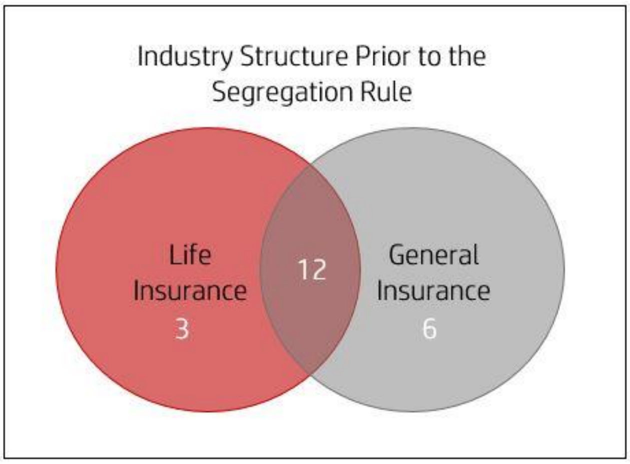
Sri Lanka's Insurance Industry: Emerging Trends and New Opportunities

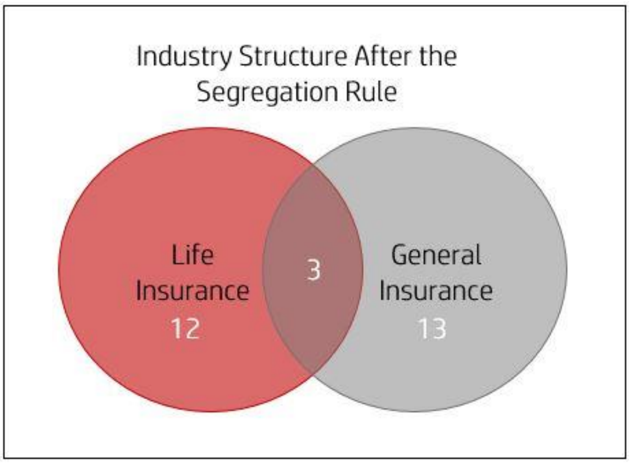
Sri Lanka's insurance industry has experienced a significant amount of transformation during the past two years, primarily due to key regulatory changes that have taken place, as well as shifts in the economy. In this Strategic Insights edition by the Economic Intelligence Unit, we take a closer look at some of the key trends that are at the heart of this. In producing this note, we sought to identify what factors are driving the growth of the industry, what challenges insurers are currently encountering and what opportunities for growth lie ahead. The EIU conducted in-depth interviews with a range of industry leaders in order to identify these particular challenges and opportunities, and how these industry leaders envisage the industry's future trajectory. The insights below draw on these findings together with our own analysis.

Regulatory Changes and Impact on Industry Structure

Segregation of Life and General

The single most important recent change to the industry came in 2011, with the enactment of Section 53 of the 'Regulation of Insurance Industry Amendment Act No. 3 of 2011'. This required composite insurance companies to separate the two classes of insurance businesses - life insurance and general insurance - into two separate companies by the 11th of February 2015. Prior to the segregation of businesses, the sector consisted of 21 companies, of which 12 companies engaged in both life and general insurance. Furthermore, 6 transacted in only non-life and 3 carried out specialist life business. Subsequent to the enforcement of the Act, there are currently 28 insurance companies in operation; 12 life insurance companies and 13 general insurance companies. Three more insurance companies – MBSL Insurance, Sanasa Rakshana Samagama and Sri Lanka Insurance Corporation (SLIC) are yet to segregate their life and non-life businesses. SLIC, the fully state owned player, has been granted special and discriminatory exemption by the Insurance Board of Sri Lanka (IBSL), the industry regulator. Meanwhile, Sanasa Rakshana Samagama is also yet to segregate and MBSL Insurance, a predominantly state owned player expects to segregate its life and general businesses in the near term. The exemption of these three insurers has been hotly debated as it causes an uneven playing field.

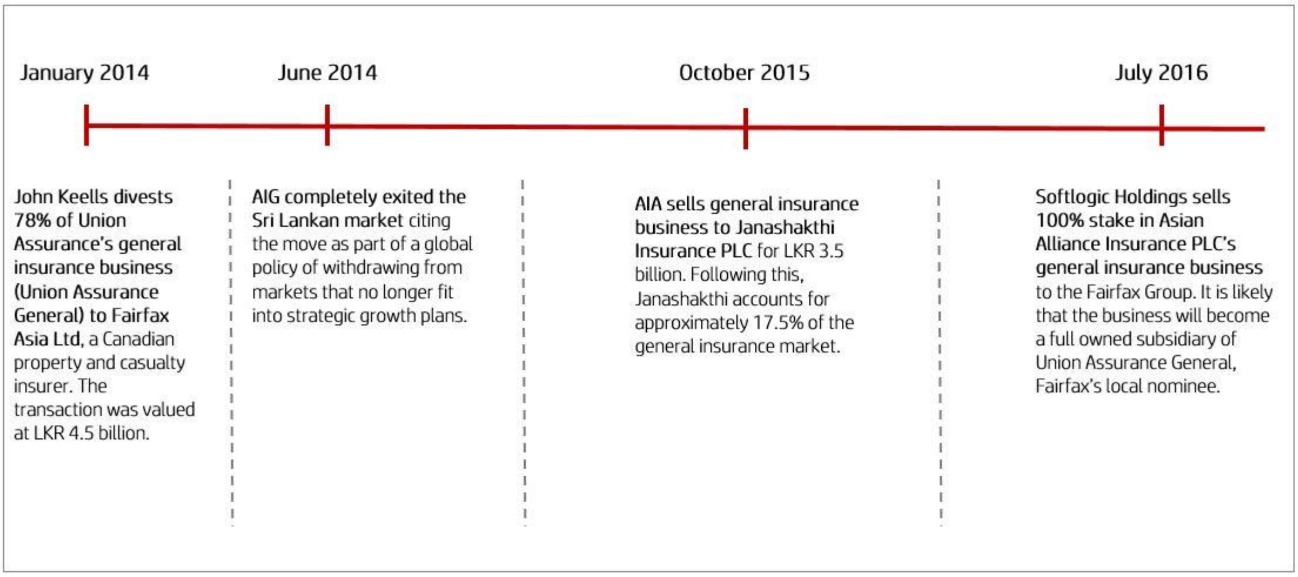




The Act has had different effects on insurers, depending on their size and type of operation. Based on our in-depth interviews, larger players identify the change as a positive one, welcoming it as an opportunity to focus better on each of the life and general businesses alike and cater to customer needs efficiently and accurately. Meanwhile, smaller players with less successful general insurance businesses view the segregation as detrimental to the company, as they can no longer depend on the profits generated by the life insurance business to help keep the general business afloat.

90% of industry leaders anticipate further consolidation to take place in the near term. Subsequent to the implementation of new Act, as well as heightened competition, general businesses in particular have found it challenging to maintain profit margins. These dynamics are leading to a gradual consolidation of the industry.

As insurance companies adjust to changes in the market following the segregation of businesses, divesting their general insurance businesses has become an emerging trend. During the last two years, the industry witnessed a series of acquisitions, as parent companies sold off their general insurance businesses. Consolidation of general insurance businesses appears inevitable as the industry is rather fragmented. With sixteen players competing in a market that is relatively under-penetrated, remaining ahead of the competition is proving to be difficult for companies with smaller portfolios.



New Listing and Solvency Rules

The Amendment Act also requires insurers to be listed on the stock exchange[1] by February 2016, with a 3-year grace period given to newly formed companies consequent to segregation. The requirement for listing according to IBSL was done in order to ensure better transparency and good governance, as companies would be under the purview of the SEC. However, exemptions to listing have been granted to companies if;

a) The companies are foreign owned and its parent company is listed on a foreign stock exchange
b) The parent company of a local insurer is listed on the CSE

IBSL introduced the change of the solvency regime; from a rules-based one to a risk-based one. This translates to insurers having to focus on managing their risks as opposed to solely following the rules set out by the regulator. As stated by the IBSL, the Risk Based Capital (RBC) Rules will replace the current Solvency Margin Rules and insurers will be mandated to comply from year 2016. Subsequent to the enactment of the RBC mandate, insurers are compelled to report their risks to the regulator on a quarterly basis. Furthermore, insurance companies registered subsequent to June 2011, are required to have a stated capital not less than LKR 500 million.

Transitioning from the rules based regime to the risk based regime forces companies to be financially secure and compels companies to be more liquid. However, smaller companies are continually struggling to remain abreast of competition and comply with the regulatory requirements. The high cost of segregation, coupled with the need to maintain the required capital adequacy ratio, while select insurers remain exempt from segregation, is quite disconcerting to industry players. The high costs of complying with these regulatory changes, coupled with challenges of remaining competitive will be a key factor driving consolidation in the industry.

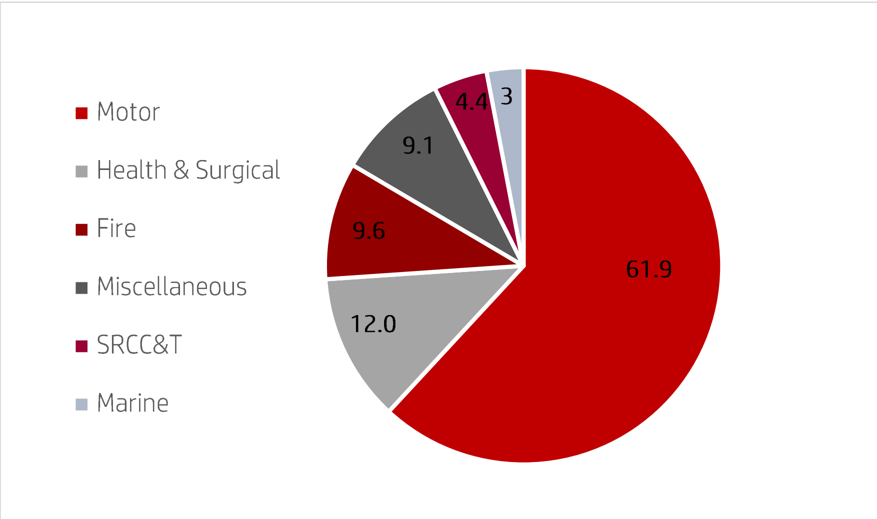
Recent Growth Drivers

Amidst these shifts, the industry has recorded considerable growth over the past year and a half. Overall Gross Written Premium (GWP) income grew at 16% in 2015, compared to 5.4% in 2014. This growth was primarily driven by the life insurance business, which recorded growth of 20.14%, compared to 7.01% in 2014[2]. The growth in the industry has continued during 2016, having recorded 15% growth in GWP income during the first quarter of the year.

During the in-depth interviews, industry leaders attributed growth in the life insurance business to three factors. Firstly, an increase in per capita incomes that enables individuals to spend more. Secondly, a steady rise in people living in urban areas and a greater complexity of their lifestyles and needs. Thirdly, a growing awareness of the benefits of, and need for, insurance. An increase in per capita income in recent years has led to the demand for life insurance, as the ability for individuals and families to afford a 'non-essential good' like insurance has increased. Meanwhile, greater urbanization and urban living has led to a changing complexity of lifestyles, and evolution of needs, which in turn spurred the demand for insurance. Individuals and households acquire higher risks to cater to the demands of their lifestyle (primarily through acquiring loans to purchase vehicle, housing, and luxury items). As families relocate to cities, their ability to depend on a village support network and other means of localized security diminishes. Sustaining an urban family, should the breadwinner of the family face a tragedy that affects the household's income, spurs the desire to have life insurance coverage.

The general insurance businesses, meanwhile, recorded growth of 13.18% GWP in 2015, driven by the growth of the motor insurance segment which accounts for 62% of GWP income (see Figure 1). The growth in motor insurance can be attributed to an increase in the overall[3] number of vehicles imported in 2015 of 8%. An increase in per capita income, alongside urbanized lifestyles and more asset like vehicles being acquired, spurs the demand for vehicle insurance. As lifestyles change (including eating, working and living patterns) the demand for health insurance would increase.

Figure 1- Class-wise share (%) of GWP of General Insurance Businesses -2015



Notes: SRCC&T = Strike, Riot, Civil Commotion and Terrorist activities; Miscellaneous includes Title, Personal Accident, Contractors' All Risk, Professional Indemnity, Travel Insurance, Fidelity Guarantee, Burglary, Cash in Transit Including Cash in Safe, Goods in Transits, Products Liability, Public Liability, Bankers' Indemnity, Air Craft Hull, Workmen's Compensation Insurance and Others
Source: IBSL Statistical Review 2015

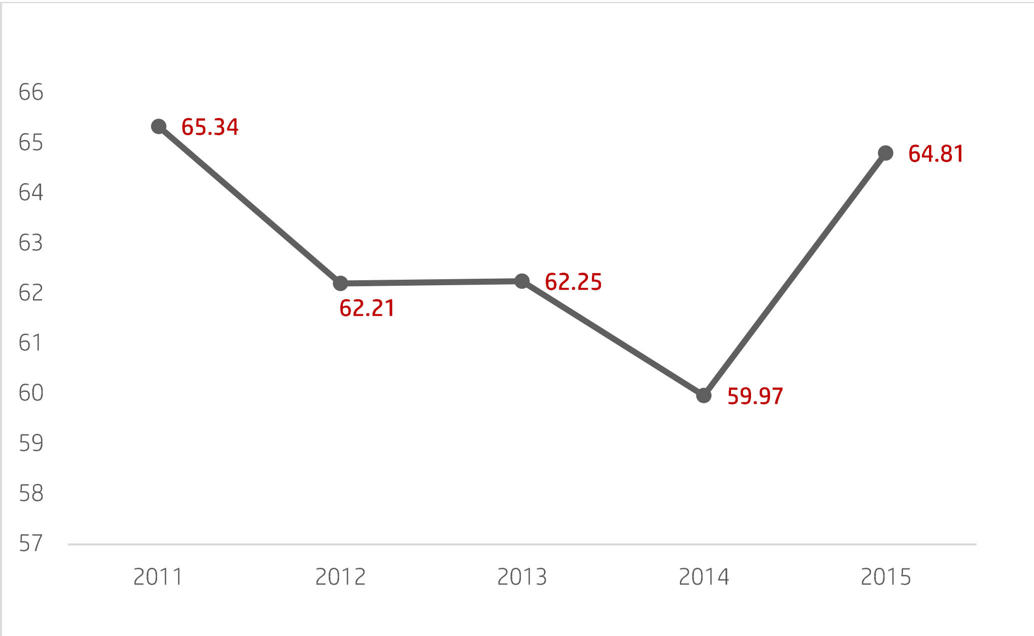
Yet, despite its recent growth performance, the insurance industry is facing some immediate challenges.

High Cost of Motor Claims and the Need for Greater Scrutiny

Alongside the increase in vehicle imports, there has been a rise in the cost of motor claims, and this has become a considerable challenge to general insurance businesses. The motor insurance segment particularly witnessed a sharp rise in loss ratio (also known as net claims ratio) in 2015 (see Figure 2 below). The rise in the cost of motor claims is related to the rise in the number of vehicles on Sri Lankan roads and the higher probability of vehicles being prone to damage or destruction. There have been particular increases in more affordable vehicles leading to many first time vehicle drivers coming to the roads, increasing the frequency and severity of accidents and thereby raising motor claims.

Another considerable factor contributing to the high cost of claims is the increase in the number of electric and hybrid vehicles. The vehicle market witnessed a drastic increase in the number of electric vehicles in 2015, with the number of vehicles increasing from 230 in 2014 to 4,483 in 2015. Furthermore, the number of hybrid vehicles experienced a Y-o-Y growth of 54% in 2015.[4] According to industry leaders, the high cost of parts of both electric and hybrid vehicles, and the availability of parts primarily through original equipment dealers has been significant drivers of the cost of claims.

Figure 2- Motor Insurance Net Claims Ratio (%) 2011 - 2015



Source: IBSL Statistical Review 2015

Industry leaders have identified numerous strategies to mitigate these losses. Some of these include effective management of supply chain and negotiations with repair companies; changing pricing structures to those who opt for original equipment, and leveraging technology through providing real-time service delivery. Most importantly, industry leaders agreed that more prudent underwriting is key to avoiding losses. However, underwriting based on the condition of the vehicle alone would not suffice; underwriting based on driver profiles would be key to avoiding claims losses. A few leading insurers have already begun underwriting based on a wide and general driver profile, taking into consideration age, experience, and other demographics.

Agent Retention and Low Penetration

According to 90% of industry leaders, retaining insurance agents is a critical challenge at present. Life insurance businesses in particular are affected by high turnover as agents account for roughly 90%[5] of the distribution channel. Some life insurance companies have recorded turnover rates as high as 60% during the past year. According to top management interviewed, the lack of interest in the job, coupled with the rigorous qualification process, deters most agents from building a long-term career at a single company. Following are extracts from two C-suite interviews that highlight the challenge of agent retention;

- *"Talent is always in short supply. Attracting and retaining the top quality talent is a challenge"*
- *"One of the very difficult things is finding agents and retaining them. Why? Because this is an intangible product, and youngsters would rather join an exciting industry like tourism. There is also a level of certification by IBSL. We need to move to technology driven solutions in order to be less dependent on them."*

Keeping agents constantly motivated through compensation and healthy competition, as well as investing in their education and training, were identified as two important ways to reduce the high turnover rates among agents. Agents are a vital part of the insurance business because they play a lead role in creating awareness in a significantly underpenetrated insurance market. Sri Lanka's insurance penetration stands at 1.09% of GDP (2015; average of 1.06% since 2011), considerably lower than other countries in the region such as India at 3.3%, Malaysia at 4.8% and Indonesia at 1.7%. Industry experts believe that increases in urbanization and urban living, as well as steadily rising income levels – both trends already being experienced in the past five years – would drive higher levels of penetration in the coming years.

Finding Strategic Partners and the Next Phase of Growth

Insurers remain largely optimistic about the near term growth prospects for the insurance industry and acknowledge that there are ample opportunities for business expansion. When asked, "Do you anticipate the growth in the insurance industry to continue over the next 5 years?" all CEOs interviewed responded emphatically in the affirmative.

Mobile to Micro & SME

One of the most promising industries for strategic partnerships that insurers identify is the mobile telecommunications industry. Sri Lanka has a robust telecom sector with mobile penetration levels of 107%[6]. Utilizing the wide spread use of mobile phones to create awareness and provide customer care and convenience, is seen as a key strategy to overcome challenges of the industry – particularly agent retention and low penetration. Mobile telecommunications can create more awareness on the need for, and benefits of, insurance and reach out to more and new customers. This in turn would reduce the firms' dependency on a costly agent structure.

Partnering with telcos can also help insurers provide micro-insurance in a cost effective manner, and address the demands of the bottom of the pyramid, which has so far been largely untapped market in an efficient way. According to a study conducted by Munich Re Foundation on the 'The Landscape of Microinsurance in Asia and Oceania' in 2013, it was identified that Sri Lanka recorded high premium growth rates (with a compounded annual rate of 578% since inception), compared to its market size[7]. However, some insurers we interviewed found that utilizing an agent to collect small premium values of micro-insurance was not cost effective and did not provide an incentive for the agent. So this segment is largely left out. With a substantial rural population in Sri Lanka as well as a large micro, small and medium enterprise sector (around 99% of all industrial establishments), there is strong potential to grow in this segment. Partnering with telecom providers presents an ideal platform for insurers to address the demands of this market by providing customers the opportunity to pay their premiums via mobile top-ups or reloads.

Larger players have been quick to identify this opportunity and have already begun leveraging these partnerships to address the needs of the market. For example; In July 2014, Union Assurance PLC partnered with Dialog Axiata PLC and Bima (a global mobile micro-insurance provider) to provide a entirely mobile-based 'Accident Cover' (hospitalization support) insurance policy, which mobile customers can subscribe monthly via a short text message

- In August 2015, HNB General Insurance signed an MOU with Mobitel that would facilitate Mobitel Customers to subscribe for the "Ran Medura" household insurance policy with a monthly subscription.[8]
- In June 2015 Union Assurance PLC joined the Dialog eZ cash network, which offers subscribers the reach to send and receive money from rural villages to the cities via mobile phones.[9]

- In May 2015, Dialog Axiata PLC introduced a mobile insurance offering with the introduction of 3rd party motor insurance together with Ceylinco Insurance PLC.[10]

Digital for Insurance - Opportunities for Tech Firms

Streamlining operations to reduce operational costs and using innovative technology to improve product offerings would have to become significant focus areas for insurance companies. Our industry interviews revealed that digitizing current legacy systems have been a key focus for insurers during the past year. 80% of industry leaders interviewed stated that migrating from their legacy core systems to modern digital systems was where a considerable amount of the companies' budgets were being allocated. Furthermore, given the trend towards consolidation, insurers identified that the ability to customize these systems to their bespoke needs and the ability to integrate them with existing platforms will be a key consideration when investing in new technology. Apart from digitization of core systems, insurers also agree that software 'apps' that enable better management of agent operations and those that provide customer convenience and engagement would also be key considerations in new technological investments.

All industry leaders interviewed agreed that their tech budgets are likely to increase during the next five years, reaching between LKR 30 – 100 million annually. Furthermore, when asked, "Do you see an opportunity for local tech companies to partner with insurers?" we received a unanimous positive response, demonstrating interest and willingness to outsource key tech functionalities.

This no doubt presents an opportunity for Sri Lankan tech firms that would not have seen the insurance industry as a potential market, to capitalize on the evolving business models in this industry. 'First mover' tech firms that develop unique and engaging systems for core functions and apps for customer retention and engagement will be able to benefit from the large budget outlays for technology.

Prepared by Economic Intelligence Unit (EIU), The Ceylon Chamber of Commerce.
For queries, contact Shenali on shenali@chamber.lk

[1] Licensed under the Securities and Exchange Commission (SEC) of Sri Lanka Act, No. 36 of 1987
[2] IBSL statistical review 2015
[3] Sri Lanka Vehicle Market 2015, The Ceylon Chamber of Commerce; April 2016
[4] Sri Lanka Vehicle Market 2015, The Ceylon Chamber of Commerce; April 2016
[5] IBSL Statistical Review 2015
[6] "Mobile Boom", The Sunday Leader, January 3, 2016
[7] 'The Landscape of Microinsurance in Asia and Oceania'; Munich Re Foundation; 2013
[8] 'HNB partners with Mobitel'; The Nation; Aug 1, 2015
[9] 'Union Assurance ties up with eZ Cash'; The Daily FT; 29 June 2015
[10] 'Ceylinco 3rd Party Insurance via Your Dialog Mobile' The Island; May 16, 2015