



Rating Action

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Analysts

Jhangeer Hanif
(+92-42-586 9504)
jhangeer@pacra.com

Adnan Dilawar
(+92-42-586 9504)
adnan@pacra.com

PACRA SEES INSURANCE SECTOR UNDER PRESSURE

Pakistan's insurance sector has experienced accelerated growth and robust profitability, augmenting its overall risk absorption capacity in recent years. However, the sector now faces major challenges arising from various broad socio-economic risks, including ongoing stock market turbulence, rising trend in the interest rates, widening fiscal and trade imbalances, and worsening security conditions. PACRA, therefore, sees pressure mounting on the insurance sector, which may impact its growth prospects, profitability and liquidity, undermining its overall financial strength.

Profitability of the sector has remained a function of underwriting business and investment income. The sector underwrites risks in fire, motor, marine and miscellaneous segments including health. Motor insurance, on the back of conducive environment for auto financing, has provided impetus for significant growth in the underwriting business in recent years. The sector has always maintained sizeable investment portfolio, predominantly concentrated in the stock market. Equity investment, while contributing significantly towards the profitability in the form of dividends and capital gains – attributable to the then booming stock market – also served as a source of liquidity.

The current downturn in the economy, also coinciding with the turmoil in the international financial markets, is likely to impact the growth prospects of the insurance business. The country's GDP growth, which remained well above 6% on average in recent years, is expected to come down significantly. The rising interest rate scenario has already dampened auto financing, besides impairing business initiatives hitherto demonstrated by large-scale manufacturing and SMEs. Consequently, insurance companies, due to difficult operating environment and with relatively limited product diversification, may come under pressure to compromise on risk management standards or to cut on premium pricing to achieve business growth. Meanwhile, some pressure is also expected on treaties with re-insurers.

The meltdown of the stock market has exerted further pressure on the sector's profitability and liquidity. Although the imposition of the floor to the country's stock markets has halted the rising revaluation losses for the time being, it has engendered another potential problem of liquidity management. Taking equity investments out of liquid assets, the sector experiences a substantial squeeze in its liquidity position.



PACRA, therefore, sees pressure on insurers' capacity to meet claims, if there is any sudden increase. This may not be remote possibility, given prevailing law and order situation coupled with deteriorating macro-economic conditions. Insurers, which have financial arrangement in place, may resort to short-term credit lines to manage liquidity, though impacting the bottomline.

PACRA, as a part of its ongoing surveillance, is monitoring all developments very closely, and may take a client specific rating action wherever it is deemed appropriate.

We would like to emphasize that for any concern about the financial strength of a rated entity in the country, it is appropriate to consult the respective rating agency before drawing any conclusion. This does not necessarily exclude any independent analysis or objective reservations about the rating opinion. Nevertheless, discussion with the respective rating agency could only help in developing a more informed view about the company.

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