


RATINGS

CREDIT RATING RATIONALE

CLAIMS-PAYING ABILITY – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad – an affiliate of Standard & Poor's

Sri Lanka Insurance Corporation Ltd - Initial Rating

Claims-Paying Ability

Rating:

AA-[Assigned]

Rating Outlook:

Stable

Strengths:

- Strong competitive position
- Robust capitalisation
- Largest player in terms of assets
- Adequate reserving
- Good financial flexibility

Weakness:

- Corporate Governance

Principal Activities:

Provision of general and life insurance coverage

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Summary

RAM Ratings has assigned a claims-paying ability rating of AA- (with a stable outlook) to Sri Lanka Insurance Corporation Ltd ("SLIC" or "the Company"). The rating is supported by the Company's strong competitive position and unparalleled capitalisation as well as the size and strength of its balance sheet.

Previously a State-owned monopoly, SLIC was privatised in 2003. The Company is the oldest and largest insurer in Sri Lanka, in terms of the size of its balance sheet. The Company accounted for 45.19% of the industry's assets at the end of FYE 31 December 2006 ("FY Dec 2006"). RAM Ratings opines that SLIC enjoys ample financial flexibility due to its robust balance sheet.

As the oldest player in the industry, SLIC has amassed unmatched strength in its capitalisation through retained profits. As at end-FY Dec 2006, the Company's shareholders' funds amounted to a staggering LKR8.40 billion, which constituted approximately 50% of the industry's shareholders' funds. However, SLIC has relinquished its monopoly status with the liberalisation of the industry. Nevertheless, it still maintains a strong competitive position as the second-largest premium writer in both the general and life segments. Under private hands, the Company is being transformed into a more dynamic and competitive player; in recent months, it has made strides in improving its flagging market share.

As at end-FY Dec 2006, SLIC managed a diversified investment portfolio valued at LKR 30 billion– the industry's largest. RAM Ratings perceives the Company to have adequate portfolio-management skills as it had been able to report a respectable bottom line – supported by investment income – even after having paid out claims vis-à-vis the tsunami tragedy. On a related note, SLIC acquired controlling interest in Lanka Hospitals PLC.

SLIC also possesses good underwriting capabilities in 3 major classes of general insurance. Nonetheless, its overall underwriting standards vis-à-vis general insurance are tempered by the high claims incidence in the "all risk" category, which falls under the miscellaneous class of insurance. In the meantime, the Company's life underwriting standards are deemed adequate as they are modelled after those of its international re-insurers, i.e. Munich Re and Swiss Re.

The Company's reserving is perceived to be strong. Since FY Dec 2006, SLIC has been providing for both life and non-life reserves, as per actuarial recommendations. We note that SLIC is also the only insurer that has been able to consistently keep its reserve adequacy ratio above 100% in the past 4 years.

Elsewhere the disclosure and corporate governance have room to improve and as the board implements a board charter and seek stock exchange listing, there could be improvements in this regard.

Outlook

The stable outlook on the rating is premised on SLIC’s retention of its market position, while continuing to adequately manage its investment portfolio. In addition, RAM Ratings expects reserving levels to remain sufficient and underwriting standards remain at present levels.

The rating may, however, come under pressure should SLIC’s investment income decline significantly, its market share shrink, its reserving become inadequate or its claims experience weaken significantly. On the other hand, an upward revision of the rating could materialise once SLIC demonstrates a consistently better-than-average claims ratio (over the next 2 to 3 years) while further strengthening its internal systems. Additionally, its market position and solvency margins should be preserved at current levels.

Corporate Profile

Largest insurer in Sri Lanka

SLIC is the largest insurer in Sri Lanka in terms of assets. Initially established under the Insurance Corporation Act No. 2 of 1961, the Company now comes under the regulatory control of the Insurance Board of Sri Lanka (“IBSL”). SLIC provides both general and life insurance coverage in Sri Lanka and also in the Maldives islands.

Oldest local insurance company

SLIC is the oldest and largest domestic insurer in terms of assets. The Company’s balance sheet represents about half of the industry’s assets. SLIC had previously been under state control and had also been a monopoly. The Company was privatised in 2003, winning many accolades in 2007.

Won many accolades

SLIC has been recognised as a “Super Brand” by Super Brand International, and is the first and only local insurer to have won such recognition. It also ranks among the top 30 most respected entities in Sri Lanka, according to LMD - a leading domestic business magazine. Meanwhile, the Company has also won the following awards:

- Gold, for business excellence in the insurance sector
- Gold, for the “Best Capacity Builder” category
- Gold, for the “Business and Financial Sustainability” category
- Silver, for the business excellence in the “Extra-large Company” category
- Silver, for overall business excellence

In addition, the Company’s in-house software team won 3 awards at the National Best-Quality Software awards in 2007. In July the same year, SLIC obtained ISO 9001/2000 certification for quality management systems vis-à-vis its life and general claims settlements. In this respect, SLIC is unparalleled in the local industry.

Dynamic privatised entity

RAM Ratings notes that SLIC has successfully shed its image as a lethargic State-owned giant, as private ownership and keen competition have necessitated a more dynamic and customer-focused organisation. The Company had previously been acclimatised to operating within a monopolistic environment for almost 3 decades (since 1962). Furthermore, political influence had led to a rise in its head-count, with no corresponding increase in efficiency, thereby retarding its service standards. Although the State had sought to improve SLIC’s service standards by introducing competition in 1977 (by establishing another State-owned insurance company) and 1986 (through liberalising the insurance

Ample financial flexibility

industry by including private players), real progress had not been evident until ownership transferred to the private sector.

Ownership Structure & Financial Flexibility

SLIC is deemed to have a strong degree of financial flexibility as it has a robust balance sheet and minimal debt. Given the Company’s financial standing and franchise, RAM Ratings opines that SLIC has ample financial flexibility. The Company is a part of the Distilleries Group, and its ultimate parent is Milford Export (Ceylon) Ltd. The latter is held through Milford Holdings (Pvt) Ltd, a subsidiary of Distilleries Company of Sri Lanka. The Distilleries Group is one of the largest blue-chip entities listed on the Colombo Stock Exchange. It has also been one of only 2 Sri Lankan companies to be ranked among Asia’s 200 most successful companies, with annual sales of under USD 1 billion, by Forbes magazine.

Part of DHS Jayawardena’s empire

The Chairman of the Distilleries Group, Mr DHS Jayawardena, is a well-known businessman and chairs or has strategic stakes in almost all leading corporates in Sri Lanka.

Privatised in 2003

Before being privatised in April 2003, the Company had been a government-held corporation under the provisions of the Insurance Corporation Act No. 2 of 1961. It had been incorporated in February 1993 under the Companies Act No. 17 of 1982, as a limited-liability company known as Sri Lanka Insurance Corporation Ltd.

Competitive Position

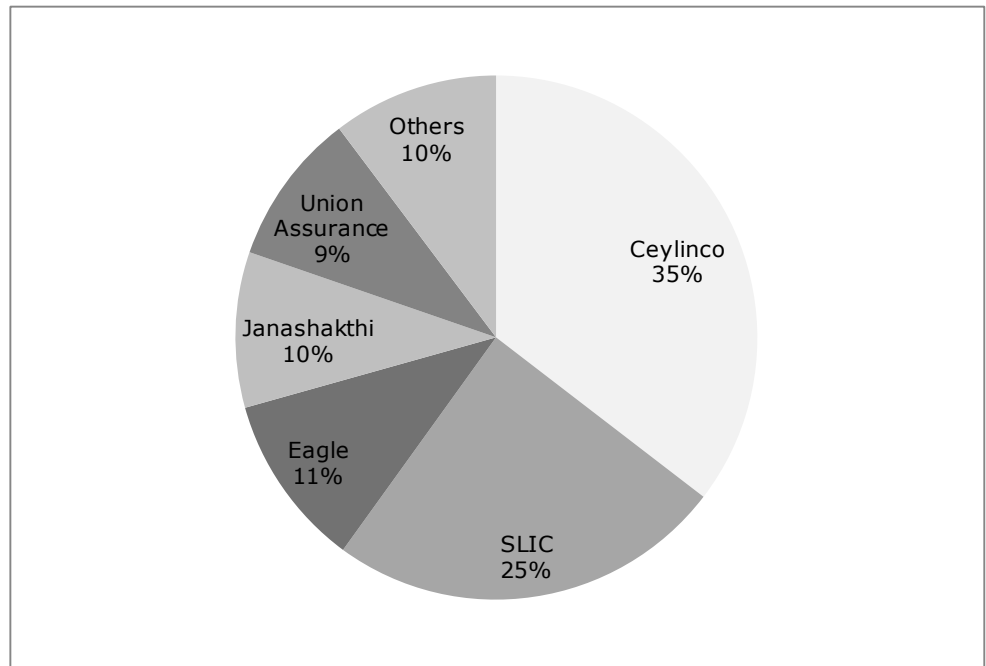
Strong competitive position

SLIC is perceived to have a strong competitive position as it is ranked second in the industry in terms of premium income and accounts for 25% of composite industry premiums. Even though the Company’s market presence has been waning since relinquishing its monopolistic status under State ownership, SLIC’s recent efforts to arrest further decline are bearing fruit.

Maintains industry ranking

In FY Dec 2006, SLIC’s composite gross premiums amounted to LKR10.57 billion, thus maintaining its position as the second-largest insurance underwriter and accounting for 24.51% of the industry’s premiums (refer to Chart 1). RAM Ratings’ opinion on SLIC’s competitive position is supported by the Company’s wide lead over the country’s third-biggest premium writer, whose absolute premiums came up to only about a third of SLIC’s. Furthermore, SLIC and its closest rival, Ceylinco Insurance PLC (“Ceylinco”), make up 60% of the industry’s composite premiums; the rest of the industry is fragmented and divided among 12 players. Although SLIC has been losing market share, we note that this has been because of the conversion of the once-monopolistic industry into a competitive sector; the Company has nonetheless been able to maintain its premium growth.

Chart 1: Market share of composite premiums as at end-FY Dec 2006



Loss of monopoly status

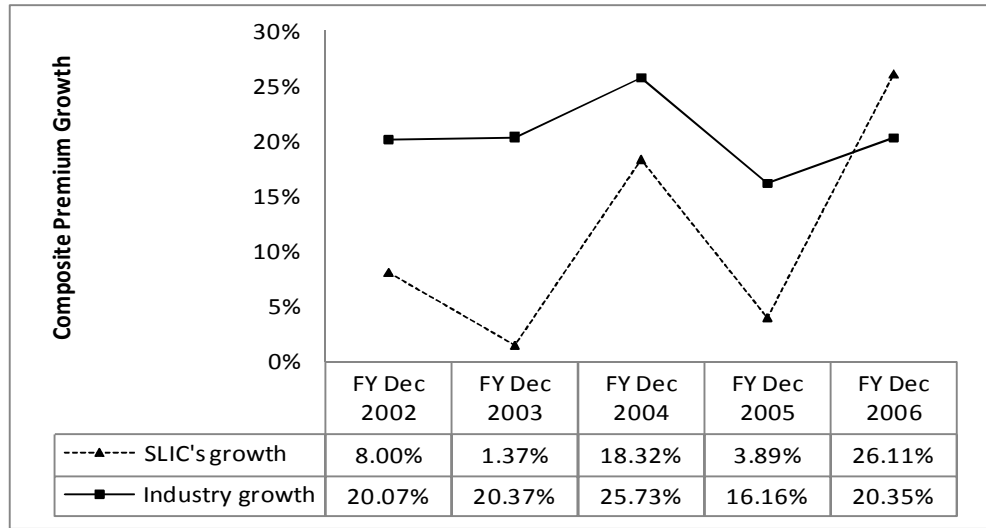
SLIC has maintained its dominant market presence, despite the keen competition that came about with the influx of new entrants which allowed market forces to determine premiums; the latter has also encouraged more innovations and enhanced customers’ convenience. Against this backdrop, SLIC had initially been unable to capitalise on the market’s expansion, as its service standards had not been able to keep pace with those of newer and nimbler players. Moreover, internal issues such as ownership and management changes had also contributed to the significant deceleration of SLIC’s premium growth. In addition, the Company lost key government contracts as it had maintained its pricing discipline such as “Agrahara”. SLIC had been the premium leader until FY Dec 2003, when it was overtaken by Ceylinco.

Poised to increase market share

In FY Dec 2007, SLIC staged a come-back by increasing its market share. This achievement marked the culmination in the Company’s internal processes and marketing efforts. This is reflected by the trend in its premium growth, which has been aligned with the industry’s over the past 2 years. Previously, the Company’s premium growth had been contracting, while the industry’s had been expanding. Although SLIC only charted a modest 3.89% growth in FY Dec 2006, we note that this was despite having lost a large chunk of insurance for public servants to the National Insurance Trust Fund. SLIC’s composite gross premiums amounted to a staggering LKR10.56 billion in FY Dec 2006.

Industry data shows that SLIC was able to increase its composite insurance premiums by 32.60% in FY Dec 2007 (FY Dec 2006: +3.89%) (refer to Chart 2). Moving forward, RAM Ratings expects SLIC to take strides in broadening its already significant market share.

Chart 2: Composite premium growth



Strong competitive position in general insurance

The Company has still a strong presence in the general insurance segment, accounting for a significant portion of the industry's premiums. SLIC's general insurance premiums represented 25.62% of the industry's in FY Dec 2006. Furthermore, the Company has augmented its market share to 28.40% in FY Dec 2007. Previously, SLIC had been the leader with 43.65% of the industry's premiums in FY Dec 2002, however, the uncertainties surrounding its privatisation and its focus on internal issues had crimped its market share. The decline in its market presence related to mainly in 2 classes, i.e. motor and miscellaneous. Motor insurance has been the fastest-growing segment during the past 4 years, charting an average expansion of 32.99% amid soaring vehicle sales. SLIC's market share in this segment declined from 44.17% in FY Dec 2002 to 24.52% in FY Dec 2005, as its competitors had rolled out innovative products that prioritised customers' convenience. Nevertheless, SLIC introduced a more comprehensive motor-insurance coverage branded as *Formulaplus* in FY Dec 2007.

Similarly, SLIC also has a strong competitive position in the life insurance segment, laying claim to 22.71% of the industry's premiums in FY Dec 2006. Here, too, the Company ranks after the largest premium writer. Although SLIC has relinquished its leadership in premiums since FY Dec 2003, it is still the second-largest in the industry. Unlike in general insurance, however, the gap between SLIC and the third-largest life-insurance underwriter is rather narrow. Once again, its market share has been eroded by keener competition and the uncertainties that had abounded during the change in its ownership. Nonetheless, we note that the new management has sought to arrest this attrition by focusing on staff training and by rebranding its life products. RAM Ratings expects these measures to shore up SLIC's market share over the medium term.

Strong presence in corporate segment

Meanwhile, SLIC has clinched large corporate deals through its corporate-business division, which was set up in January 2004. The Company has a strong presence in the corporate segment, as it is able to leverage on its established track record and sturdy balance sheet. In addition, service standards have been enhanced by streamlining internal processes. Consequently, SLIC has been able to secure large projects and intends to underwrite infrastructure projects in future.

Island-wide branch network

In the retail segment, SLIC has a 110-strong branch network that ranks among the top 3 in Sri Lanka; this enables it to maintain its industry position. The Company has been able to establish an extensive branch network throughout its almost 50-year history. SLIC has also embarked on a renovation programme for its branches while training its staff, in a bid to improve productivity and customer service. The management has introduced key performance indicators to identify high performing units as “star branches”. RAM Ratings expects these efforts to pay dividends in the future.

Developing new channels

Meanwhile, the development of new channels is also high on SLIC’s agenda, to strengthen its market presence. In this regard, the Company has already signed up with some leading banks to provide bancassurance. As this business is still new, RAM Ratings does not expect these tie-ups to benefit SLIC in the medium term. Over the longer term, however, SLIC is well poised to take advantage of this new line of business.

Overall, RAM Ratings opines that SLIC will be able to retain its market position in terms of premium ranking. The Company is also expected to regain some of its lost market share over the intermediate term. This view is supported by SLIC’s current marketing efforts and preliminary industry statistics.

Management & Strategies

Very good in formulating and executing strategies

The management is viewed to have the ability to effectively formulate and execute strategies. Subsequent to the change in ownership, a new management team comprising professionally qualified industry veterans, has been installed. Simultaneously, SLIC has also sought consultancy services from ING financial institutions (“ING”), to reorganise the Company and improve its actuarial, reinsurance, underwriting and information systems. Even though ING withdrew from non-core activities in 2005, SLIC continues to benefit from its consultants as the Company has renewed their contracts. After its privatisation, the Company had gone through some challenges such as downsizing excess staff and computerising its records (previously, most processes had been carried out manually). In addition, its existing staff had to get used to a more dynamic and market-oriented management culture; the Company has changed from a product-focused firm to a customer-centric organisation. Even though some of these changes are still ongoing, SLIC has transformed into a more dynamic organisation in the process.

Clear lines of accountability and responsibility

Meanwhile, there is also clear accountability at SLIC. A new management framework has been put in place, with a 10-member executive committee (“ExCo”); each member has both top- and bottom-line responsibilities. The ExCo is comprised of heads of divisions, and is led by the Chief Executive Officer.

Set to become regional player

Despite the challenges, SLIC aspires to become a regional player. Accordingly, the management’s short-term strategy is to change the image of the Company while rebranding and repositioning its products in selected markets. In FY Dec 2006 and FY Dec 2007, the Company was engaged in branding and promotional campaigns. Concurrently, the management is also continuing its internal process-improvement programme.

**Beefing up
Internal systems**

RAM Ratings notes that SLIC's accounting and information systems have been improving; the Company is further developing these systems with the aid of consultants. The management intends to develop an integrated information system to speed up the decision-making process. Under the previous State ownership, the Company had not had a computerised accounting system. Auditors had qualified their audit reports based on inherited, un-reconciled balances. Since its privatisation, SLIC has embarked on a computerisation programme and has been able to reduce the number and magnitude of audit qualifications. The Company's audited financials for FY Dec 2006 were reduced to only a single qualification, based on an un-reconciled balance of LKR518 million originating from its pre-privatisation era; SLIC has provided for this liability in its balance sheet. RAM Ratings does not consider this a material factor, given SLIC's impressive stature.

On another note, SLIC has a strong compliance culture. The Company has set up a compliance division to monitor and ensure conformity with all relevant statutory and regulatory requirements.

Corporate Governance

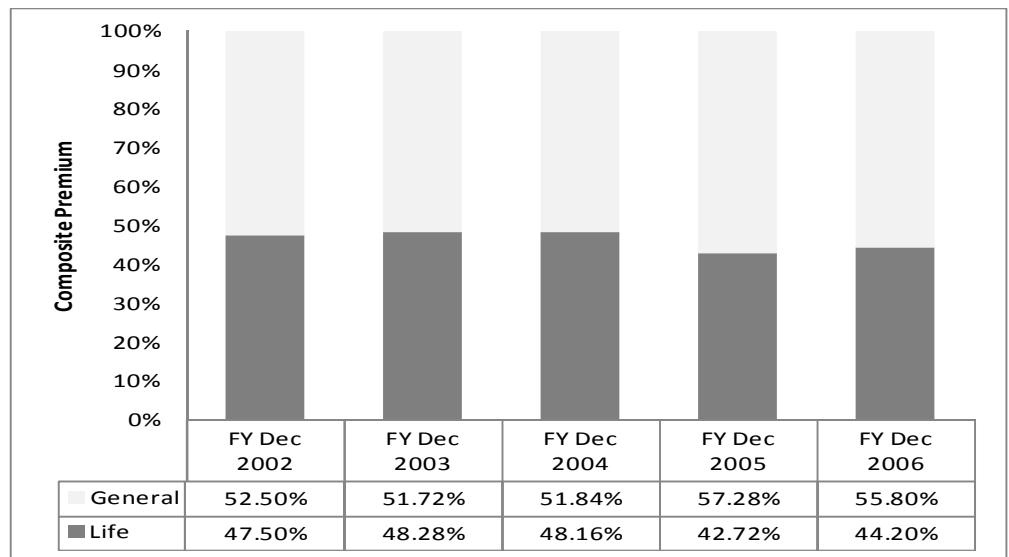
SLIC's Board is assisted by 3 Committees: Investment, Audit & Compliance, and Remuneration & Nomination. As RAM Ratings was not privy to the Company's board papers, we cannot comment on the content or quality of its board meetings.

Nonetheless, we note that SLIC has significant related-party transactions, which include investments in subsidiaries and companies where the board members have interests. Although we view related-party transactions with concern, we note that the Board is implementing a Board charter, in a bid to improve corporate governance. In pursuance of this, the Board has appointed 3 independent directors.

Underwriting Quality & Risk Exposure**Adequate overall
underwriting
standards**

RAM Ratings considers SLIC to have adequate overall underwriting standards. The Company has a good mix of life and general premiums, with non-life premiums accounting for about 55% and life accounting for about 45% of its composite premiums (refer to Chart 3). As of September 2007, general insurance made up about 60% of its total premiums; the balance comprised life premiums.

Chart 3: SLIC's premium mix



Marginally adequate underwriting standards

General Insurance

On the whole, SLIC's general underwriting standards are deemed marginally adequate. RAM Ratings deems the Company has good underwriting standards in 3 classes of general insurance. However, its overall general-insurance underwriting results are lower than the industry's owing to SLIC's elevated claims experience in the fire and miscellaneous classes. The miscellaneous segment is the second-largest contributor in terms of net and earned premiums. Nonetheless, claims in this class have been substantial, thereby contributing significantly to SLIC's heftier claims ratio. RAM Ratings therefore opines that there is ample room for the Company to improve in these classes.

The Company's unaudited third-quarter results showed a healthier claims ratio of 81.4%, compared to 87.05% for FY Dec 2006. In contrast, other industry players posted worsening trends in claims in FY Dec 2007.

Motor

Motor claims ratio in line with industry's

The Company's motor segment, as with the industry, is the largest contributor in terms of net premiums. In the past 2 years, SLIC's exposure to this segment has been hovering at about 70% (refer to Chart 4). The Company's underwriting standards in the motor segment have been in line with the industry's (refer to Chart 5). Despite facing more risks, SLIC's cumulative average 5-year claims ratio of 64.67% is very close to the industry's 63.81%.

Chart 4: SLIC's net premium composition

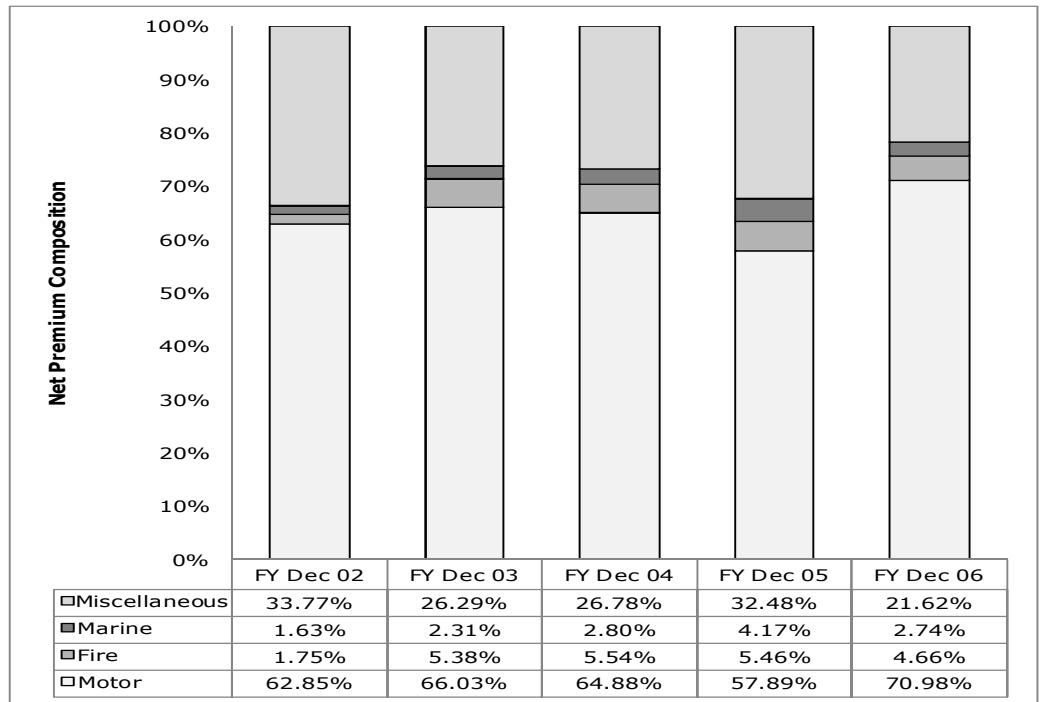
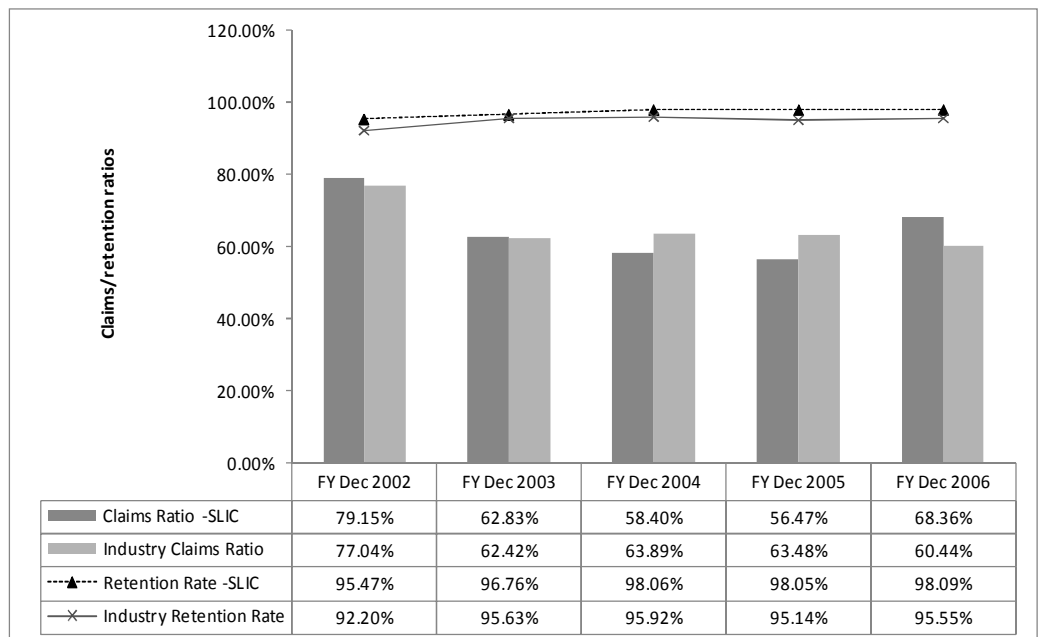


Chart 5: Motor claims and retention rates of SLIC and the industry

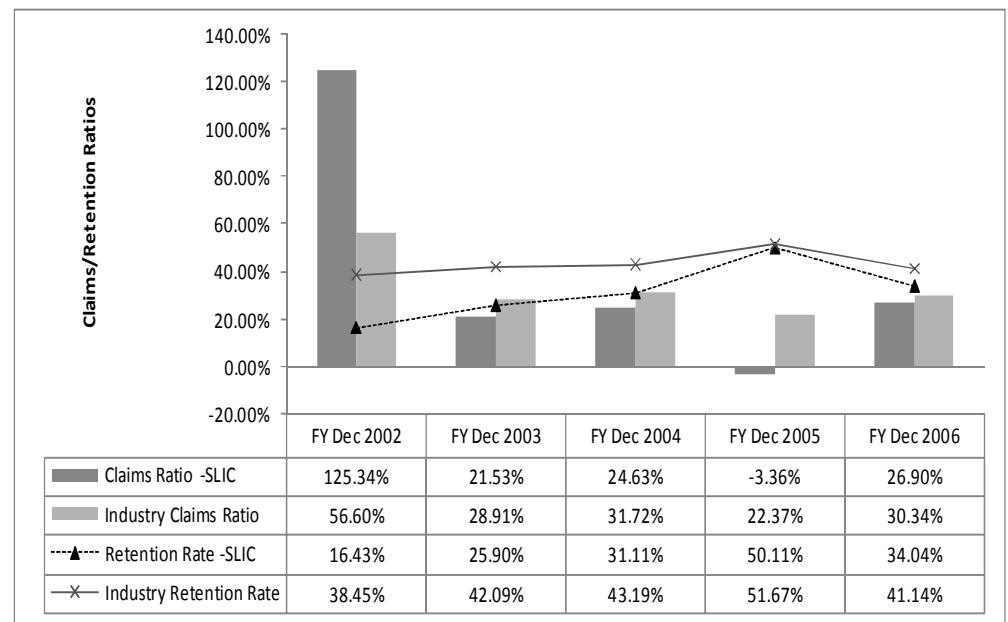


Marine

Elsewhere, the marine segment is by far the smallest contributor, making up only about 4% of SLIC's net premiums. However, the Company's underwriting standards in this segment are better than the industry average (refer to Chart 6). Its 5-year claims ratio stands at 31.49% compared to the industry's 32.39%. We also note that SLIC's retention rate is more conservative than the industry's.

Higher-than-industry underwriting standards

Chart 6: Marine claims and retention rates of SLIC and the industry



Fire insurance claims pushed up by heftier reserving

Fire

In the fire segment, which represents about 5% of the Company’s net premiums, SLIC’s average claims ratio is weaker than the industry’s. This is mainly because of the Company’s heftier transfers to reserves. Nonetheless, RAM Ratings notes that SLIC’s average 5-year claims-to-net-premium ratio (FY Dec 2002 to FY Dec 2006) comes up to an impressive 44.79% (industry: 73.44%).

Miscellaneous

The miscellaneous segment has been a problem for the general insurance segment; this class includes workers’ compensation, *Agrahara*, and “all-risk”. The claims in this segment more often than not exceed the Company’s earned premiums. In fact, SLIC’s 5-year average cumulative claims ratio stood at a high 102.14% as at end-FY Dec 2006. Even before provisions, this claims ratio still came up to a high 96.15%.

Life Insurance

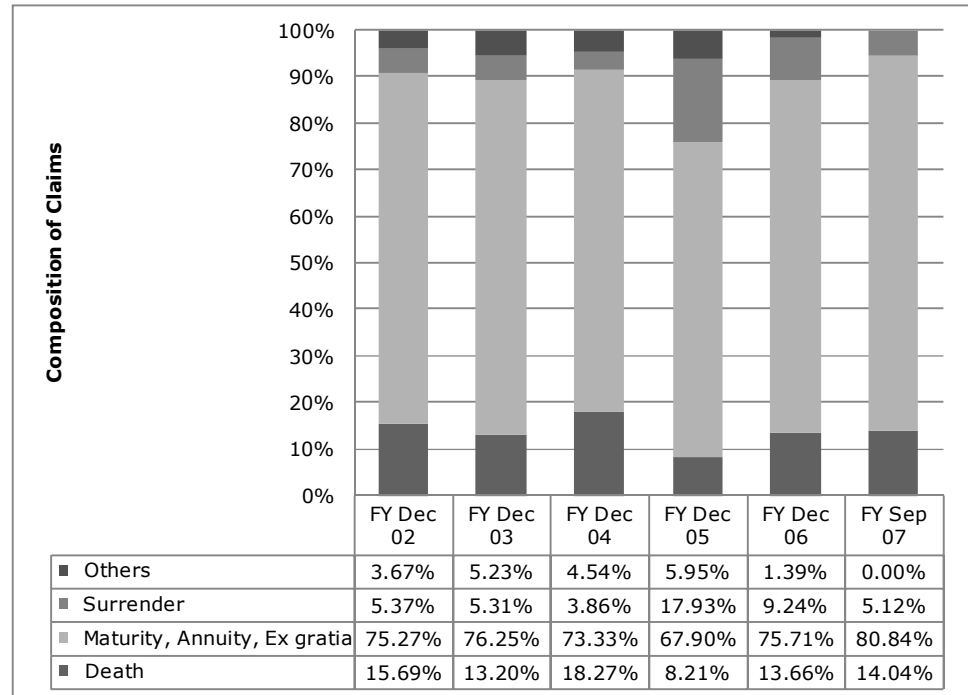
RAM Ratings opines that SLIC maintains high standards in life underwriting, underscored by the underwriting criteria derived from its re-insurers. In addition, its life fund has been exhibiting steady growth, while expanding at a faster pace than premiums as investment yields are transferred to life funds.

High life underwriting standards

Claims composition in line with industry’s

Our analysis of the Company’s claims reveals that its composition is in line with the industry’s, with the bulk of it stemming from policy maturities, followed by death claims (refer to Chart 7). We note that SLIC’s policy terminations are higher than its peers’; this is not surprising as the Company has the oldest life portfolio, thus giving rise to a higher incidence of policy maturities.

Chart 7: Composition of life claims



Underwriting criteria based on international re-insurance

SLIC has automated its life-underwriting process. The underwriting criteria are based on those of its re-insurers, Munich Re and Swiss Re. Therefore, the re-insurer’s technical backing, together with the Company’s actuarial expertise, assists SLIC in maintaining adequate underwriting standards. Furthermore, there has been a focus on easing the expense ratio, which has been averaging at about 42%. In FY Dec 2006, the Company had a surplus in its life revenue account, allowing it to transfer LKR3.32 billion to its life funds.

Investments adequately managed by investment committee

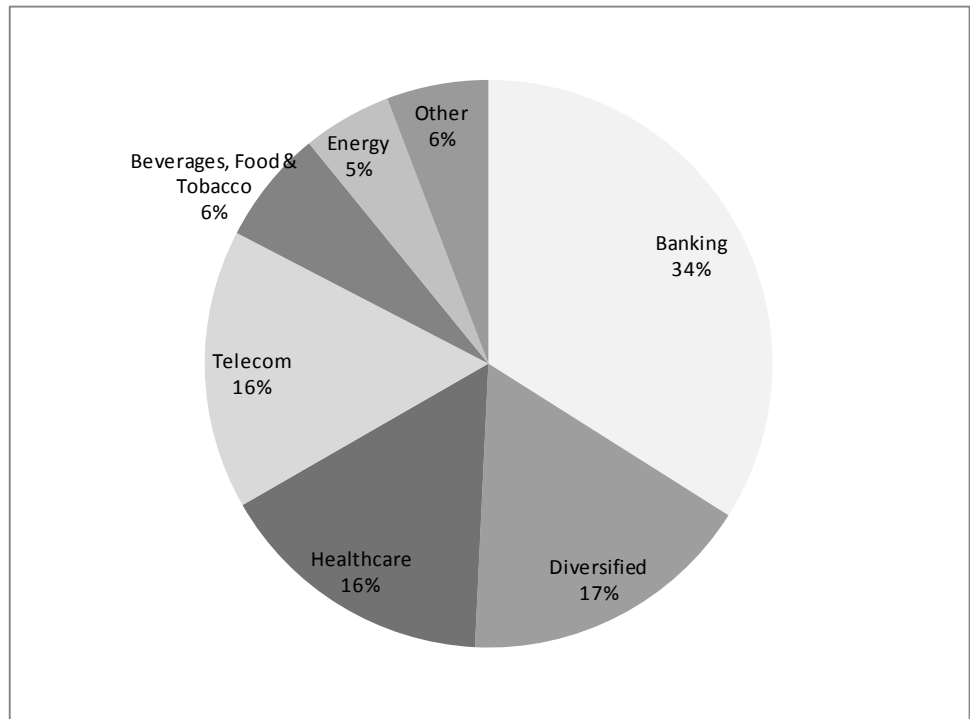
Investment Portfolio

SLIC manages its investments adequately through an investment committee. The Company’s investments amounted to a staggering LKR30.36 billion as at end-FY Dec 2006. The investment committee formulates policies on investing both life and non-life funds, monitors the external environment, assesses the funds’ performances on a monthly basis, and undertakes strategic asset allocations.

Portfolio shift to more aggressive stance

In the past 5 years, most of the Company’s portfolio has been invested in government securities, followed by equities and debentures. In FY Dec 2007, SLIC acquired Lanka Hospitals Corporation Ltd, which became a subsidiary. Before its privatisation, over 60% of SLIC’s investments comprised government securities. After its privatisation, the Company has sought to gradually increase yields by investing in equities and debentures. As at end-3Q FY Dec 2007, SLIC’s exposure to government securities stood at 55.83% while investments in equities and corporate debts collectively took up another 39.46%. SLIC has increased its exposure to equities by raising its interests in the banking and telecommunication sectors (refer to Chart 8). Previously, these 2 segments had respectively accounted for about 28% and 12% of its investment portfolio. All said, RAM Ratings notes that these investments are in fundamentally sound corporates. Moreover, given SLIC’s proven track record, RAM Ratings opines that its investment portfolio is adequately managed.

Chart 8: SLIC's exposure to listed equities as of September 2007



Excellent record for regulatory compliance

The IBSL requires all insurance companies to invest a respective 20% and 30% of their general and life insurance funds on government securities - which SLIC has been complying with.

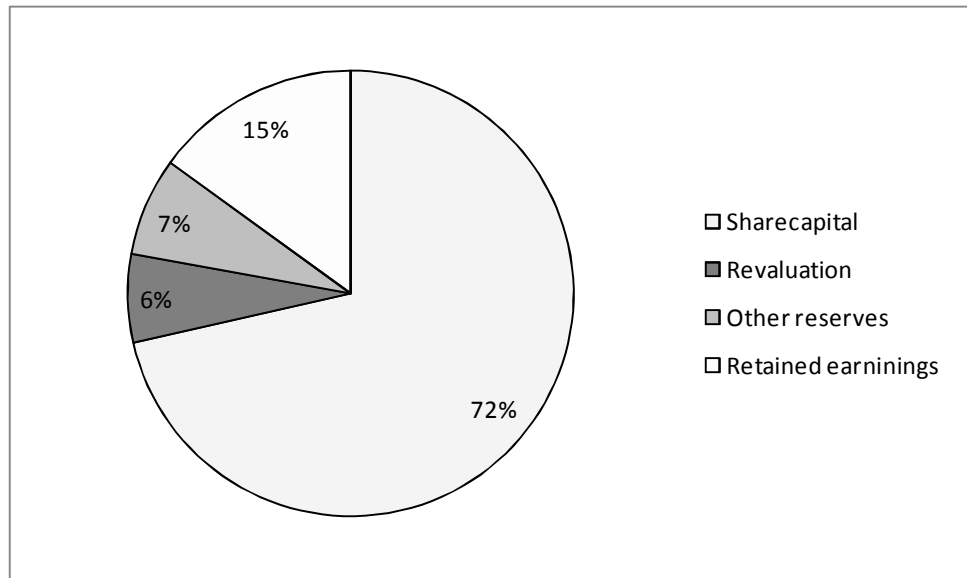
On another note, SLIC is deemed to have sufficient liquidity in the form of cash and cash equivalents as well as marketable securities. Moreover, the Company's equities portfolio also contains liquid-blue-chip shares.

Strength of Capitalisation

Strong capitalisation

The Company is deemed to have a very strong level of shareholders' funds, which accounted for 14.40% of its total assets. In absolute terms, these funds stood at an impressive LKR8.37 billion as at end-3Q FY Dec 2007. In FY Dec 2006, SLIC's shareholders' funds made up nearly 50% of the industry's aggregate. We note that the Company has enlarged its shareholders' funds through revaluations and retained profits (refer to Chart 9).

Chart 9: Composition of SLIC's shareholders' funds



Excellent solvency margins

In addition, the Company has been maintaining excellent solvency margins; these stood at a respective 5.63 times and 4.88 times for the life and general segments as at end-FY Dec 2006. Even though its solvency levels may narrow slightly due to increased investments in equities and corporate debts, RAM Ratings expects SLIC to be able to keep its solvency margin above the statutory minimum.

Move towards risk-based solvency

As a well-capitalised insurer SLIC has minimal debt, in the form of overdrafts, on its balance sheet. Consequently, its gearing ratio has stayed below 5%.

Looking ahead, SLIC intends to implement risk-based capital, which RAM Ratings views positively.

Adequate reserving policy

Adequacy of Reserving

SLIC is viewed to have a strong reserving policy; it has consistently maintained a net premium-to-technical reserve ratio of above 100% in respect of general insurance. In addition, its reserving for the life business is based on actuarial studies of life funds.

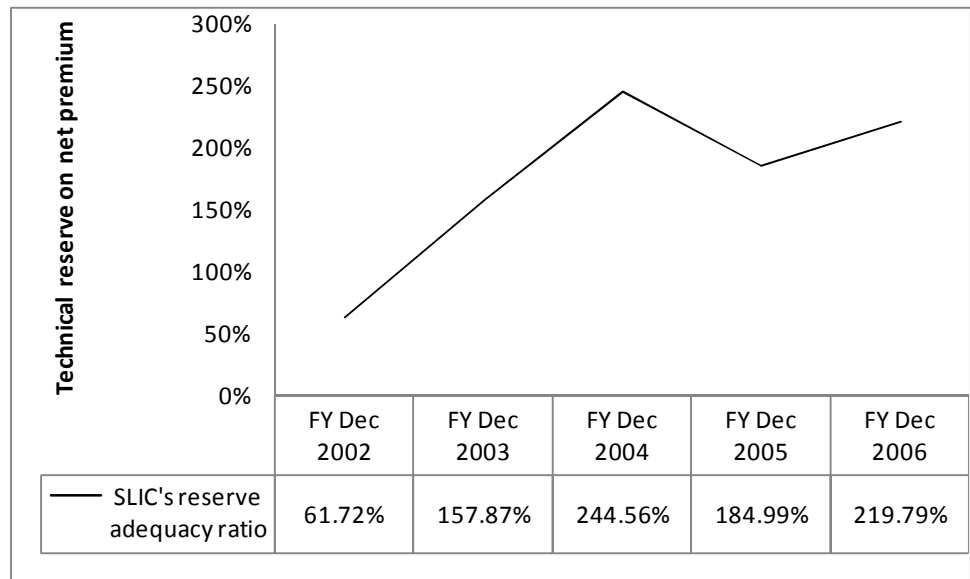
Sufficient reserving for general insurance

SLIC's level of reserving as at end-FY Dec 2006 is considered both prudent and very robust, as the Company had made provisions for both life and non-life products based on actuarial assessments; IBSL requires actuarial assessment only for life funds.

Previously, in respect of general insurance, both SLIC's and other industry players provisioned based on the claim assumptions of individual insurers. However, to ensure a more objective and scientific basis, the IBSL requires all insurers to make general insurance provisions based on actuarial recommendations. Accordingly, the regulator has requested the insurers to voluntarily reserve based on actuarial studies for FY Dec 2006. In this regard, SLIC's voluntary initiative is viewed in a positive light. Furthermore, the Company's reserving adequacy ratio, i.e. general business technical reserves to net premiums, has been adequate (refer to Chart 10).

**Adequate life
reserving**

Chart 10: Trends in SLIC’s technical-adequacy ratio



Life-insurance reserving is based on actuarial valuations of life funds. In this regard, SLIC is the only insurer to have a qualified, in-house actuary; other players rely on external actuaries as there is a dearth of such qualified professionals in Sri Lanka.

Looking ahead, RAM Ratings opines that SLIC should be able to maintain robust reserves, as it will make provisions based on actuarial studies.

Re-insurance

**Adequate re-
insurance support**

SLIC’s re-insurance arrangements are deemed comprehensive as it has a well-diversified pool of re-insurers, all of which meet the IBSL’s requirements. SLIC cedes about 27% of its general insurance premiums to its re-insurers. The IBSL requires all re-insurers to have at least BBB ratings, or be sovereign-owned. We note that SLIC engages international re-insurance brokers, i.e. JB Broda & Co and JLT Re Asia. Prior to privatisation, the Company had not had a scientific basis for re-insurance. Since being privatised, SLIC has adopted a more scientific method of obtaining re-insurance. As such, RAM Ratings opines that the Company’s ceding may decline. However, we do not expect the adequacy of its re-insurance to weaken.

In respect of the life insurance business, SLIC benefits from re-insurers Swiss Re and Munich Re respectively rated AA and AA- by Standard & Poor’s. Going forward, SLIC expects to continue with its current re-insurance programme.

Profitability

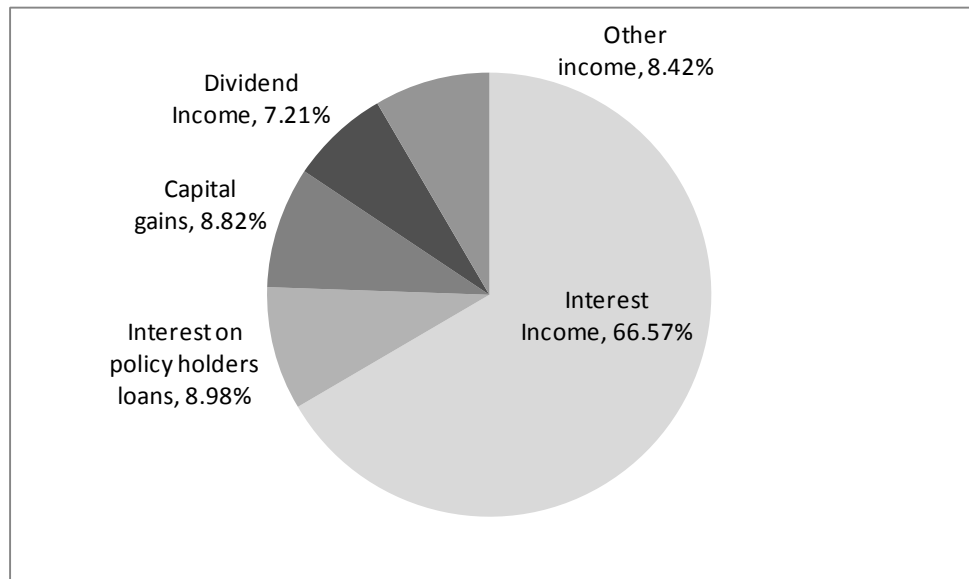
**Moderate profit
performance**

RAM Ratings deems SLIC’s profitability to be adequate as the insurer’s profit performance hinges on investment income and the life-insurance segment. Although the non-life segment’s profits have been thin due to hefty claims vis-à-vis the miscellaneous class, the Company has been able to generate ample income by adequately managing its investment portfolio. In addition, SLIC’s top line adequately supports its overheads

Profitability depends on investment income

SLIC’s investment income has traditionally supported its bottom line. Despite a technical loss of LKR921.41 million in its general insurance business, the Company posted an overall pre-tax profit of LKR1.11 billion in FY Dec 2006. Most of its investment income (an average of 66.57% over the past 4 years) has stemmed from interest income while the second-largest contributor has been interest from loans extended to policy holders (averaging 8.98% over the same period). The third-biggest generator of SLIC’s investment income is capital gains (averaging 8.86% over the past 4 years). Meanwhile, dividend income has contributed another 7.21% of SLIC’s earnings in the last 4 years (refer to Chart 11). As a result, the bulk of its interest income is supported by gilt-edged or investment-grade corporate debts. RAM Ratings considers SLIC’s investment income to be robust.

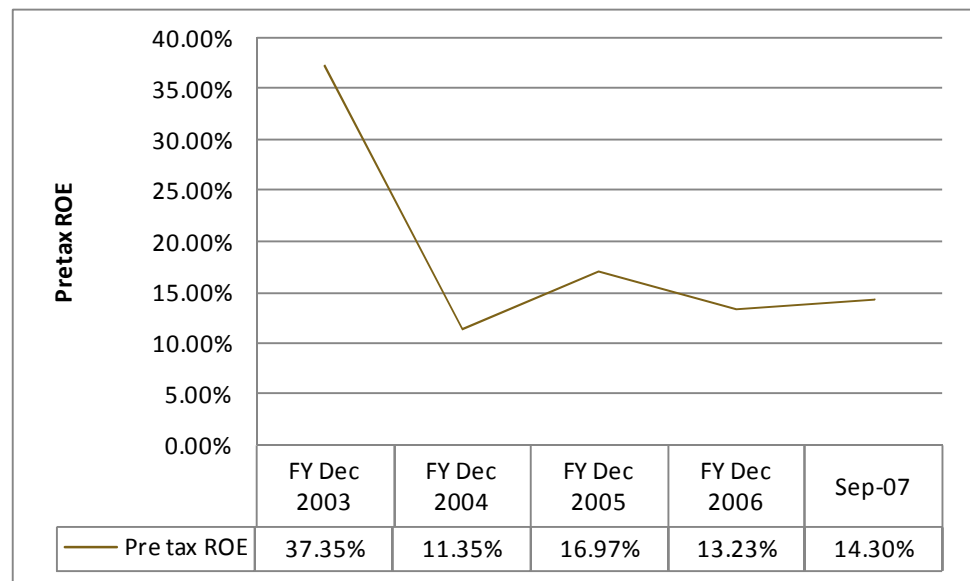
Chart 11: Investment and other income composition



Consistent performance

Despite having had to pay out tsunami-related claims, SLIC was able to chalk up a commendable pre-tax profit of LKR540.45 million in FY Dec 2004. In this respect, it should be noted that interest rates were low in FY Dec 2003 and FY Dec 2004; In spite of lower yields, investment income had propped up the Company’s financial performance – its underwriting loss had been amply set off. Consequently, SLIC has been able to generate a positive pre-tax return on equity post-privatisation (refer to Chart 12). The loss reported in FY Dec 2002 (the year it was privatised) had been on account of having written off bad debts and having made provisions for claims under litigation. RAM Ratings considers these measures to be prudent.

Chart 12: SLIC's ROE trends



Excellent expense ratios

SLIC's strong competitive position has enabled it to achieve an enviable composite expense ratio of about 40% (prior to life transfers). We note that most other insurers average over 50%. In addition, the management has begun improving operational efficiency by shedding excess staff. To this end, SLIC has introduced a voluntary retirement scheme, the results of which are reflected in its expense ratio.

Prospects

Still holds commanding market position

SLIC is considered to be in a commanding position in a highly skewed industry. The Company and its closest rival together share approximately 60% of the industry's composite premiums. RAM Ratings opines that SLIC will be able to retain its ranking as Sri Lanka's second-largest premium writer. The Company has already embarked on a strategy of reversing its shrinking market share; these initiatives have already borne fruit.

Able to withstand competition

Despite keen competition, SLIC's balance sheet and adequate investment-management framework are expected to stand the Company in good stead vis-à-vis facing competitive pressures. Although SLIC's strategies to regain market share may lead to further pricing pressure, its investments are expected to ensure an overall surplus despite price competition and the resultant strain on its underwriting profits. In addition, the Company's initiatives to tighten underwriting discipline are likely to cushion its technical results.

Well poised to fulfil regulatory requirements

In the meantime, SLIC is also well poised to face regulatory changes, if any. The Company has already complied with the IBSL's requirement of a minimum capital of LKR1 billion for each business segment by 2012. RAM Ratings opines that SLIC will also be in a relatively strong position to comply with the IBSL's plans to de-link composite insurers. The IBSL intends to split the life and general insurance businesses into separate legal entities. Although this has yet to become a regulation, SLIC has already announced its decision to legally segregating these 2 lines of business.

Corporate Information

Date of Incorporation:	February 1993			
Commencement of Business:				
Major Shareholders:	Milford Holdings (Pvt) Ltd	85.00%		
	Greenfield Pacific EM Holding Ltd	14.90%		
Directors:	Mr DHS Jayawardena	Chairman		
	Mr Raj Obeysekera	Deputy Chairman		
	Mr Royal Jansz	Director		
	Mr Damien Fernando	Director		
	Mr H Wickremasinghe	Director		
	Mr AS Abeywardena	Director		
	Mrs C Muttukumar	Director		
Auditor:	Ernst & Young			
Listing:	Not listed			
Key Management:	Mr Damien Fernando	Director		
	Mr Chaminda De Silva	Chief Operating Officer (Reinsurance)		
	Mr Prasad Samarasinghe	Chief Operating Officer		
	Mr Suren Galagoda	Chief Operating Officer		
	Mr Suresh Paranavithana	Deputy General Manager (Life)		
	Mr Anil Kumara	General Manager(Personal Lines)		
	Mr Alexander Sandkuyl	Business & Risk Management Consultant		
	Dr Jaap Plugge	Senior Consultant and Actuary		
	Mr CC Jayasuriya	General Manager (Technical)		
	Mr RGH Lewis	Deputy General Manager (Marine)		
	Mr Ranjith Perera	Chief Compliance Officer		
	Mr MOGS Paris	Deputy General Manager (Internal Audit)		
	Mr PPJ Perera	Deputy General Manager (Planning & Support Services)		
Major Subsidiaries and Associates:	Management Services Rakshana (Pvt) Ltd	100.00%		
	The Lanka Hospital Corporation Ltd	58.16%		
Capital History:	Year	Remarks	Amount (LKR million)	Cumulative Total (LKR million)
	2000	Brought forward		500
	2005	Bonus issue	5,500	6,000

Financial Summary - Company

	Unaudited				
BALANCE SHEET (LKR Million)	31-Dec-03	31-Dec-04	31-Dec-05	31-Dec-06	30-Sep-07
ASSETS					
Cash and Bank Balances	10,985.00	11,272.88	16,775.26	10,635.85	5,972.26
Investments					
Fixed Income Securities	13,531.78	14,790.33	14,783.72	22,047.52	27,777.14
Unit Trust	283.18	310.17	307.47	335.03	1,368.86
Equity Securities	2,629.06	4,361.20	6,272.19	7,546.52	9,232.07
Fixed and Call Deposits	2,125.57	3,414.90	169.34	433.99	458.16
Net Loans	2,612.91	2,572.24	2,432.64	2,412.44	2,564.40
Outstanding Premium from agents/brokers	348.75	540.19	773.81	623.98	1,063.02
Amount Due from reinsurers/ceding company	384.13	2,576.00	1,161.64	1,080.33	1,771.79
Investments in Subsidiaries/Associates	0.00	0.00	0.00	2,556.30	2,558.21
Other Assets	1,376.66	852.69	937.97	1,647.02	1,949.98
Property, Plant & Equipment	2,273.42	3,036.30	3,118.74	3,826.50	3,927.15
TOTAL ASSETS	36,550.45	43,726.90	46,732.78	53,145.47	58,643.02
LIABILITIES					
Provision for outstanding claims:					
Admitted/estimated but not yet paid & IBNR	28,275.61	33,704.45	34,857.44	40,405.61	45,324.63
TOTAL INSURANCE FUNDS	28,275.61	33,704.45	34,857.44	40,405.61	45,324.63
Accrued expenses & Trade and Other Creditors	3,074.04	3,264.04	2,684.62	3,220.73	3,358.74
Bank Overdraft & Other bank borrowings	0.00	0.00	170.28	291.78	672.23
Provision for Taxation/Deferred Tax Liabilities	64.71	147.36	1,319.93	830.79	913.85
TOTAL LIABILITIES	31,414.36	37,115.85	39,032.26	44,748.92	50,269.45
Paid-up Capital	500.00	500.00	6,000.00	6,000.00	6,000.00
Share Premium & Other Reserves	1,923.38	2,556.46	0.00	536.34	536.34
Retained Profits/(Accumulated Losses)	2,712.70	3,554.59	1,700.51	1,860.21	1,837.22
TOTAL SHAREHOLDERS' FUNDS	5,136.08	6,611.05	7,700.51	8,396.55	8,373.56
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	36,550.44	43,726.90	46,732.78	53,145.47	58,643.02

Financial Summary - Company

	Unaudited				
INCOME STATEMENT (LKR Million)	31-Dec-03	31-Dec-04	31-Dec-05	31-Dec-06	30-Sep-07
Net Premiums	6,488.92	6,603.17	8,049.47	8,707.22	8,043.26
Less: Provision for Reserves for Unexpired Risks	(172.24)	(36.26)	(330.15)	(827.05)	(838.23)
Earned Premiums	6,316.68	6,566.91	7,719.32	7,880.17	7,205.03
Less: Claims Incurred and Claims Admitted	(3,753.06)	(4,025.02)	(4,378.03)	(5,698.66)	(6,273.13)
Gross Underwriting Surplus/(Deficit)	2,563.62	2,541.89	3,341.29	2,181.51	931.90
less: Underwriting Expenses (of the Funds)	(1,973.67)	(3,061.80)	(2,847.06)	(3,134.29)	(1,717.50)
Net Underwriting Surplus/(Deficit)	589.95	(519.91)	494.23	(952.78)	(785.60)
Investment Income	3,950.84	3,021.42	3,224.43	4,375.50	3,656.54
Other Income	631.69	799.47	538.91	1,008.65	586.67
Surplus / (deficit) transferred from Revenue Account					
- General Insurance	1,592.56	718.98	1,187.83	554.05	318.32
- Life Insurance	325.98	31.58	119.01	556.64	579.79
Company's Operating Turnover	1,918.54	750.56	1,306.84	1,110.69	898.12
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	1,918.54	750.56	1,306.84	1,110.69	898.12
Less: Depreciation and Amortisation	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Interest and Tax	1,918.54	750.56	1,306.84	1,110.69	898.12
Less: Interest and Finance Charges	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Tax	1,918.54	750.56	1,306.84	1,110.69	898.12
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	1,918.54	750.56	1,306.84	1,110.69	898.12
Less: Tax	(385.12)	91.34	(446.78)	(550.99)	(521.11)
Adjusted Profit/(Loss) After Tax	1,533.42	841.90	860.06	559.70	377.01
Less: Minority Interests	0.00	0.00	0.00	0.00	0.00
Less: Dividends	0.00	0.00	(400.00)	(400.00)	0.00
Retained Profit For The Year	1,533.42	841.90	460.06	159.70	377.01

Financial Ratios - Company

	Unaudited				
KEY FINANCIAL RATIOS (%)	31-Dec-03	31-Dec-04	31-Dec-05	31-Dec-06	30-Sep-07
PROFITABILITY (%)					
Gross Underwriting Margin	39.51%	38.49%	41.51%	25.05%	11.59%
Net Underwriting Margin	9.09%	(7.87%)	6.14%	(10.94%)	(9.77%)
Pre-tax Operating Margin	79.71%	49.99%	52.89%	50.89%	42.99%
Pre-tax Return on Assets (av.)	15.25%	8.22%	9.41%	8.87%	8.25%
Investment Yield (av.)	19.91%	16.42%	15.28%	26.78%	22.87%
After Tax Return on Equity	29.86%	12.73%	11.17%	6.67%	6.00%
Return on Capital Employed	37.35%	11.35%	16.78%	12.94%	13.40%
Claims Ratio	59.42%	61.29%	56.72%	72.32%	87.07%
Expense Ratio	31.25%	46.62%	36.88%	39.77%	23.84%
Combined Ratio	90.66%	107.92%	93.60%	112.09%	110.90%
Investment Income Ratio	70.62%	57.86%	46.75%	61.84%	52.75%
Operating Ratio	20.04%	50.05%	46.84%	50.26%	58.15%
CAPITALISATION / SOLVENCY					
Gearing Ratio	0.00%	0.00%	0.02	0.03	0.08
Operating Profit Debt Coverage Ratio (times)	NA	NA	25.00	15.19	6.86
Insurance Fund Liability Ratio	5.51	5.10	4.53	4.81	5.41
Total Surplus Assets Coverage	0.16	0.18	0.20	0.19	0.17
LIQUIDITY					
Total Liquid Assets / Total Insurance Funds	0.66	0.68	0.62	0.75	0.86
Total Liquid Assets / Total Assets	0.51	0.52	0.46	0.57	0.66
OTHER PERFORMANCE RATIOS					
Retention Ratio	76.52%	76.81%	79.14%	82.40%	0.00%

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)

RAM Ratings' rating of an insurance company is an assessment and current opinion on the strength and performance of the rated institution.

LONG-TERM RATINGS

AAA	Insurance companies rated AAA are judged to be of the best quality and offer the highest claims-paying ability.
AA+ AA AA-	High claims-paying ability. Protection factors are strong. Risk is low but may vary slightly over time, due to underwriting and/or economic conditions. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.
A+ A A-	Adequate claims-paying ability. More susceptible to changes in underwriting and/or economic conditions than insurers in higher-rated categories. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.
BBB+ BBB BBB-	Moderate claims-paying ability. Changes in underwriting and/or economic conditions are more likely to weaken capacity to meet obligations to policyholders, compared to insurers in higher-rated categories. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.
BB+ BB BB-	Claims-paying ability is uncertain and not well-assured. Changes in underwriting and/or economic conditions are likely to substantially weaken capacity to meet obligations to policyholders. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.
B+ B B-	Poor claims-paying ability. Adverse underwriting or economic conditions would lead to lack of ability on the part of the insurer to meet obligations to policyholders. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.
C+ C C-	Very high risk that obligations to policyholders will not be paid when due. Factors present cause claims-paying ability to be vulnerable to default. Timely payment of obligations to policyholders possible only if favourable underwriting and economic conditions emerge. The signs plus (+), flat and minus (-) indicate that the financial institution ranks at the higher, mid or lower end within this generic rating category respectively.
D	Insurance companies rated in this category are either currently in default or expected to be in default of obligations to policyholders. Such companies are likely to come under regulatory action and will need immediate external support of a higher order to avoid receivership, liquidation or any other action that reflects regulatory concern about the companies' financial conditions.

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