



RATINGS

CREDIT RATING RATIONALE

CLAIMS-PAYING ABILITY – SRI LANKA

A wholly owned subsidiary of RAM Holdings Berhad

Sri Lanka Insurance Corporation Ltd Rating Review

Claims-Paying Ability
Rating: AAA [Upgraded]

Rating Outlook:
Stable

Previous Rating:
AA- (positive outlook)

Strengths:

- State support
- Strong competitive position
- Robust capitalisation
- Strong reserving

Weaknesses:

- Weak underwriting performance
- IT framework

Principal Activities:

Provision of general and life insurance coverage

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Summary

RAM Ratings Lanka has upgraded Sri Lanka Insurance Corporation Ltd's ("SLIC" or "the Company") claims-paying ability rating, from AA- to AAA. Concurrently, the outlook on the long-term rating has been revised from positive to stable.

SLIC's rating had been placed on a positive outlook in June 2009, subsequent to its reinstatement as a state-owned entity. The rating upgrade reflects the stronger degree of financial flexibility derived from such state support. The rating is also supported by the Company's competitive position and strong capitalisation.

Incorporated as a state-owned monopoly in 1962, SLIC was privatised in 2003. However, the Supreme Court overturned the privatisation decision in 2009; the Company was re-nationalised in June the same year. SLIC is the oldest insurer in Sri Lanka, and the second-largest in terms of premiums underwritten; the Company accounted for 23.45% of the industry's composite premiums as at end-December 2009. Given SLIC's systemic importance, RAM Ratings Lanka opines that state support will be readily extended if needed. Prospectively, SLIC's strategic direction will be broadly in line with the government's long-term economic development plans.

The Company has maintained its strong competitive position as the second-largest premium writer in both the life and general segments. While it has lost some market share since relinquishing its monopoly status upon the industry's liberalisation in 1986, we opine that credibility associated with state ownership, the captive business derived from state institutions and SLIC's aggressive expansion plans will shore up its market share over the medium to long term. On a separate note, the Company's capitalisation remained strong as at end-September 2009, with a staggering LKR 10.37 billion of shareholders' funds.

Meanwhile, SLIC's investment portfolio amounted to LKR 59.09 billion as at end-December 2009, the largest in the domestic industry. While investments had traditionally been focused on government securities, the Company has in recent times adopted a more aggressive stance with regard to equity; SLIC's total exposure to equity securities increased to 32.17% as at end-December 2009 (end-December 2008: 29.23%). RAM Ratings Lanka opines that the Company's investment portfolio is adequately managed. Meanwhile, SLIC's reserving is deemed strong as both its life and general reserves are actuarially assessed.

SLIC's underwriting standards are deemed adequate; life underwriting standards are derived from the Company's international reinsurer, Munich RE whereas in the general segment the Company has experienced relatively low claims in 3 major classes of business. However, RAM Ratings Lanka notes with concern that the Company's life underwriting performance has been weakened by a high

incidence of maturity claims in its currently maturing life portfolio. As such total claims in the segment increased from LKR 2.50 billion during FYE 31 December 2007 (“FY Dec 2007”) to LKR 3.29 billion during FY Dec 2008; it further increased by 5.88% on an annualised basis during the 9 months ending September 2009. Meanwhile, we note that in the Company’s general segment, SLIC is plagued with high claims in the miscellaneous segment owing primarily to the general accident and bankers’ indemnity policies.

On a separate note, SLIC’s information system has much room for improvement, as independent functions have yet to be integrated. In this regard, the management intends to implement a comprehensive, integrated information-technology framework over the coming year. RAM Ratings Lanka will continue monitoring developments in this regard.

Outlook

The stable outlook reflects the firm support derived from state ownership and the resultant financial flexibility. The rating outlook is also premised on our expectation that the Company’s competitive position will improve due to the captive market and credibility associated with state ownership.

Corporate Profile

Established as a state-owned entity in 1962, SLIC is Sri Lanka’s oldest insurance company. It is also the second largest insurer in terms of premium underwritten, accounting for 23.45% of the industry’s composite premiums as at end-December 2009. The Company currently offers a wide range of products in both general and life insurance segments within Sri Lanka; it also operates in the Maldives.

At the outset SLIC had operated as a monopoly; however, the Company lost this position in 1986 with the liberalisation of the insurance industry, which resulted in private sector players entering the market. As such, keener competition combined with an enlarged work force and inefficiencies within the Company resulted in the gradual erosion of its market share. Consequently, SLIC was privatised in 2003, thereby coming under the umbrella of the Distilleries Group, a large, blue-chip listed conglomerate with wide-ranging business interests. However, after a 6-year stint as a private sector entity, SLIC was once again nationalised and reinstated as a state entity in June 2009.

During the period in which SLIC was under private ownership, the Company had successfully transformed itself from a relatively dormant player to a competitive organisation with improved customer focus. As such, the infrastructural framework was improved and internal processes had been put in place. While there is still room for improvement with regards to the Company’s information system, RAM Ratings Lanka believes that the privatisation era has equipped the Company with a sense of professionalism and dynamism. Some transition difficulties are anticipated in the short to medium term; however, we believe the Company will retain its customer-focused approach while broadly benefitting from the credibility associated with state ownership.

Oldest, second-largest insurer

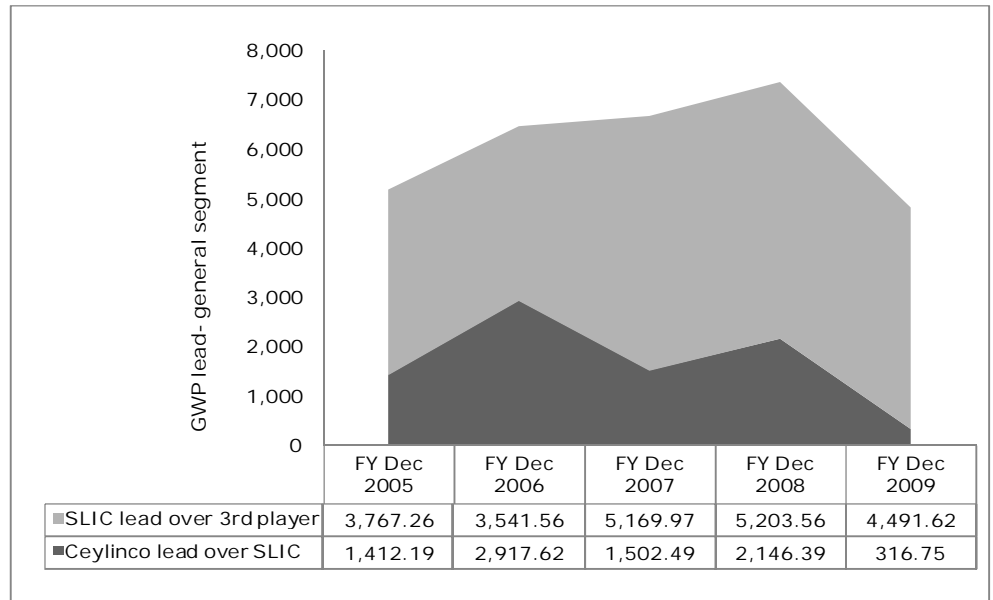
Privatised and renationalised

Transformation into a dynamic entity

General-narrowing gap with market leader

SLIC had maintained its competitive position in the general segment, accounting for 25.97% of industry premiums as at end-December 2009 (FY Dec 2008: 25.75%). Meanwhile, RAM Ratings Lanka notes that the premium gap between SLIC and the Ceylinco has narrowed significantly during FY Dec 2009 (refer to Chart 2) primarily due to adverse publicity associated with the latter. Within the general segment, SLIC has faced stiff competition in the motor segment, with market share falling slightly to 25.20% as at end-September 2009 (FY Dec 2008: 26.45%). Prior to nationalisation, the Company's premium motor product had been *Formula plus* which had enabled vehicle repairs through the Distilleries Groups' *Formula World* garage. However, with the nationalisation the Company had lost access to *Formula World*. SLIC has countered this loss by partnering with 11 leading original vehicle agents, allowing the policy holders to receive priority services at these facilities. This initiative is expected to bear fruit in the short to medium term.

Chart 2: SLIC vs closest competitors- general segment



Aggressive expansion strategies

Prospectively, SLIC's medium-term competitive strategy is aimed towards achieving market leadership in both the life and general businesses. To this end, the Company intends to adopt a two-pronged strategy, namely channel development and product development. As such, SLIC will focus on expanding its reach through bancassurance, utilising the extensive branch network of two giant state-linked banks; Bank of Ceylon ("BOC") and Seylan Bank. Meanwhile, new product development will focus primarily on national insurance products, which will target large groups of individuals (eg: families of military personnel etc). RAM Ratings Lanka opines that these initiatives will bear fruit in the medium to long term.

Life – keener competition from smaller players

Meanwhile, intensified competition in the life segment had similarly eroded large players' market share. The Company had maintained its position as the second largest premium writer as at end-FY Dec 2009, accounting for 19.94% of industry premiums as at the same date. Having said that, we note that SLIC's lead over the third player, NDB Aviva Insurance PLC ("NDB Aviva") had narrowed significantly in recent years; NDB Aviva accounted for a 19.17% slice of the pie as at end-September 2009. Looking ahead, RAM Ratings Lanka opines that the Company's initiatives to diversify its delivery channels and product development will reap benefits in the future; however, given the long-term

Strong presence in the corporate segment

nature of the business, we believe this growth is unlikely to materialise in the short term.

On a separate note, SLIC continues to maintain its strong footing in the corporate segment. This segment is driven by the Corporate Business Division (“CBD”) which was established subsequent to privatisation. In the course of last year’s nationalisation process, several large corporate contracts relating to the Distilleries Group had been discontinued. SLIC intends to compensate for this exodus by intensifying its marketing and promotional campaigns; the Company believes growth prospects in this segment remain healthy.

Large government contracts

Meanwhile, subsequent to the nationalisation, we believe SLIC is positioned to benefit from a captive market of state institutions, thereby further strengthening its competitive position. In this regard, the Company has already obtained several large government contracts as well as infrastructure development projects in the southern region of the country. Meanwhile, the Company’s improved credibility as a state owned entity with treasury backing coupled with public perception of better stability is anticipated to reap benefits for SLIC going forward.

Management & Strategies

Crucial transition stage

Subsequent to the privatisation in 2003, a management team consisting of professionally-qualified industry veterans had been brought in. Meanwhile, efforts were made to automate its processes and transform the Company into a more market-oriented organisation. With the nationalisation last year, we note that a few key individuals who were appointed during the privatisation era had exited the Company. The current management team comprises a mix of young individuals who were brought in during the privatised phase, experienced seniors who had been with the Company since its inception as well as experience industry specialists that were taken on board subsequent to nationalization. RAM Ratings Lanka believes that the Company is well-positioned to benefit from this mix, especially if the transition period is managed effectively. The management team is led by Dr Nalaka Godahewa, a leading academic and professional.

Room for improvement in information system

Meanwhile, RAM Ratings Lanka notes that there is significant room for improvement in the Company’s information system. For example, we observe that claim processing in the general non-motor segment is conducted manually. We further note with concern that the finance function is independent from the front office as the Company does not possess an integrated information system. The Company’s audited financials for FY Dec 2008 indicated qualifications based on unreconciled premiums received in advance of LKR 1.35 billion and the inability to confirm related party balances as at end-FY Dec 2008. Prospectively, the Company intends to implement a fully-integrated information system within the next year; RAM Ratings Lanka views these developments positively.

Expanding regional presence

In addition to strengthening its domestic presence, SLIC also intends to expand its regional reach. The Company already operates in the Maldives and aspires to strengthen its presence in the country through motor insurance. Meanwhile, SLIC is currently in the process of conducting feasibility studies to venture to other South Asian and Middle Eastern countries.

State-appointed board

Overall adequate underwriting

Corporate Governance

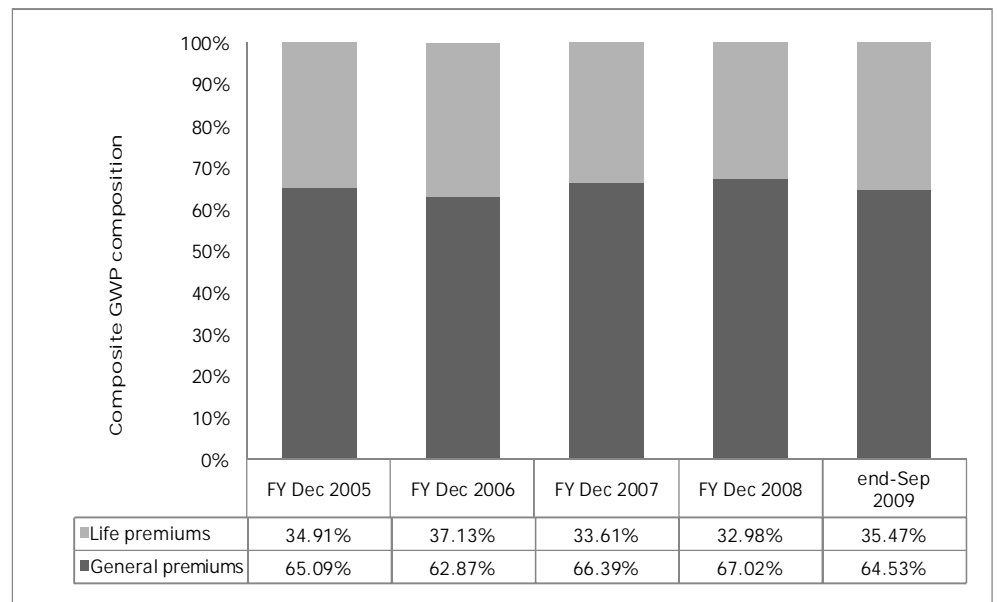
Subsequent to the Company's nationalisation in June 2009, a new Board of Directors was appointed by the government. The seven-member board comprises leading professionals from a wide range of specialities, including economists, chartered accountants, investment analysts etc. The Board is led by Mr. Pradeep Kariyawasam, a veteran in the corporate sector with wide-ranging experience in marketing and management. The Board is supported by five subcommittees: Investments, Audit & Compliance, Human Resources, Sales-Marketing & Reinsurance and finally Legal.

SLIC had significant related-party transactions during the privatisation era, particularly with regards to group companies within the Distilleries Group. While we note that related-party transactions were still evident as at end-FY Dec 2008, subsequent to nationalisation these transactions cease to be classified as related.

Underwriting Quality & Risk Exposure

SLIC's underwriting standards are deemed to be adequate; the claims ratio in the general segment has remained relatively stable and is in line with its industry peers. In contrast, we note that the Company's life claims ratio is weaker than its peers; this is primarily due to the maturing of SLIC's life portfolio. We note with concern that the Company has incurred net underwriting losses in both the life and general segments. Meanwhile, general premiums continued to dominate the premium mix, accounting for around 65% of total premiums as at end-September 2009 (refer to Chart 3).

Chart 3: SLIC's premium mix



High claims in miscellaneous

General Insurance

SLIC's general segment is dominated by the motor sub-segment, followed by fire, miscellaneous (primarily general accident, health etc) and marine (refer to Chart 4). RAM Ratings Lanka notes that the Company had incurred underwriting losses in the general segment; losses declined to LKR 364.02 million during FY Dec 2008 (FY Dec 2007: LKR 821.48 million). Nevertheless, we believe this to be an industry-wide phenomenon, as premium undercutting and high claims are prevalent among most industry players. The general segment's overall claims ratio amounted to 74.43% as at end-September 2009, broadly in line with its industry peers (refer to Chart 5). That said, we note that the Company's general claims ratio had been dragged down by miscellaneous claims. Meanwhile, the Company's 5-year average claims ratios in the other sub-segments compare well with the overall industry average.

Chart 4: SLIC's general premium composition

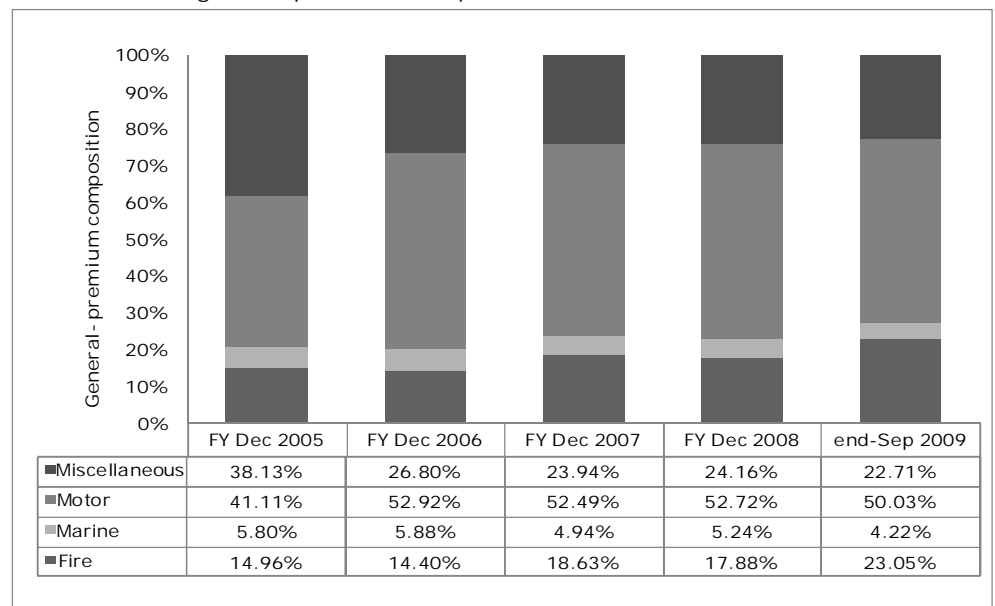
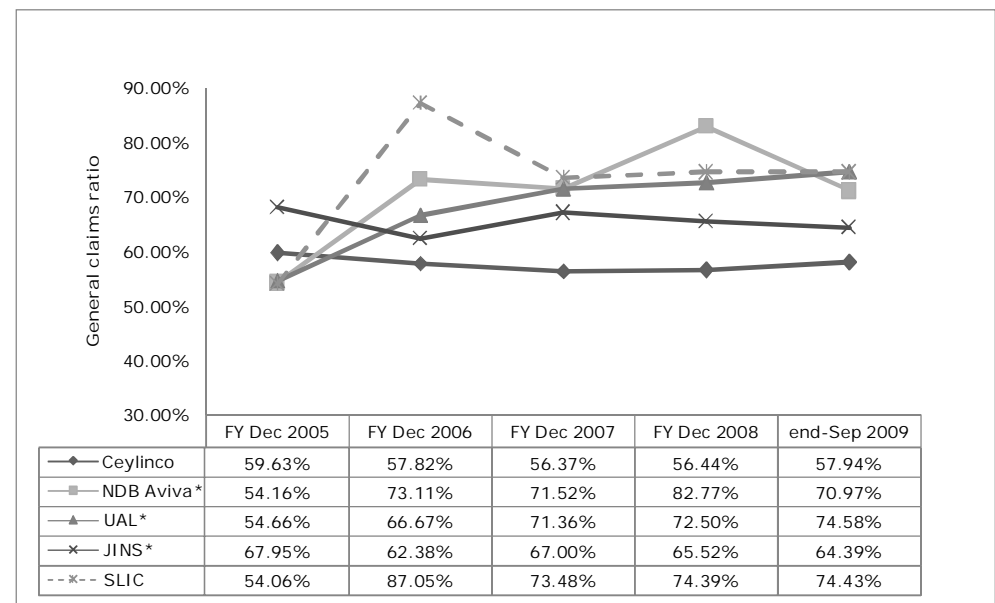


Chart 5: SLIC's general claims ratio vs the industry



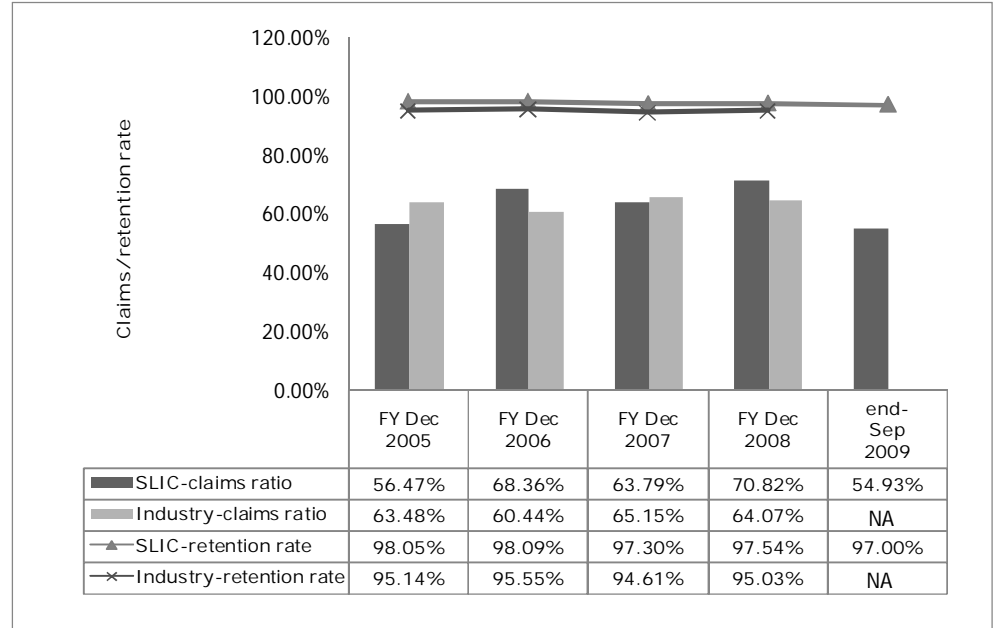
* FY Dec 2009

UAL: Union Assurance PLC; JINS: Janashakthi Insurance PLC

Motor

The motor sub-segment continued to dominate SLIC’s general premium mix. The segment’s cumulative 5-year average claims ratio amounted to 64.85%, broadly in line with the industry’s 63.49% (refer to Chart 6). We note that the Company has decentralised its claim settlement process to an extent, allowing payments within certain limits to be made through branches.

Chart 6: SLIC’s motor claims and retention vs the industry



Favorable claims ratio

Marine

On a separate note, the underwriting standards in the marine sub-segment compare favourably with the industry. SLIC’s cumulative 5-year claims ratio stood at 8.81%, better than the industry’s 29.68%. Meanwhile, the retention rate at 33.27% was in line with the industry average.

Fire

The Company’s fire segment had surpassed the miscellaneous segment as the second-largest premium generator after the general segment during the period to September 2009. SLIC’s claims experience in the fire segment has been somewhat volatile. However, the sub-segment’s 5-year claims ratio, at 72.21%, is stronger than the overall industry average of 76.80%.

Miscellaneous

SLIC’s miscellaneous segment has experienced high claims in recent times, with the claims ratio consistently exceeding the earned premiums in the last 4 years; the segment’s claims ratio stood at a high of 162.54% as at end-September 2009 (FY Dec 2008: 118.18%). Claims in the segment had emanated primarily from health, bankers’ indemnity and pawning insurance.

High claims

Good underwriting standards

Increase in maturity claims

Life Insurance

SLIC's life-underwriting standards are deemed to be good as they are derived from its reinsurer – Munich RE. This technical support and the Company's internal actuarial expertise had enabled SLIC to maintain good standards. All the same, higher claims in the life segment have resulted in net underwriting losses; RAM Ratings Lanka views this with concern.

RAM Ratings Lanka notes that SLIC's maturity claims had widened over the years; the higher prevalence of maturities is in line with the Company's relatively old life-insurance portfolio. Maturity claims as a percentage of total claims had increased from 76.63% during FY Dec 2007 to 86.50% during FY Dec 2008; however, we note that this had improved to 81.70% as at end-September 2009. Concurrently, we note that the Company's life claims ratio increased to 75.02% as at end-September 2009, which is weaker than its peers (refer to Chart 8). The Company intends to introduce a new single premium investment plan product in order to shore up its premiums in the life segment.

Chart 7: Composition of life claims

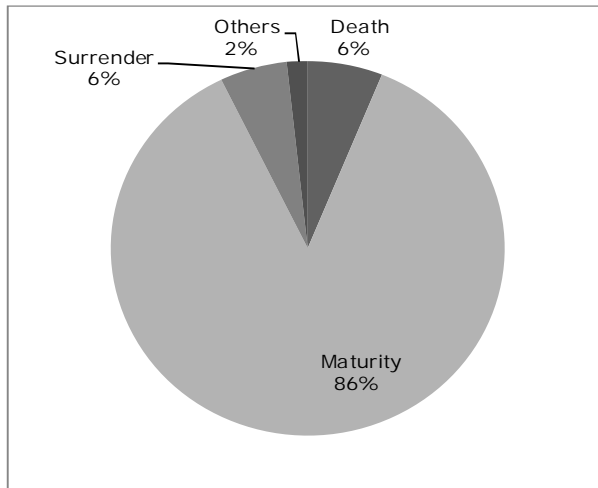
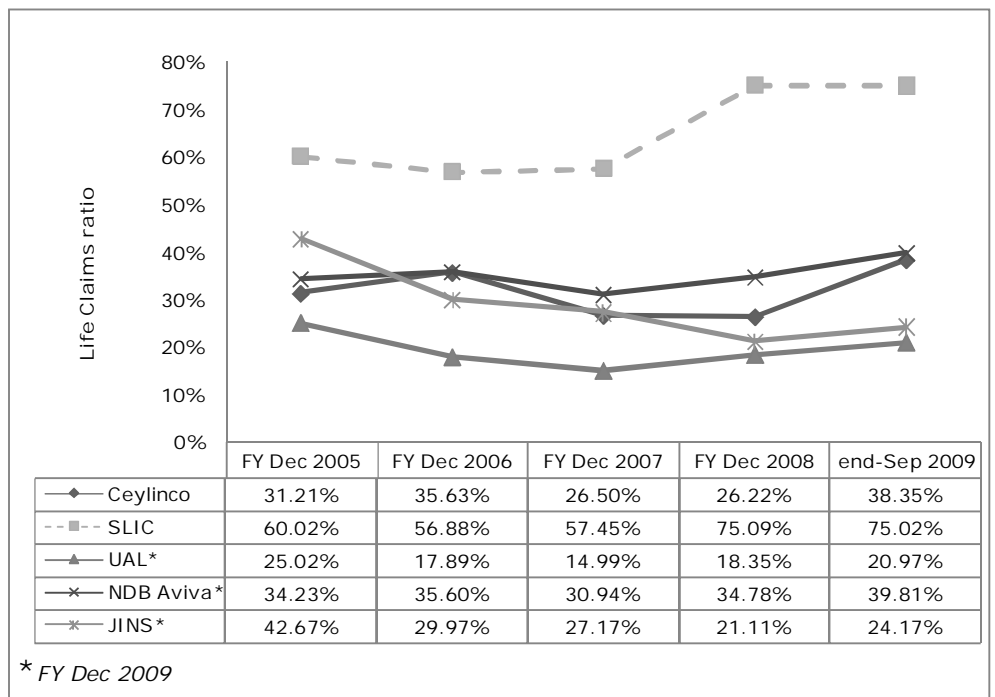


Chart 8: SLIC's life claims ratio vs peers



Investment policy in place

Shift towards equity investments

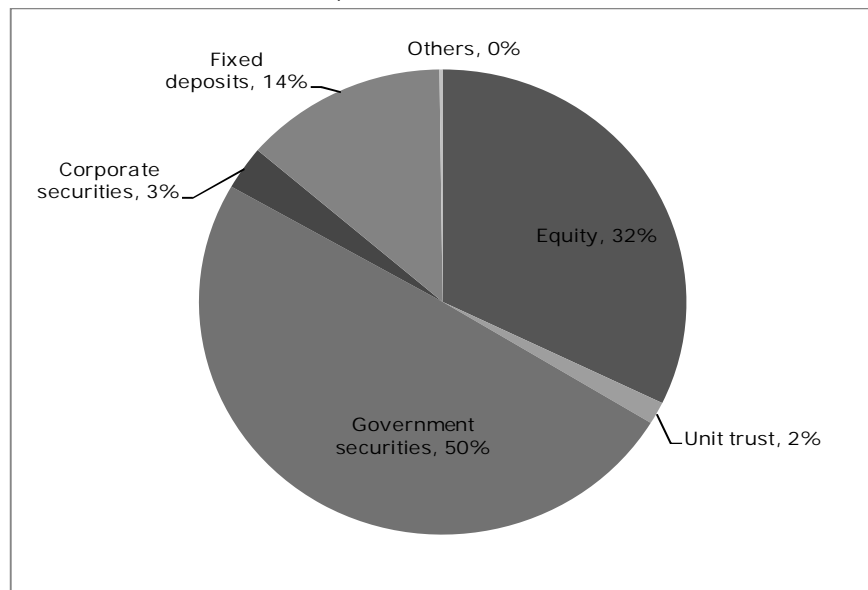
Acquired strategic stakes

Investment Portfolio

RAM Ratings Lanka deems SLIC's investment portfolio to be adequately managed. The Company's investment decisions are formulated by its investment committee, which convenes at least bi-monthly. Additionally, the Company had obtained the services of a consultant in 2009 in order to implement a formal investment policy. This policy specifies investment exposures for various categories of instruments; the Company intends to comply with the requirements of the policy in the medium term. These developments are viewed positively.

SLIC's investment portfolio had achieved robust growth in recent years, almost doubling since FY Dec 2006 to reach LKR 59.09 billion as at end-FY Dec 2009. Traditionally, the bulk of the investment portfolio had been in government securities. However, in line with the upturn in the share market, the Company has taken a more aggressive stance. As such, equity accounted for 32.17% of total investments as at end-FY Dec 2009 (FY Dec 2008: 29.23%) (refer to Chart 9). Further, during the past three months, the Company had further increased its equity exposure; we therefore estimate the current equity component to be approximately 50% of the total portfolio. RAM Ratings Lanka observes that equity investments may expose the Company to market risk, given the volatility in prices. The Company's investment policy indicates a maximum equity target of 40% for both life and general investment portfolios; hence we anticipate the Company to reduce its current equity exposure in the medium term.

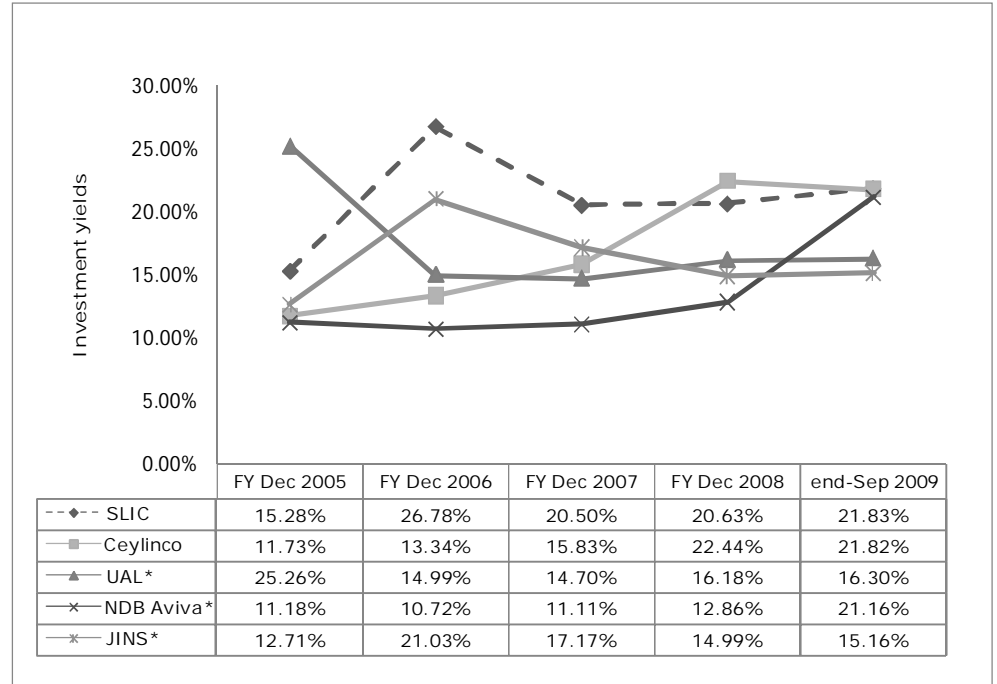
Chart 9: SLIC's investment portfolio-FY Dec 2009



With regards to the Company's equity portfolio, RAM Ratings Lanka deems it to be well-diversified. Further, the majority of these investments consist of liquid, blue-chip shares. Subsequent to the nationalisation, we note that SLIC had purchased strategic stakes in several leading commercial banks, including Seylan Bank, Hatton National Bank and National Development Bank. This is believed to be in line with the government's strategy of strengthening its presence in the financial services sector. As such, while direct state influence is anticipated to be limited in investment decisions, we believe SLIC's investments will broadly be in line with the state's long term economic strategies. Elsewhere, it is noteworthy that the Company's investment yields are among the best in the industry (refer to Chart 10).

Strong capitalization

Chart 10: SLIC's investment yields vs peers

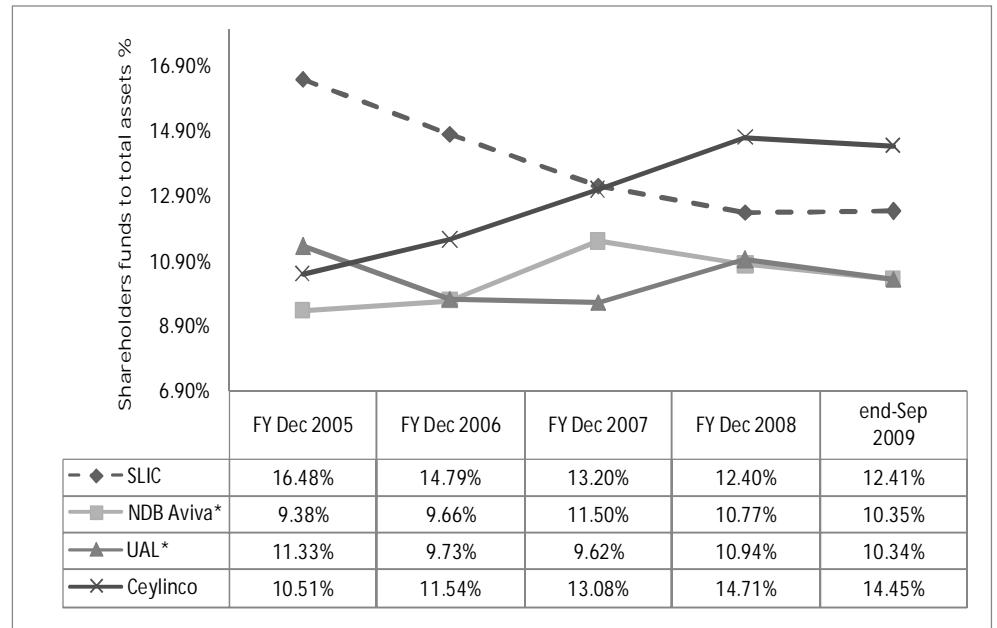


* FY Dec 2009

Strength of Capitalisation

SLIC is amongst the well-capitalised insurers in the industry, with shareholders' funds amounting to a staggering LKR 10.37 billion as at end-September 2009. The Company's shareholders' funds have been strengthened through retained profits and revaluations. As such, SLIC's shareholders' funds (excluding revaluation reserve) to total assets amounted to 12.41% as at end-September 2009, comparing favourably to its peers (refer to Chart 11). On a separate note, the Company will be required to repay the profits that were generated and retained during the privatised period to Distilleries Group; this estimation is currently ongoing.

Chart 11: SLIC's shareholders' funds to total assets vs peers



* FY Dec 2009

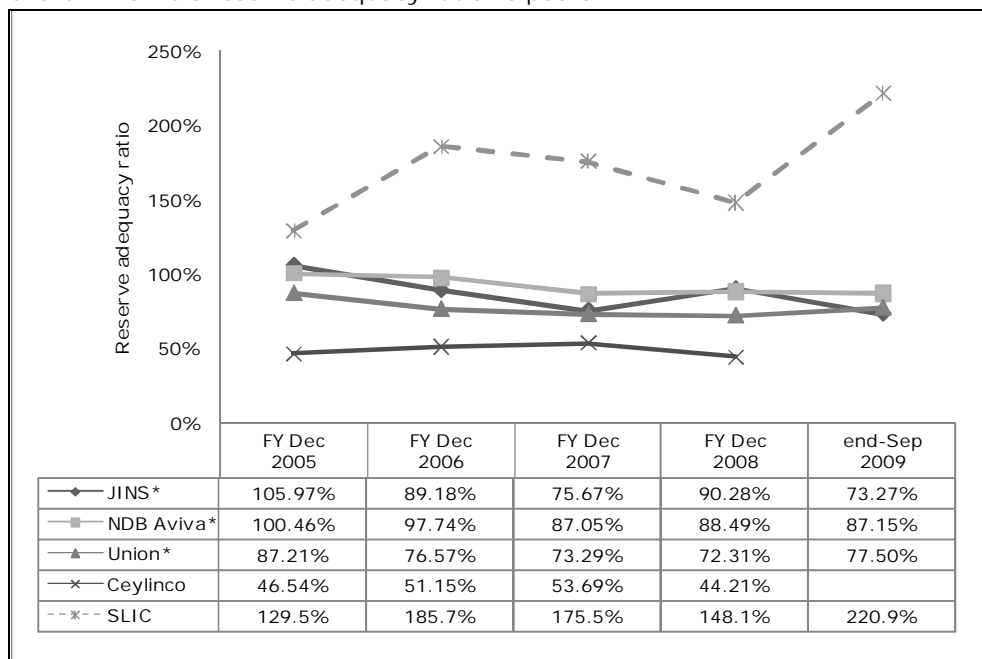
Life and general – actuarially assessed

Meanwhile, SLIC’s solvency margins remained well above the regulatory limit. The life and general segment’s solvency margins amounted to 6.53 times and 5.10 times respectively as at end-September 2009.

Adequacy of Reserving

SLIC’s reserving is considered strong as both life and general reserving is actuarially assessed. At LKR 43.63 billion, the Company’s life fund is currently the largest in the insurance industry. Meanwhile the Company had declared an unprecedented bonus of LKR 3.0 billion (this was credited to the policies) to its life policy holders in November 2009, further demonstrating its strong reserving policy. Elsewhere, with regards to the general segment, SLIC’s net premium-to-technical reserves has consistently been above 100%, much stronger than its industry peers (refer to Chart 12).

Chart 12: SLIC’s reserve adequacy ratio vs peers



* FY Dec 2009

Diverse pool of reinsurers

Reinsurance

RAM Ratings Lanka deems SLIC’s re-insurance arrangements to be good as it has a diversified pool of re-insurers, all of which meet the IBSL’s statutory requirements. As such, all the reinsurers have BBB or above ratings or are sovereign-owned. The Company cedes around 32.74% of its general insurance to its reinsurers. With regards to life insurance, Munich RE operates as the Company’s reinsurer.

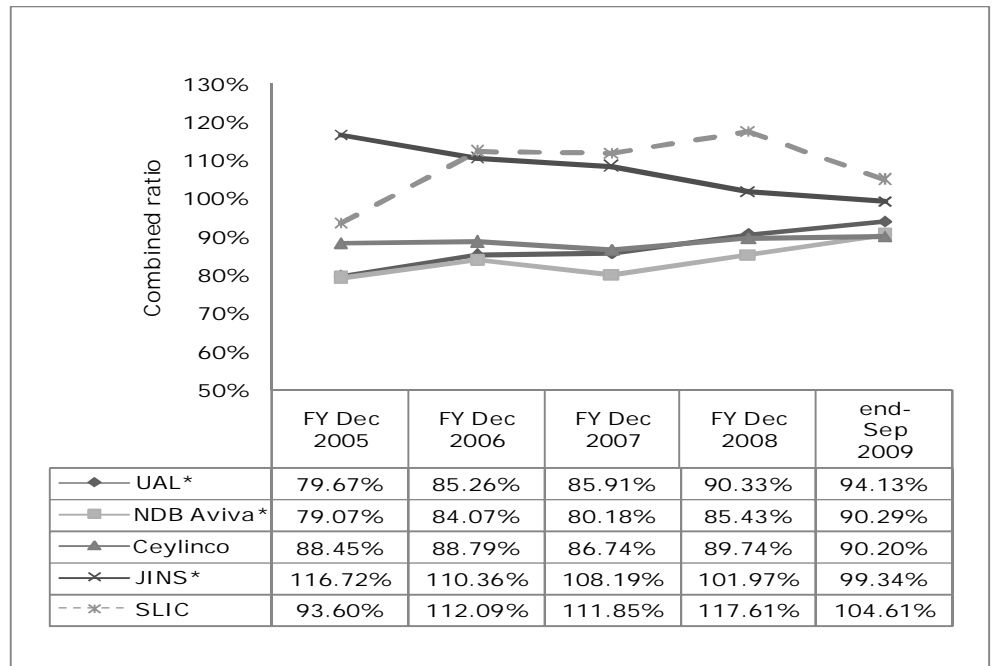
Profitability

Despite incurring overall underwriting losses, the Company has maintained a healthy bottom line as a result of robust growth in its investment income. RAM Ratings Lanka notes that both the life and general segments had incurred net underwriting losses due to increased claims.

High combined ratio

SLIC's expense ratio had historically been in line with the overall industry; nevertheless we note that the ratio had improved from 42.48% as at end-FY Dec 2008 to 29.92% as at end-September 2009. This was primarily due to the discontinuation of several routine promotional and other expenses subsequent to the nationalisation. With the aggressive expansionary plans in the medium term, the expense ratio is expected to climb back to its traditional levels. Meanwhile, SLIC's combined ratio continues to be higher than its peers, due to its higher overall claims ratio (refer to Chart 13).

Chart 13: SLIC's overall combined ratio vs peers



*FY Dec 2009

Underwriting losses

Meanwhile, the general and life segments incurred technical losses (subsequent to deducting all expenses) during the reviewed period, mainly in view of higher claims. The general segment however, recorded a decline in underwriting losses to LKR 364.02 million during FY Dec 2008 (FY Dec 2007: loss of LKR 821.48 million). Meanwhile, the life segment recorded an increased loss in its underwriting profits during FY Dec 2008, mainly in view of the expansion in maturity claims; the underwriting loss amounted to LKR 1.50 billion (FY Dec 2007: loss of LKR 317.89 million). RAM Ratings Lanka views this with concern. Overall, net underwriting losses had dipped to LKR 373.68 million during the period to September 2009, in line with the reduction in the cost base.

Profits dependent on investment income

That said, the Company's robust investment income had compensated for the technical losses incurred. SLIC's overall investment income grew 21.79% y-o-y to LKR 6.10 billion during FY Dec 2008, and expanded further by 3.18% (on an annualised basis) by end-September 2009. Investment income expanded in line with the enlarged government securities portfolio and aggressive equity investments. Consequently, the Company's overall pre-tax profit more than doubled to LKR 1.63 billion during FY Dec 2008; it expanded a further 61.22% (on an annualised basis) to LKR 1.97 billion during the period ended September 2009.

Industry Overview

Sri Lanka's gross domestic product ("GDP") expanded 3.5% in 2009. Although this was weaker than the 6.0% growth attained in 2008, the slower growth has to be put in the context of the present global downturn. Not surprisingly, all 3 major sectors of the Sri Lankan economy have been hit by the global upheaval.

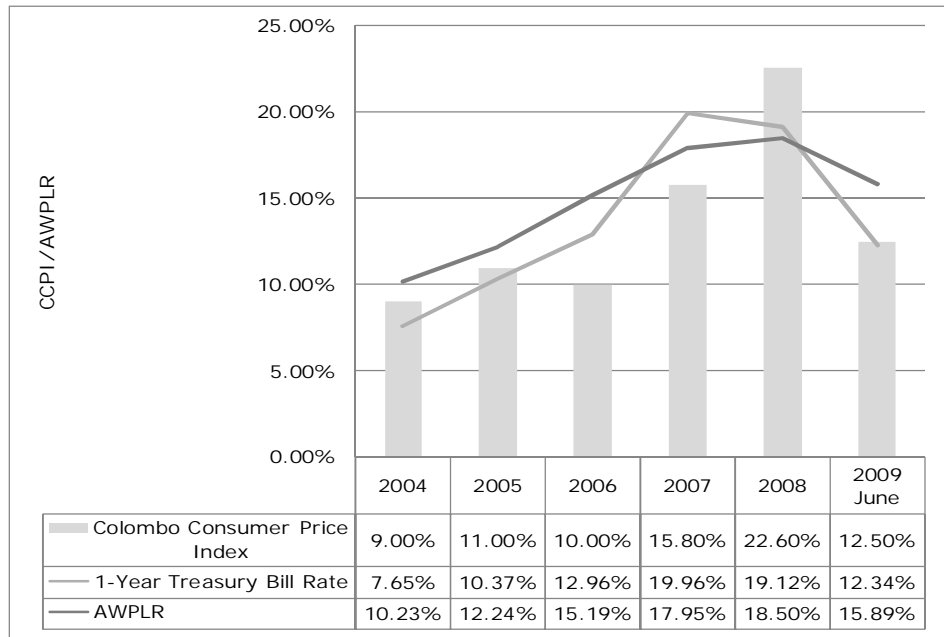
The performance of the island's primary sector (i.e. agriculture, forestry and fishing) had been hampered by droughts, weaker prices and receding world demand. The sector contracted 0.9% in 3Q 2009, in sharp contrast to a 12.4% growth in 3Q 2008. Value addition from all major export crops had declined, depressed by droughts and reduced production following the steep fall in commodity prices in the latter part of 2008. Other sectors, meanwhile, had advanced at a slower pace, principally due to poorer export demand (refer to Table 1). Moreover, GDP growth for 2010 is expected to clock in at 6.0%, which is significantly higher than 3.5% recorded for 2009.

Table 1: Overall and sectoral GDP growth in 3Q 2008 and 3Q 2009

Sector	2008	2009
Agriculture, forestry and fishing	7.5%	3.2%
Industrial	5.9%	4.2%
Services	5.6%	3.3%
GDP	6.0%	3.5%

On a more positive note, the end of the 25-year war against the separatist Tamil Tigers has spawned renewed hope for the country. The advent of the standby facility from the International Monetary Fund, together with the issuance of USD500 million of sovereign bonds in the latter half of 2009, has also helped augment Sri Lanka's 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 14). While these augur well for the economy, sluggish export demand is still a concern. Furthermore, interest rates have dipped sharply, in tandem with the Central Bank's loosened monetary policy. While continually lower interest rates may not be sustainable given the country's budget deficit, RAM Ratings Lanka also notes that interest rates will not revisit the highs of 2008. On the whole, however, we envisage the credit cycle to chart a rising trend.

Chart 14: Inflation and interest rates

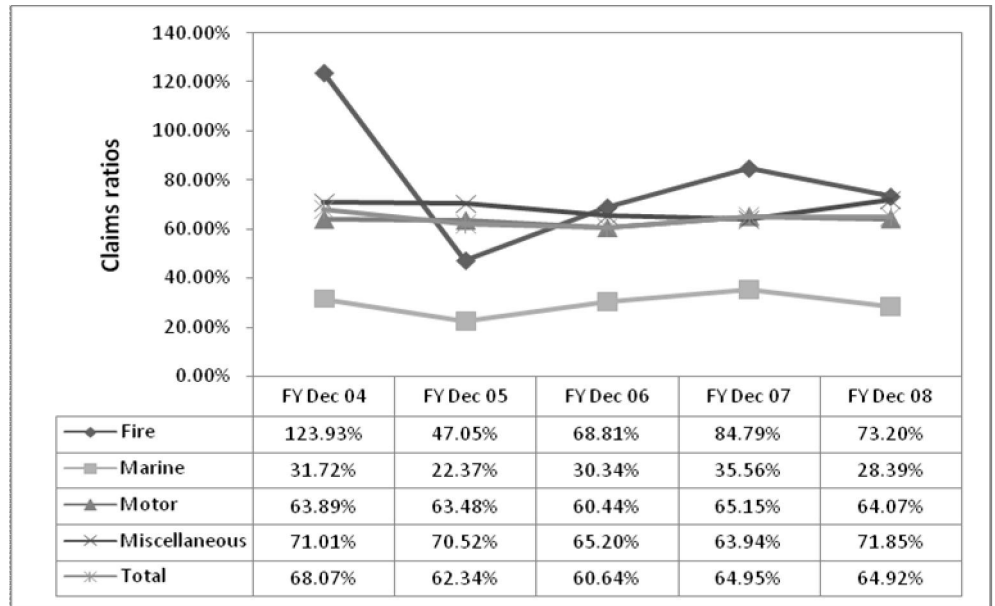


Against this macroeconomic backdrop, the domestic insurance sector made up 3.2% of the financial industry’s total assets as at end-December 2008. The industry is composed of 18 players, 2 of which are engaged in only the life business while another 5 are only in general insurance; the rest are involved in both sectors. However, the 2 largest players in the Sri Lankan insurance market commanded 52% of the industry’s GWPs while the top 5 accounted for about 84% as at end-December 2009.

Owing to the dampened business sentiment and the distress faced by one of the largest insurance company, overall industry premiums written saw a dip. Composite written premiums declined 0.43% during end-December 2009 to stand at LKR 57.92 billion (end-December 2008: LKR 58.17 billion). The contraction in written premiums had stemmed from the general segment which crimped by 2.31% from LKR 34.55 billion in end-December 2008 to LKR 33.75 billion in end-December 2009. The decline was driven by a LKR 2.21 billion dip in premiums from a single company. On the other hand, the life insurance segment grew 2.34% over the same period to LKR 24.16 billion from LKR 23.61 billion. 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 had improved compared to 2004, it was still high at 73.20% as at end-December 2008 (refer to Chart 15). The miscellaneous sub-class includes a variety of insurance products vis-a-vis burglary, travel and medical purposes, and has generally been prone to high claims incidences. Generally, the medical sub-class has been cited as the main reason, as its insurers generally face hefty claims and only underwrite such policies to retain clients.

Chart 15: 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 a 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 500 million in respect of each business by end-2010. 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. The industry's larger and more efficient players are expected to benefit from these changes.

Corporate Information

Date of Incorporation:	February 1993		
Commencement of Business:	1962		
Major Shareholders:	Government of Sri Lanka	99.93%	
Directors:	Mr Pradeep S Kariyawasam Dr Nalaka Godahewa Mr Rajapakse A Jayatissa Mr Ravi Abesuriya Mr Anura B Meddegoda Mr Chithral Amaratunga Mr Anura P Lekamge	Chairman Managing Director Director Director Director Director Director	
Auditor:	KPMG Ford, Rhodes, Thornton & Co		
Listing:	Not listed		
Key Management:	Dr Nalaka Godahewa Mr Suresh Paranavithana Mr Chandima Hemachandra Dr Jaap Plugge Mr CC Jayasuriya Mr RGH Lewis Mr R Perera Mr PPJ Perera Mr S Gunawardena Mrs R Ekanayake Mrs P Siriwardana Mr MOGS Paris Mrs Niroshini Pethiyagoda Mr Prasanna Vithanage Mr Padmasiri Perera Mr Nilanga Wickramasinghe Mr Harsha Samaranayake Mr Pubudu Wimalratne Mr Hasantha Perera Mr Rasika Ranatunga Mr Dayaratne Perera Mr Kithsiri Bandara Wijeratne Mr Mahen Peiris Mr Palinda Perera Mr Raja Ranatunga Mr Tharaka Balasuriya Mr Jerome Vincent Mr Nalin Subasinghe	Managing Director Chief Officer Life Chief Information Officer Chief Actuary and Senior Consultant Consultant-General Insurance Consultant- Marine Insurance Senior DGM- Finance Senior DGM-Investment DGM- Fire & Engineering DGM- Motor DGM-General Accident DGM- Internal Audit DGM-Marketing DGM-Administration AGM-Life AGM National Sales (Life) AGM National Sales (General) AGM Technical Sales AGM ICT Governance & Administration AGM Facilities Management AGM Life (Technical) AGM Finance AGM Legal AGM HRD AGM Branch Administration AGM Corporate Sales AGM Sales Development & Administration Act. AGM Actuarial & Risk Management	
Major Subsidiaries and Associates:	Management Services Rakshana (Pvt) Ltd The Lanka Hospital Corporation Ltd Hatton National Bank Seylan Bank National Development Bank	100.00% 58.16% 15.00% 15.00% 10.00%	
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

	<i>Unaudited</i>				
BALANCE SHEET (LKR Million)	31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-08	30-Sep-09
ASSETS					
Cash and Bank Balances	16,775.26	10,635.85	7,988.26	10,332.95	4,392.33
Investments					
Properties	0.00	0.00	0.00	0.00	0.00
Fixed Income Securities	9,972.03	16,877.67	22,467.15	22,282.34	29,778.43
Unit Trust	307.47	335.03	1,368.86	1,830.91	899.45
Equity Securities	11,083.88	12,716.37	13,794.97	16,001.57	18,613.86
Fixed and Call Deposits	169.34	433.99	114.47	518.65	4,152.53
Investment-Linked Investments	0.00	0.00	0.00	0.00	0.00
Net Loans	2,432.64	2,412.44	2,544.45	2,738.29	2,640.97
Outstanding Premium from agents/brokers	773.81	623.98	1,084.48	953.18	673.06
Amount Due from reinsurers/ceding company	1,161.64	1,080.33	930.71	1,198.62	1,071.70
Investments in Subsidiaries/Associates	0.00	2,556.30	2,558.21	2,558.21	2,558.21
Other Assets	937.97	1,647.02	1,680.08	2,072.37	2,426.03
Property, Plant & Equipment	3,118.74	3,826.50	3,785.58	4,748.02	4,624.27
TOTAL ASSETS	46,732.78	53,145.47	58,317.20	65,235.11	71,830.84
LIABILITIES					
Provision for outstanding claims:					
Admitted/estimated but not yet paid & IBNR	6,255.06	7,758.48	8,998.14	10,039.49	10,558.72
Reserve for Unexpired Risks (General Insurance)	0.00	583.70	889.58	596.70	595.15
Actuarial Liabilities (Life Insurance)	28,496.29	31,947.13	35,654.30	39,470.89	43,626.98
Bonus & Unallocated surplus carried forward	0.00	0.00	0.00	0.00	0.00
TOTAL INSURANCE FUNDS	34,751.34	40,289.30	45,542.02	50,107.08	54,780.85
Amount Due to Agent, Brokers & Reinsurers	0.00	0.00	0.00	0.00	0.00
Accrued expenses & Trade and Other Creditors	2,790.71	3,337.04	3,304.47	4,106.52	4,469.17
Amount due to Related Companies	0.00	0.00	0.00	0.00	0.00
Bank Overdraft & Other bank borrowings	170.28	291.78	625.51	266.42	576.41
Investment-linked Liabilities	0.00	0.00	0.00	0.00	0.00
Provision for Taxation/Deferred Tax Liabilities	1,319.93	830.79	612.14	1,218.39	1,639.28
Provision for Dividends	0.00	0.00	0.00	0.00	0.00
TOTAL LIABILITIES	39,032.26	44,748.92	50,084.14	55,698.41	61,465.71
Paid-up Capital	6,000.00	6,000.00	6,000.00	6,000.00	6,000.00
Irredeemable Hybrid Capital	0.00	0.00	0.00	0.00	0.00
Share Premium & Other Reserves	0.00	536.34	536.34	1,448.14	1,448.14
Retained Profits/(Accumulated Losses)	1,700.51	1,860.21	1,696.72	2,088.56	2,917.00
Minority Interest	0.00	0.00	0.00	0.00	0.00
TOTAL SHAREHOLDERS' FUNDS	7,700.51	8,396.55	8,233.06	9,536.70	10,365.14
TOTAL LIABILITIES & SHAREHOLDERS' FUNDS	46,732.78	53,145.47	58,317.20	65,235.11	71,830.84

Financial Summary - Company

	<i>Unaudited</i>				
INCOME STATEMENT (LKR Million)	31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-08	30-Sep-09
Net Premiums	8,049.47	8,707.22	10,792.51	10,448.02	7,991.24
Less: Provision for Reserves for Unexpired Risks	(330.15)	(827.05)	(1,173.74)	411.56	121.12
Earned Premiums	7,719.32	7,880.17	9,618.77	10,859.59	8,112.37
Less: Claims Incurred and Claims Admitted	(4,378.03)	(5,698.66)	(6,369.17)	(8,108.99)	(6,058.47)
Gross Underwriting Surplus/(Deficit)	3,341.29	2,181.51	3,249.59	2,750.60	2,053.89
less: Underwriting Expenses (of the Funds)	(2,847.06)	(3,134.29)	(4,388.96)	(4,613.61)	(2,427.57)
Net Underwriting Surplus/(Deficit)	494.23	(952.78)	(1,139.36)	(1,863.01)	(373.68)
Investment Income	3,224.43	4,375.50	5,002.63	6,092.71	4,714.76
Other Income	538.91	1,008.65	452.75	508.41	1,285.89
Surplus / (deficit) transferred from Revenue Account					
- General Insurance	1,187.83	554.05	153.17	838.28	1,120.32
- Life Insurance	119.01	556.64	634.88	793.21	852.45
Company's Operating Turnover	1,306.84	1,110.69	788.05	1,631.50	1,972.78
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	1,306.84	1,110.69	788.05	1,631.50	1,972.78
Less: Depreciation and Amortisation	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Interest and Tax	1,306.84	1,110.69	788.05	1,631.50	1,972.78
Less: Interest and Finance Charges	0.00	0.00	0.00	0.00	0.00
Operating Profit Before Tax	1,306.84	1,110.69	788.05	1,631.50	1,972.78
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	1,306.84	1,110.69	788.05	1,631.50	1,972.78
Less: Tax	(446.78)	(550.99)	(551.55)	(1,047.81)	(1,144.34)
Adjusted Profit/(Loss) After Tax	860.06	559.70	236.50	583.69	828.44
Less: Minority Interests	0.00	0.00	0.00	0.00	0.00
Less: Dividends	(400.00)	(400.00)	(400.00)	(200.00)	0.00
Retained Profit For The Year	460.06	159.70	(163.50)	383.69	828.44

Financial Ratios - Company

	<i>Unaudited</i>				
KEY FINANCIAL RATIOS (%)	31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-08	30-Sep-09
PROFITABILITY (%)					
Gross Underwriting Margin	41.51%	25.05%	30.11%	26.33%	25.70%
Net Underwriting Margin	6.14%	(10.94%)	(10.56%)	(17.83%)	(4.68%)
Pre-tax Operating Margin	52.89%	50.89%	39.99%	45.35%	70.41%
Pre-tax Return on Assets (av.)	9.41%	8.87%	7.74%	7.67%	10.95%
Investment Yield (av.)	15.28%	26.78%	20.50%	20.63%	21.83%
After Tax Return on Equity	11.17%	6.67%	2.87%	6.12%	10.66%
Return on Capital Employed	16.78%	12.94%	9.04%	16.85%	24.87%
Claims Ratio	56.72%	72.32%	66.22%	74.67%	74.68%
Expense Ratio	36.88%	39.77%	45.63%	42.48%	29.92%
Combined Ratio	93.60%	112.09%	111.85%	117.16%	104.61%
Investment Income Ratio	46.75%	61.84%	50.55%	63.18%	75.09%
Operating Ratio	46.84%	50.26%	61.30%	53.97%	29.52%
CAPITALISATION / SOLVENCY					
Gearing Ratio	0.02	0.03	0.08	0.03	0.06
Operating Profit Debt Coverage Ratio (times)	25.00	15.19	6.90	18.27	13.02
Insurance Fund Liability Ratio	4.51	4.80	5.53	5.25	5.29
Total Surplus Assets Coverage	0.20	0.19	0.16	0.17	0.17
LIQUIDITY					
Total Liquid Assets / Total Insurance Funds	0.62	0.75	0.83	0.81	0.98
Total Liquid Assets / Total Assets	0.46	0.57	0.65	0.62	0.74
OTHER PERFORMANCE RATIOS					
Retention Ratio	79.14%	82.40%	81.01%	76.61%	78.17%

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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