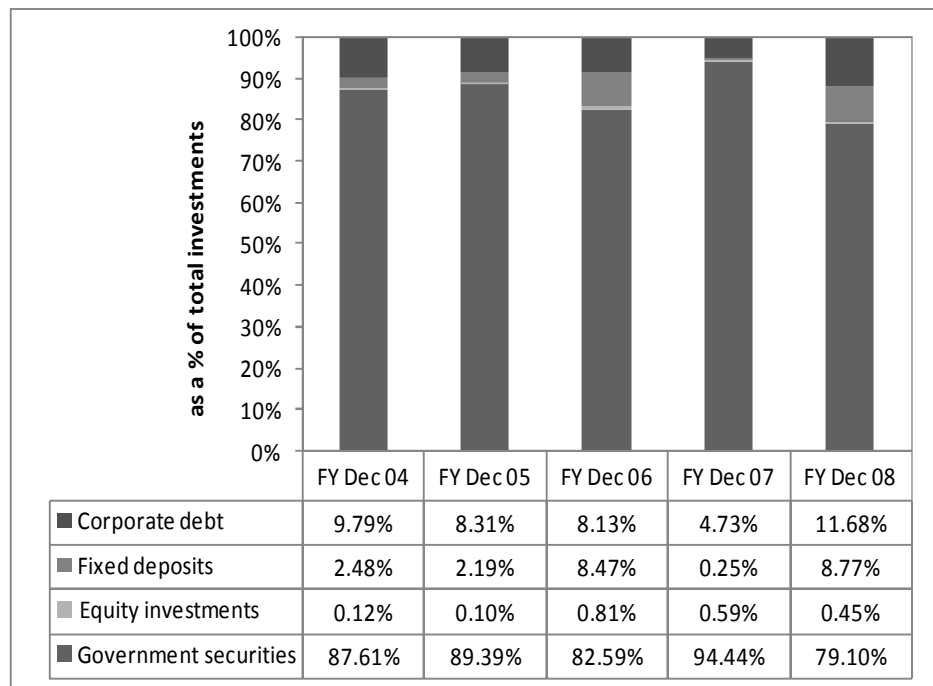
CICL had maintained its conservative investment strategy during the review period, by investing about 79% of its funds in government securities. The Company’s investment portfolio expanded 45.77% (or LKR 193.74 million) in FY Dec 2008. Most of the increase in its investments had originated from government securities, which had surged LKR 88.35 million.

Meanwhile, RAM Ratings Lanka notes that CICL’s investment committee is diversifying its investment portfolio. About 94% of the Company’s investments comprised government securities as at end-FY Dec 2007. As at end-FY Dec 2008, its exposure to government securities receded to 79.10% while investments in fixed deposits (“FDs”) and corporate debts augmented to 8.77% (end-FY Dec 2007: 0.25%) and 11.68% (end-FY Dec 2007: 4.73%), respectively (refer to Chart 5). The Company has deposits in either investment-grade financial institutions or those backed by the state. Nonetheless, we note that a deposit amounting to LKR 20 million has been placed with an RFC, which cannot be included when arriving at the Company’s solvency margins. However, the management of CICL has informed RAM Ratings Lanka that this will be corrected. Apart from FDs, CICL has also increased its exposure to corporate debt securities.

Conservative investment strategy

Portfolio diversification

Chart 5: CICL's investment composition



Regulatory compliance

In the meantime, CICL's portfolio of government securities remained above the regulatory minimums (the IBSL requires all insurance companies to invest a respective 20% and 30% of their general and life insurance funds in government securities).

Despite rising claims, CICL's liquidity levels stayed broadly unchanged as at end-FY Dec 2008; its ratio on liquid assets to total insurance funds stood at 1.32 times (end-FY Dec 2007: 1.30 times).

Strength of Capitalisation

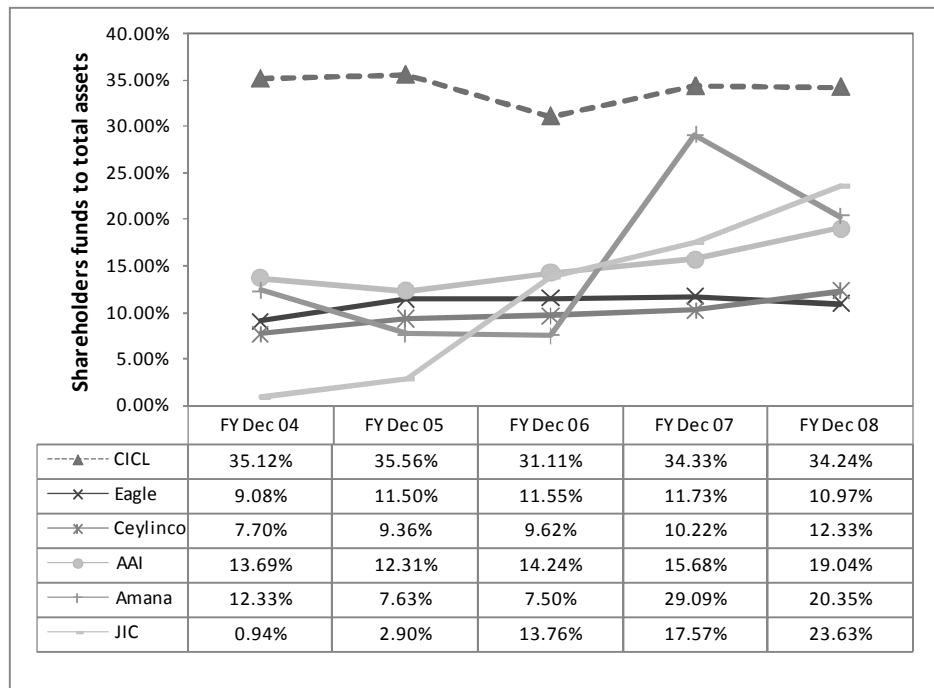
RAM Ratings Lanka considers CICL's capitalisation to be moderate. The Company had strengthened its capital position by issuing LKR 62.86 million of ordinary shares and LKR 21.24 million of preference shares during the reviewed period. Furthermore, retained profits had improved CICL's capitalisation from LKR 197.25 million to LKR 287.68 million as at end-FY Dec 2008. These initiatives have improved the Company's ratio on shareholders' funds against total assets (end-FY Dec 2008: 34.24%), which is better than those of the other industry players (refer to Chart 6).

Moderate overall capital adequacy

Capital plan

The shareholders of CICL intend to raise its capital to meet the regulatory minimum requirement of LKR 500 million by end-FY Dec 2009. However, we note that this regulation has yet to be gazetted. In this regard, the management is expected to infuse capital via a rights issue and a new share issue (or IPO), involving a maximum of 5% of the Company's shares. The shareholders have also agreed to reinvest their dividends every year. RAM Ratings Lanka will monitor the developments in this regard..

Chart 6: Ratio on shareholders' funds to total assets (CICL vs peers)



Source: Published annual reports of the industry players

Adjusted life solvency- below stipulated minimum

CICL reported a solvency ratio of 1.13 times in general insurance as at end-FY Dec 2008 (end-FY Dec 2007: 1.04 times) (refer to Table 5). At the same time, the Company filed a solvency ratio of 1.10 times in respect of its long-term insurance business. However, we note that CICL has included a LKR 20 million FD held with an RFC as admissible assets; this is not in line with the IBSL's regulations. CICL's adjusted life solvency ratio (excluding the LKR 20 million FD) would come up to only 0.79 times. As noted earlier, the management has taken remedial action by converting this FD to listed debenture issued by the same RFC; thus do not envisage any regulatory risk.

Table 5: Solvency ratios of CICL (life and general segments)

LKR millions	Life insurance		General insurance	
	FY Dec 08	FY Dec 07	FY Dec 08	FY Dec 07
Value of admissible assets	252.89	200.27	428.40	242.90
Total liabilities*	241.24	181.61	318.91	189.35
Available solvency margin	11.65	18.66	109.49	53.54
Required solvency margin	10.59	8.26	96.84	51.40
Solvency Ratio (times)	1.10	2.26	1.13	1.04

* Includes policy liabilities and other liabilities

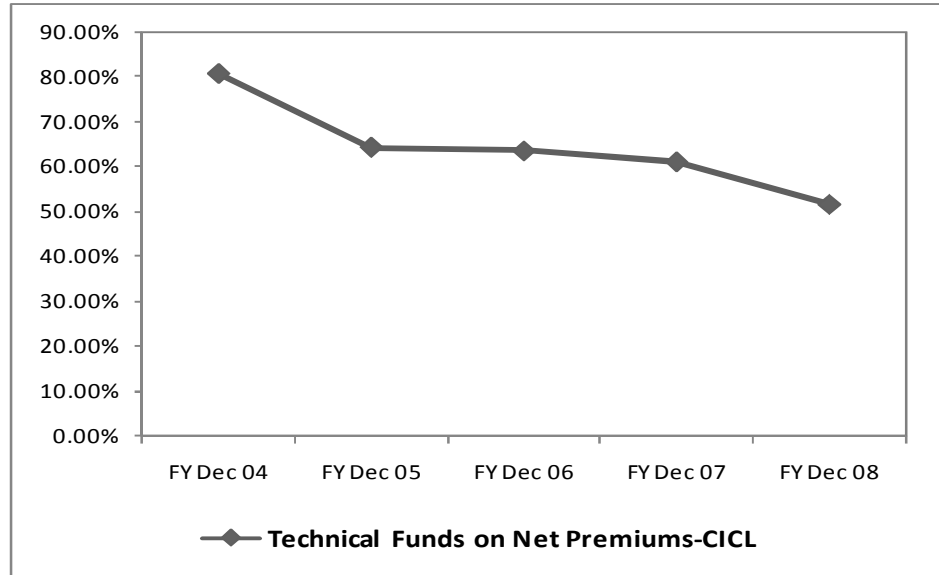
Adequacy of Reserving

Weak reserving

RAM Ratings Lanka considers CICL's reserving levels to be weak as the Company's reserves in its general business were LKR 14.99 million short of the actuary's recommendations. CICL obtained an actuarial assessment of its overall technical funds for the first time in FY Dec 2008. We note that this had been done voluntarily as there is no regulatory requirement to actuarially determine general-insurance technical reserves. We also note that the Company's reserve-adequacy ratio had continued to slide, which remains a concern (refer to chart 7).

Meanwhile, CICL’s actuarial requirements vis-a-vis life insurance are fulfilled by Messer Actuarial and Management Services (Pvt) Ltd. This actuary has certified that the Company’s overall life funds are adequate to meet its policy liabilities.

Chart 7: Trend in CICL’s reserve-adequacy ratio



Adequate reinsurance arrangements

Reinsurance

CICL’s reinsurance arrangements are considered adequate as it complies with the regulatory requirements, which stipulate that only reinsurers rated BBB or above or those that are sovereign-backed can be engaged (refer to Table 6). In this respect, General Insurance Company (“GIC”) India is CICL’s main reinsurer. Furthermore, the Company’s reinsurance arrangements are carried out by a reinsurance broker, Messer JB Boda and Co.

We note that as at end-June 2009, CICL’s reinsurance receivables in the “over 6 months” bracket amounted to LKR 0.33 million (end-March 2009: LKR 1.03 million). Hence, RAM Ratings Lanka is not overly concerned at this juncture.

Table 6: CICL’s reinsurers and their ratings

Reinsurer	Country of origin	Rating	Date of Rating
GIC India	India	A-	February-09
Best Re	Malaysia	BBB	May-09
African Re	Nigeria	A-	June-09
Malaysian Re	Malaysia	A-	June-09
Asian Re	Thailand	B++/State backed	March-08
Hannover Re	Germany	AA-	March-09

Weak performance

Profitability

CICL’s pre-tax profit vaulted 70.42% y-o-y to LKR 53.17 million in FY Dec 2008. The hike in profits was underscored by a surge in its investment income and also weak reserving levels. Nonetheless, the Company’s core business performance is considered weak due to its heavy overheads.

**Expense ratio
higher than
peers**

CICL's composite combined ratio, which has traditionally stood below 95%, weakened further to 102.79% as at end-FY Dec 2008. The main contributing factor for the loss in core business was the Company's high claims experience and elevated overheads, which augmented 59.12% (or LKR 106.48 million) last year. Its geographical expansion and marketing efforts had also taken a toll on its overall expense ratio; CICL opened 29 service centres and a branch in 2008. In tandem with the expansion, the Company's headcount increased by 197 (130 sales staff and 67 office staff) while marketing and selling expenses jumped 53.41 % (or LKR 36.06 million) in FY Dec 2008. Although CICL's expense ratio eased to 56.62% as at end-FY Dec 2008 (end-FY Dec 2007: 59.98%), it was still higher than those of its industry peers (refer to Table 7). Nonetheless, we note that the management has taken action with regard to containing its overheads.

Table 7: Analysis of CICL's expenses

Expense category	AAI	JIC	Amana	UA	CICL
Staff expenses	14.79%	14.25%	15.90%	13.46%	16.00%
Selling & marketing	10.76%	4.43%	12.18%	6.90%	20.46%
Depreciation	1.20%	2.75%	3.23%	1.63%	3.04%
Administration	18.18%	11.13%	19.74%	12.85%	17.12%
Total (% of earned premiums)	44.94%	32.55%	51.06%	34.84%	56.62%
<i>Earned premiums(LKR million)</i>	1,055.06	4,114.39	761.69	4,338.79	506.18

Source: Annual reports of the industry players

**Investment
income drove
profits**

Overall, CICL recorded a pre-tax profit of LKR 53.17 million in FY Dec 2008 (FY Dec 2007: LKR 31.20 million), supported by its investment income and life surplus. This translated in to an improved return on assets ("ROA") of 14.42% at the end of the year (end-FY Dec 2007: 13.94%). The environment of high interest rates in FY Dec 2008 had contributed towards its healthier investment income, which hiked up to LKR 102.50 million (FY Dec 2007: LKR 45.93 million). The bulk of CICL's investment income had stemmed from interest income on government securities (87.29%) and FDs (8.42%). Going forward, however, we expect this income to decline in tandem with tapering interest rates.

Over the short to medium term, RAM Ratings Lanka expects the Company's core financial performance to be constrained by hefty overheads and its profitability to be driven by easing investment income.

Industry Overview

Sri Lanka’s Gross Domestic Product (“GDP”) expanded 1.5% in the first quarter of 2009. Although this pales in comparison to the 6.2% of the previous corresponding period, the slower growth must be seen in the context of the global downturn. Not surprisingly, all 3 major sectors of the domestic economy have been hit by the global turmoil.

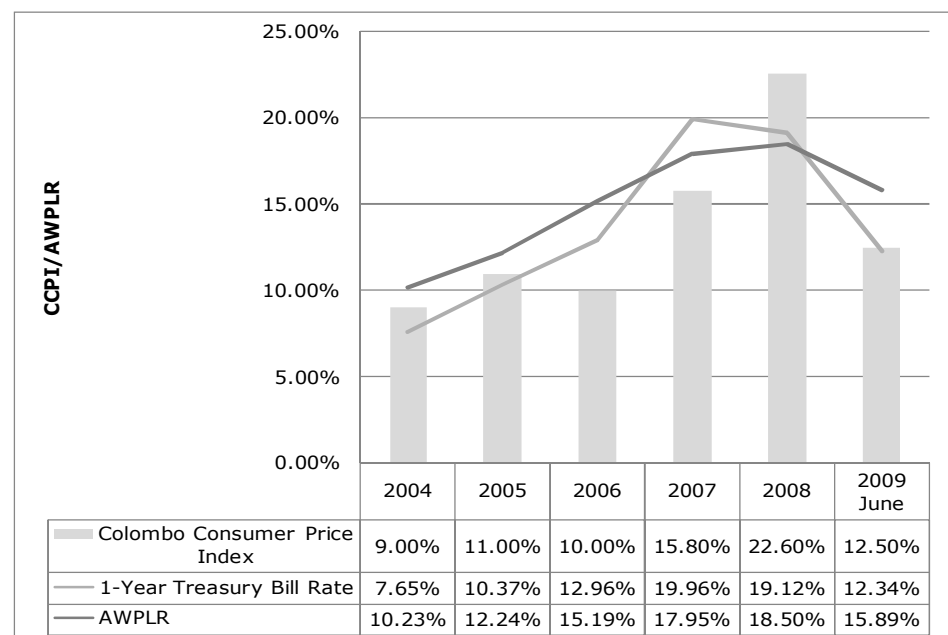
The performance of the primary sectors (agriculture, forestry and fishing) had been dented by the steep fall in tea prices, drought and slumping demand. Although value addition in tea declined 40.9%, this was partially cushioned by the expansion of other food items, including fishing. However, virtually all sub-segments within the industrial and services sectors advanced at a slower pace last year, principally due to weaker export demand (refer to Table 8).

Table 8: Overall and sectoral GDP growth in 1Q 2008 and 1Q 2009

Sector	1Q 2008	1Q 2009
Agriculture, Forestry and Fishing	5.9%	3.0%
Industry	6.0%	1.9%
Services	6.4%	1.0%
GDP	6.2%	1.5%

On a more positive note, the end of the 25-year war against the separatist Tamil Tigers has spawned renewed hope for the country. Additionally, the country’s long-awaited USD 2.5 billion stand-by facility from the International Monetary Fund is expected to elevate the nation’s sorely depleted foreign-exchange reserves. Moreover, both inflation (as measured by the Colombo Consumer Price Index) and interest rates, which peaked in 2008, have been easing consistently since early 2009 (refer to Chart 8). While this augurs well for the domestic economy, sluggish export demand is still a concern. The tapering interest rates follow the Central Bank’s reversal of its tight monetary policy.

Chart 8: Inflation and interest rates

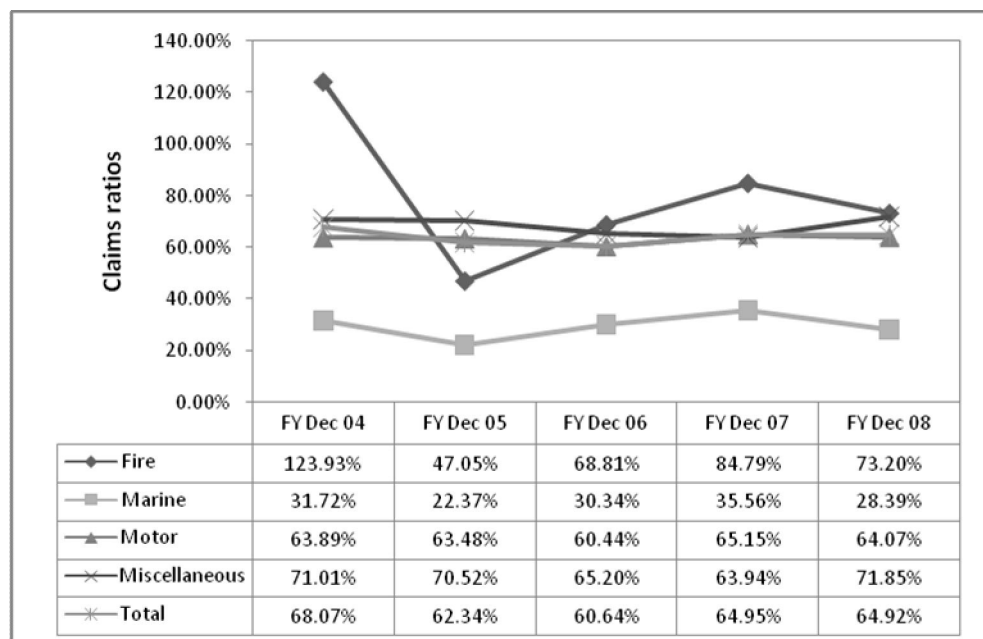


Against this macroeconomic backdrop, the domestic insurance sector made up 3.2% of the financial industry's total assets as at end-December 2008. The industry is composed of 16 players, 2 of which are engaged in only life business while another 3 are only in general insurance; the rest are involved in both general and life insurance. However, the 2 largest players in the Sri Lankan insurance market commanded 57% of the industry's GWPs while the top 5 accounted for about 90% as at end-December 2008.

Owing to the heightened inflation, the Central Bank's tight monetary policy and the gloomy business climate, the industry's overall GWPs increased at a slower pace of 12.10% to LKR 58.16 billion in 2008 (2007: 20.56%). The overall industry's growth had been mainly driven by the general insurance segment, which posted a 10.90% expansion. Within this segment, the key growth driver had been the motor sub-class. We note that there is more potential for growth in life insurance as the penetration level (as a percentage of the country's population) was still rather low at 10.4% as at end-December 2008.

In the last 5 years, the average claims ratio in general insurance has hovered at around 65%, which is in line with international norms. While RAM Ratings Lanka notes that claims in marine insurance can be few and large, this sub-class has by far been the best performer - with an average 5-year claims ratio of about 30%. Although we note that the claims ratio for the fire sub-class has improved compared to 2004, it was still high at 73.20% as at end-December 2008 (refer to Chart 9). The miscellaneous sub-class includes a variety of insurance products vis-a-vis burglary, travel and medical purposes. This wide class has generally been prone to high claims incidences. Generally, the medical sub-class has been cited as the main reason. Here, insurers generally face hefty claims and only underwrite such policies to retain clients.

Chart 9: Industry claims ratios (by product)



The investments of domestic insurers are generally conservative; about 42% of their investments comprised government securities as at end-December 2008. Thanks to the environment of high interest rates, most insurers depend on investment income for their bottom-line performance. In view of easing interest rates, however, the industry is expected to explore other avenues of investment.

As mentioned earlier, investment income has offset most insurers' weak core business performance in the past few years. However, RAM Ratings notes that this trend is not sustainable, especially in light of the current trend in interest rates. A factor for the weak core business performance is insurers' hefty overheads. The industry has been seeking to reduce its heavy overheads by broadening its channels of delivery. Currently, the 2 primary channels of delivery are insurance agents and brokers. However, the IBSL has amended regulations to allow institutional delivery channels, which could help lower acquisition costs. This aside, expense ratios are likely to remain lofty due to lack of automation.

In the context of regulation, the IBSL has been building its supervisory capacity over the past 5 years. The regulator requires insurers to send quarterly and annual returns, and has commenced an on-site study. Apart from these developments, the IBSL has also proposed a gradual increase in insurance companies' paid-up capital, to LKR 250 million in respect of each business by end-2009. Furthermore, the regulator has proposed a risk-based capital framework, the legal separation of each insurance business and the listing of insurance companies. These initiatives will encourage the industry to improve its risk-management framework and promote risk-based premiums. Prospectively, larger and more efficient players are expected to benefit from these changes.

Corporate Information

Date of Incorporation: March 1999

Commencement of Business: March 1999

Major Shareholders:

Central Province Co-Op Rural Banks union Ltd	6.09%
Wennappuwa MPCS Ltd	5.50%
Colombo District Co-Operative Rural Banks Union Ltd	4.70%
Meerigama MPCS Ltd	4.70%
Matara District Tea producers' Co-op Society Ltd	4.20%

Directors:

Mr W Lalith A Peiris	Chairman
Mr TMS Nanayakkara	Managing Director
Mr Upali Herath	Director
Mr PMC Bandara	Director
Mr SA Wickramapala	Director
Mr Bandu Ranawaka	Director
Mr A Dahanayake	Director
Mr WH Jayasiri	Director
Mr Lionel Samarasinghe	Director
Mr K Liyanage	Director
Mr VL Wanigasinghe	Director
Mr A Mathararachchi	Director
Mr DP Amaradewa	Director

Auditor: P E Mathew & Company

Listing: Not listed

Key Management:

Mr TMS Nanayakkara	Managing Director
Mr G Thalagala	General Manager
Mr M Karunaratne	General Manager-Marketing
Ms Champika Alwis	Assistant General Manager-Life
Mr Aruna Thebuwana	Finance Manager

Major Subsidiaries and Associates:

None

Capital History:

Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
2001	Share issues	-	83.55
2002	Share issues	0.75	84.30
2003	Share issues	1.32	85.62
2004	Share issues	2.15	87.77
2005	Share issues	12.36	100.13
2006	Share issues	6.60	106.73
2007	Share issues	58.63	165.36
2008	Share issues	84.11	249.47

Financial Summary - Company

Un-audited

BALANCE SHEET (LKR Million)	31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-08	31-Mar-09
ASSETS					
Cash and Bank Balances	26.97	25.91	9.04	17.23	9.73
Investments					
Properties	0.00	0.00	0.00	0.00	0.00
Fixed Income Securities	215.34	279.04	419.73	560.11	668.09
Unit Trust	0.00	0.00	0.00	0.00	0.00
Equity Securities	0.25	2.50	2.50	2.77	0.00
Fixed and Call Deposits	25.26	26.06	1.05	54.13	0.00
Investment-Linked Investments	0.00	0.00	0.00	0.00	0.00
Net Loans	3.15	0.22	6.14	10.94	13.33
Outstanding Premium from agents/brokers	14.77	17.60	36.80	58.43	101.24
Amount Due from reinsurers/ceding company	12.46	10.92	7.41	6.25	9.03
Investments in Subsidiaries/Associates	0.00	0.00	0.00	0.00	0.00
Other Assets	35.31	27.77	43.78	38.38	47.97
Property, Plant & Equipment	17.78	23.75	48.10	91.90	86.65
TOTAL ASSETS	351.29	413.76	574.53	840.13	936.03
LIABILITIES					
Provision for outstanding claims:					
Admitted/estimated but not yet paid & IBNR	27.84	29.57	30.64	32.00	49.21
Reserve for Unexpired Risks (General Insurance)	67.20	85.17	129.59	222.06	252.30
Actuarial Liabilities (Life Insurance)	92.21	127.44	165.10	213.92	220.05
Bonus & Unallocated surplus carried forward	0.00	0.00	0.00	0.00	0.00
TOTAL INSURANCE FUNDS	187.26	242.17	325.34	467.98	521.56
Amount Due to Agent, Brokers & Reinsurers	11.05	12.79	10.30	15.54	0.00
Accrued expenses & Trade and Other Creditors	25.17	10.09	17.02	49.70	106.17
Amount due to Related Companies	0.00	0.00	0.00	0.00	0.00
Bank Overdraft & Other bank borrowings	2.91	3.29	4.56	0.79	6.32
Investment-linked Liabilities	0.00	0.00	0.00	0.00	0.00
Provision for Taxation/Deferred Tax Liabilities	0.00	6.72	16.37	9.77	0.00
Provision for Dividends	0.00	9.96	3.68	8.68	0.00
TOTAL LIABILITIES	226.38	285.03	377.28	552.45	634.05
Stated Capital	100.13	106.73	165.36	249.47	251.23
Irredeemable Hybrid Capital	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	0.00	0.00	3.04	3.04	3.04
Retained Profits/(Accumulated Losses)	24.78	22.00	28.85	35.18	47.71
Minority Interest	0.00	0.00	0.00	0.00	0.00
TOTAL SHAREHOLDERS' FUNDS	124.91	128.74	197.25	287.68	301.98
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	351.29	413.76	574.53	840.13	936.03

Financial Summary - Company

Un-audited

INCOME STATEMENT (LKR Million)	31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-08	31-Mar-09
Net Premiums	205.64	249.92	355.66	603.89	189.61
Less: Provision for Reserves for Unexpired Risks	(12.92)	(18.55)	(45.67)	(97.71)	(31.10)
Earned Premiums	192.72	231.36	309.99	506.18	158.51
Less: Claims Incurred and Claims Admitted	(54.74)	(78.38)	(106.46)	(233.70)	(92.77)
Gross Underwriting Surplus/(Deficit)	137.98	152.98	203.53	272.48	65.74
less: Underwriting Expenses (of the Funds)	(105.26)	(139.38)	(185.92)	(286.61)	(81.76)
Net Underwriting Surplus/(Deficit)	32.72	13.60	17.61	(14.13)	(16.02)
Investment Income	16.59	29.76	45.93	102.50	26.79
Other Income	0.38	4.47	5.32	13.61	1.76
Surplus / (deficit) transferred from Revenue Account					
- General Insurance	22.36	12.60	29.62	48.25	6.37
- Life Insurance	(1.62)	0.00	1.57	4.93	0.00
Company's Operating Turnover	20.74	12.60	31.20	53.17	6.37
Less: (Management expenses)	0.00	0.00	0.00	0.00	0.00
(Other expenses)	0.00	0.00	0.00	0.00	0.00
Add: Investment Income	0.00	0.00	0.00	0.00	0.00
Other Income	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Depn., Interest and Tax	20.74	12.60	31.20	53.17	6.37
Less: Depreciation and Amortisation	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Interest and Tax	20.74	12.60	31.20	53.17	6.37
Less: Interest and Finance Charges	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Tax	20.74	12.60	31.20	53.17	6.37
Prior Year Adjustments	0.00	0.00	0.00	0.00	0.00
Extraordinary/Exceptional Items	0.00	0.00	0.00	0.00	0.00
Share of Associates Profit/(Loss)	0.00	0.00	0.00	0.00	0.00
Adjusted Profit/(Loss) Before Tax	20.74	12.60	31.20	53.17	6.37
Less: Tax	(3.09)	(4.32)	(8.34)	(14.27)	0.00
Adjusted Profit/(Loss) After Tax	17.64	8.28	22.86	38.90	6.37
Less: Minority Interests	0.00	0.00	0.00	0.00	0.00
Less: Dividends	0.00	(11.06)	(16.01)	(32.57)	0.00
Retained Profit For The Year	17.64	(2.78)	6.85	6.33	6.37

Financial Ratio - Company

	Un-audited				
KEY FINANCIAL RATIOS (%)	31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-08	31-Mar-09
PROFITABILITY (%)					
Gross Underwriting Margin	67.10%	61.21%	57.23%	45.12%	34.67%
Net Underwriting Margin	15.91%	5.44%	4.95%	(2.34%)	(8.45%)
Pre-tax Operating Margin	24.16%	19.14%	19.36%	16.89%	6.60%
Pre-tax Return on Assets (av.)	15.99%	12.50%	13.94%	14.42%	5.64%
Investment Yield (av.)	12.41%	12.41%	13.91%	21.96%	17.44%
After Tax Return on Equity	14.13%	6.43%	11.59%	13.52%	8.43%
Return on Capital Employed	16.24%	9.56%	15.73%	18.48%	8.43%
Claims Ratio	28.40%	33.88%	34.34%	46.17%	58.53%
Expense Ratio	54.62%	60.24%	59.98%	56.62%	51.58%
Combined Ratio	83.02%	94.12%	94.32%	102.79%	110.11%
Investment Income Ratio	8.25%	13.70%	14.41%	19.23%	15.05%
Operating Ratio	74.77%	80.43%	79.91%	83.56%	95.05%
CAPITALISATION / SOLVENCY					
Gearing Ratio	2.33%	2.56%	2.31%	0.27%	2.09%
Operating Profit Debt Coverage Ratio	19.67	14.75	15.24	133.48	12.51
Insurance Fund Liability Ratio	1.50	1.88	1.65	1.63	1.73
Total Surplus Assets Coverage	0.55	0.45	0.52	0.52	0.48
LIQUIDITY					
Total Liquid Assets / Total Insurance Funds	1.29	1.27	1.30	1.32	1.28
Total Liquid Assets / Total Assets	0.69	0.74	0.74	0.73	0.71
OTHER PERFORMANCE RATIOS					
Retention Ratio	85.72%	88.88%	91.18%	92.41%	92.97%

Notes:

* annualised

NA = Not available / Not applicable

Financial Ratios- Company

Ratio Definition:-	
Gross Underwriting Margin	Gross Underwriting Profit / Net Premiums
Net Underwriting Margin	Net Underwriting Profit / Net Premiums
Pre-tax Operating Margin	Operating Profit Before Tax / Net Premiums
Pre-tax Return on Assets (av.)	Operating Profit Before Tax / Total Asset (av.)
Investment Yield (av.)	(Interest income + Dividend Income) / Total Liquid Assets/Investments (av.)
After Tax Return on Equity	Adjusted Profit After Tax / (Shareholders' Funds + Minority Interests)
Return on Capital Employed	(Pre-tax Profit + Interest) / (Total Debt + Shareholders' Funds + Minority Interests)
Claims Ratio	(Claims Paid + Changes in Provision for Outstanding Claims) / Earned Premiums
Expense Ratio	(Commission + Management Expenses + General and Administrative Expenses + Other Expenses) / Earned Premiums
Combined Ratio	Claims Ratio + Expenses Ratio
Investment Income Ratio	Investment Income / Net Premiums
Operating Ratio	Combined Ratio - Investment Income Ratio
Gearing Ratio	Total Debt / (Shareholders' Funds + Minority Interest)
Operating Profit Debt Coverage Ratio	Operating Profit Before Depreciation Interest and Tax / Total Debt
Insurance Fund Liability Ratio	Total Insurance Funds / (Shareholders' Funds + Minority Interest)
Total Surplus Assets Coverage	(Total Assets - Total Liabilities) / Total Liabilities
Retention Ratio	Net Premium / Gross Premium

The above ratios have been computed based on information from the company and published accounts. Where applicable, some items have been reclassified according to RAM's definition to facilitate meaningful comparisons between companies.

RAM RATINGS' CREDIT RATING DEFINITIONS

(Claims-Paying Ability)

A Claims-Paying Ability Rating ("CPA") is RAM Ratings' current opinion on the overall capacity of an insurance company to meet its financial obligations to policy/contract holders. The opinion is not specific to any particular policy/contract; as it does not take into account the expressed terms and conditions of any specific policy/contract.

LONG-TERM RATINGS

- AAA** An insurance company rated AAA has a superior capacity to meet its financial obligations to policy/contract holders. This is the highest long-term CPA assigned by RAM Ratings.
- AA** An insurance company rated AA has a strong capacity to meet its financial obligations to policy/contract holders. The insurance company is resilient against adverse changes in circumstances, economic conditions and/or operating environments.
- A** An insurance company rated A has a strong capacity to meet its financial obligations to policy/contract holders. The insurance company is resilient against adverse changes in circumstances, economic conditions and/or operating environments.
- BBB** An insurance company rated BBB has a moderate capacity to meet its financial obligations to policy/contract holders. The insurance company is more likely to be weakened by adverse changes in circumstances, economic conditions and/or operating environments than those in higher-rated categories. This is the lowest investment-grade category.
- BB** An insurance company rated BB has a weak capacity to meet its financial obligations to policy/contract holders. The insurance company is highly vulnerable to adverse changes in circumstances, economic conditions and/or operating environments.
- B** An insurance company rated B has a very weak capacity to meet its financial obligations to policy/contract holders. The insurance company has limited ability to withstand adverse changes in circumstances, economic conditions and/or operating environments.
- C** An insurance company rated C has a high likelihood of defaulting on its financial obligations to policy/contract holders. The insurance company is highly dependent on favourable changes in circumstances, economic conditions and/or operating environments, the lack of which would likely result in it defaulting on its financial obligations to policy/contract holders.
- D** An insurance company rated D is currently in default on either all or a substantial portion of its financial obligations to policy/contract holders, whether or not formally declared. The D rating may also reflect the filing of bankruptcy and/or other actions pertaining to the insurance company that could jeopardise the payment of financial obligations to policy/contract holders.

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