Sri Lanka Insurance Report

July 2019
Issue 2

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Foreword

The year 2018 was a challenging year for Sri Lanka on many fronts. The sharp depreciation of our currency and the heightened political crisis led to slower economic growth. Despite negativities, the insurance industry showed resilience with low but improved penetration that is bound to help long term momentum. Consolidation of businesses through mergers and acquisitions has helped the industry to stay ahead after discounting for accounting adjustments arising from one – off surpluses in the life business. The rising health spend, greater awareness of insurance benefits, rise in micro insurance and digitalization will all have a positive impact on insurance business. The advent of IFRS 17 will influence companies to prudently manage investment and liquidity risk and ensure underwriting risks are dealt with strategically in a transparent manner.

The insurance industry of the country showcased a positive growth rate despite the low insurance penetration levels in life and general business sectors. The global insurance arena displayed a positive growth of around 3 – 4% during the year ended 2018. The global trends reflect that technological advancements continued to increase its influence in the industry with cyber insurance emerging as the latest industry development.

In 2018, Sri Lanka's insurance industry recorded a growth in Gross Written Premium (GWP) of 12.20% in life insurance and 8.37% in general insurance. The general insurance sector grew at a decreased rate due to reduced growth in motor, fire and miscellaneous sectors and the negative growth in health insurance. However, due to the Easter Bombings in April 2019, the sector has seen a sudden spike in demand for terrorism related general insurance covers. According to state owned Sri Lanka Insurance Corporation (SLIC); the company has sold over 1500 new Strike, Riot, Civil Commotion and Terrorism (SRCC & T) post the said event. LOLC General had witnessed a rise of over 50% in SRCC & T policies after the Easter Bombings.

The overall profitability of the insurance industry was also impacted by other factors; Life insurance surpluses are taxed at a higher rate of 28% effective from 1st April 2018, whereas insurers were liable to a lower tax in the previous tax regime. Sharp depreciation of the rupee specifically impacted the general insurance - motor sector due to increased claims paid in relation to imported automobile components. Further, the political tension that occurred in the latter part of 2018 notably impacted the business confidence in many business sectors in Sri Lanka.

The assets owned by the general insurance companies grew at a slower pace in comparison to life insurance companies, followed by both sectors reporting slower growth than 2017. Regulatory requirements and low risk taking have made the insurers to continue prioritizing on Government debt securities. A notable increase in deposits were observed during the year compared to 2017 due to rising interest rates. Similar factors have also influenced in resulting higher investments on corporate debt.

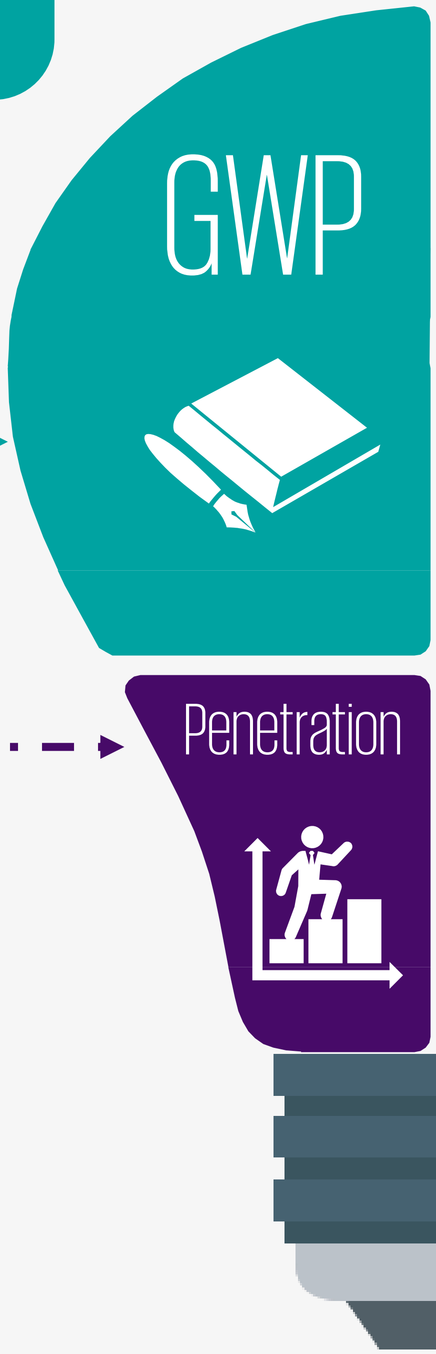
Technology is considered to be one of the key competitive advantages globally. The insurance industry is yet to identify Information Technology (IT) as the center of value creation and innovation. We believe, the IT departments of the insurance companies need to let go of legacy systems and adapt to increasingly complex IT supply chains. To add value into the insurance business, the IT function should be transparent and needs to integrate into operations to ensure service delivery and quality. Implementation of IFRS 17 will force this change on the sector.

The combination of social media and innovative technology has disrupted many industries across the globe. Technology is the enabler of such disruption and the InsureMe app is a prime example in the insurance industry of Sri Lanka. The app is expected to create a new mode of distribution that would help to drive higher penetration levels in the industry. We hope to see similar innovations to significantly increase market penetration and transform the industry.

" IFRS 17 will influence companies to prudently manage investment and liquidity risk and ensure underwriting risks are dealt with strategically in a transparent manner. "

Suren Rajakarier
Partner,
Head of Audit and Insurance
KPMG in Sri Lanka

	2013	2018	5year CAGR
Gross Written Premium (GWP) - (LKR Bn)	100	182	↑ 12.7%
GWP - Long Term Insurance (LKR Bn)	42	80	↑ 14.0%
GWP - General Insurance (LKR Bn)	58	101	↑ 11.7%



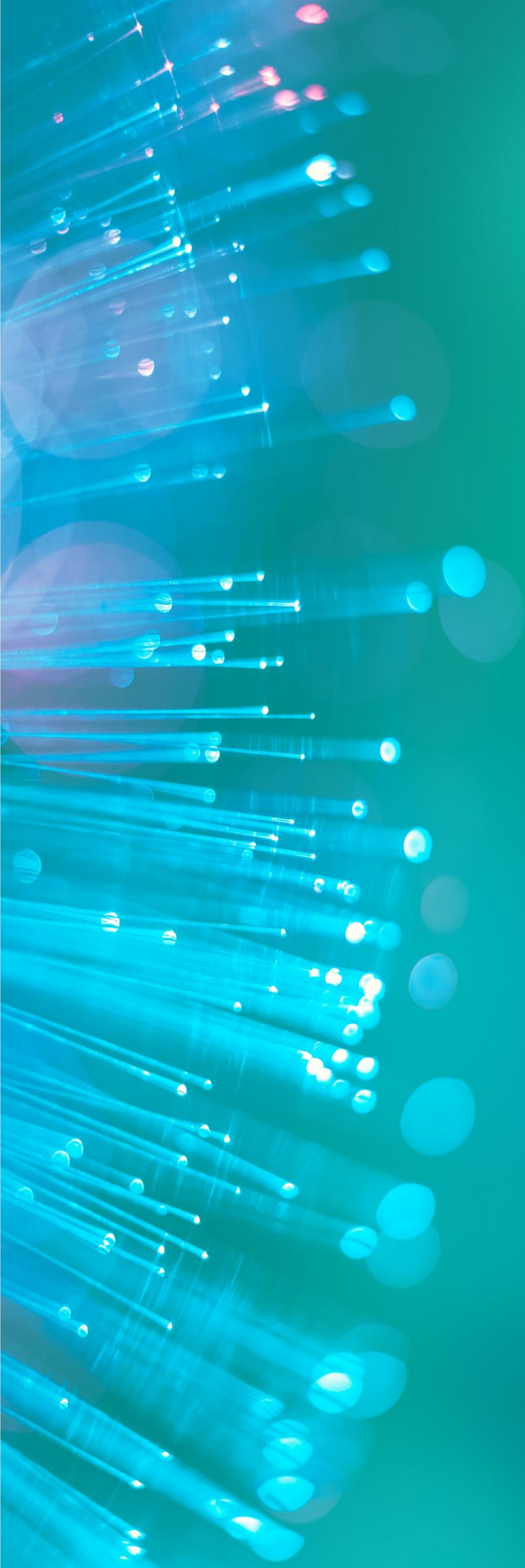
	2013	2018	Basis points
Long Term Insurance Penetration as a % of GDP	0.40%	0.56%	↑ 16bps
General Insurance Penetration as a % of GDP	0.60%	0.70%	↑ 10bps
No. of Branches	1,379	2,147	

Performance

	2013	2018	5year CAGR
Total Assets (LKR Bn)	366	623	↑ 11.3%
Long Term Insurance (LKR Bn)	216	430	↑ 14.7%
General Insurance (LKR Bn)	156	190	↑ 4.1%

	2013	2018	Basis points
General Insurance Net Combined Ratio %	95.48%	101.35%	↑ 587bps
General Insurance Net Expense Ratio %	37.97%	36.21%	↓ 176bps
General Insurance Net Claims Ratio %	57.51%	65.14%	↑ 763bps

Highlights



Market Outlook

InsureMe

Moving from traditional to a technology enabled future

InsureMe

From Traditional to a Technological Model

KPMG notes that social media and innovative technology have disrupted many industries across the economy. Markets are no longer required to exist in substance in which a buyer and a supplier need to meet physically to exchange goods or services for a monetary value. The traditional business model, where a business supplies a service or a product to a customer in exchange for money, has changed vastly with the integration of information technology.

The acceptance of a new business model was seen by the rise of companies such as Uber and Airbnb. The basis of the new model was to connect a supplier with a customer in the most cost effective manner. Technology is the catalyst for such services as the InsureMe team have discovered in Sri Lanka. InsureMe offers the best of a wide range of insurance solutions from leading insurers to corporate and individual customers. This prompted us to speak to Mr. Prajeeth Balasubramaniam and Mr. Vipula Dharmapala to get an insight to InsureMe.

Where it all began

The base of InsureMe was built upon an idea developed by Vipula Dharmapala (CEO – InsureMe). It was the thought of wanting to make it easy to be insured affordably, be able to make a claim easily, and being readily available to all consumers. From the consumer's perspective, the insurance industry does not provide a convenient and economical service. The aim of InsureMe was to disrupt the insurance industry. InsureMe is powered by both Dialog Axiata and BOV Capital, a venture capital fund headed by Prajeeth Balasubramaniam with whom we had a tete-a-tete over coffee to discover the motivation behind this.

Vipula noted the need for insurance arises when there is a requirement to mitigate risks. The insurance industry in Sri Lanka leaves a lot of room for growth, especially in the way services are provided. The process of claiming for damages is cumbersome and many consumers are disgruntled at the point of making a claim. Individuals and corporates based out of Colombo, sign up for third party insurance policies as they are less expensive. These policies are mainly purchased due to regulatory requirements but the value of being insured is not visible to the consumer. InsureMe provides a wide range of insurance policies from various insurers in Sri Lanka making it transparent and affordable to all consumers in the market. The consumer is provided with a range of options and therefore has complete autonomy on the policy he signs up for. Furthermore, the consumers are educated on key areas of insurance.

The InsureMe Way

We noted the availability of InsureMe on the Play Store and App Store making it reachable to anyone with a smartphone. The development of the app has created accessibility to anyone with the need for insurance and makes it attractive to obtain an insurance policy. Under this, all insurance options and their specifications are easily accessible by all consumers, which in turn would increase the motivation to obtain one. The increase in users exposed to the internet will have a positive impact on all online platforms.

"More than disrupt, we wanted to make it available for everyone."

Prajeeth Balasubramaniam
Managing Director – BOV Capital

Prajeeth noted InsureMe would help the industry as a whole as it is the first online insurance aggregator in Sri Lanka. The application would be a mode of penetration for the insurance industry acting as a new distribution channel adding more value. "The customized policies include insurance schemes for senior citizens, critical illnesses and per day policies." said Vipula.

Most life insurance schemes cover individuals up to the age of 60 years. InsureMe provides an insurance scheme for senior citizens up to the age of 80 years, a service covering a wider market as well as reaching for customers not serviced by traditional insurers before. Creating insurance schemes for non-communicable diseases especially for diabetes patients is another innovative product offered by InsureMe. The specialization of insurance schemes within the industry is a whole new area to be explored. Per Day Motor is a scheme that provides a pay as you go method to the consumer. The consumer may get the vehicle insured only for the required number of days the vehicle is exposed to any risks such as a long tour. Per Day Motor could be an attractive insurance scheme for vehicles that are used only on weekends, third party insurance holders and vehicle dealers. These unique features of InsureMe has provided a greater degree of flexibility to consumers, unprecedented in the industry before.

InsureMe is developing a platform to claim for damages by its users which would be an exercise in backward integration. Once there is a claim for damages, InsureMe would take over the front end and back end operations of the process with minimum involvement of the policy holder. Their hope is that greater efficiency in providing claims would encourage consumers to sign up for more and better insurance.

Looking Ahead

Prajeeth Balasubramaniam as a promoter said "The use of technology and innovative concepts should create an improved insurance industry in Sri Lanka. The potential of InsureMe is high and has the capability of transforming the insurance industry. Awareness needs to be built among consumers in order to increase the user base of the application. Digital infrastructure in Sri Lanka needs to improve where online purchasing and digital wallets increase among consumers. Adequate digital infrastructure would pave the way for the online purchase of insurance policies. The use of artificial intelligence (AI) is an area where most businesses have begun to invest in. The involvement of AI would bring in foreign capital into the business where growth is essential."

Mr. Dharmapala was proud to say that "InsureMe is a team of individuals who are professionally qualified and possess over 50 years of combined experience in the insurance industry, dedicated towards providing the best of insurance schemes for an affordable price in order to maximize benefits for the consumers. Backed by Dialog Axiata and BOV Capital, InsureMe has the required support to overcome challenges within the industry and the economy as a whole."

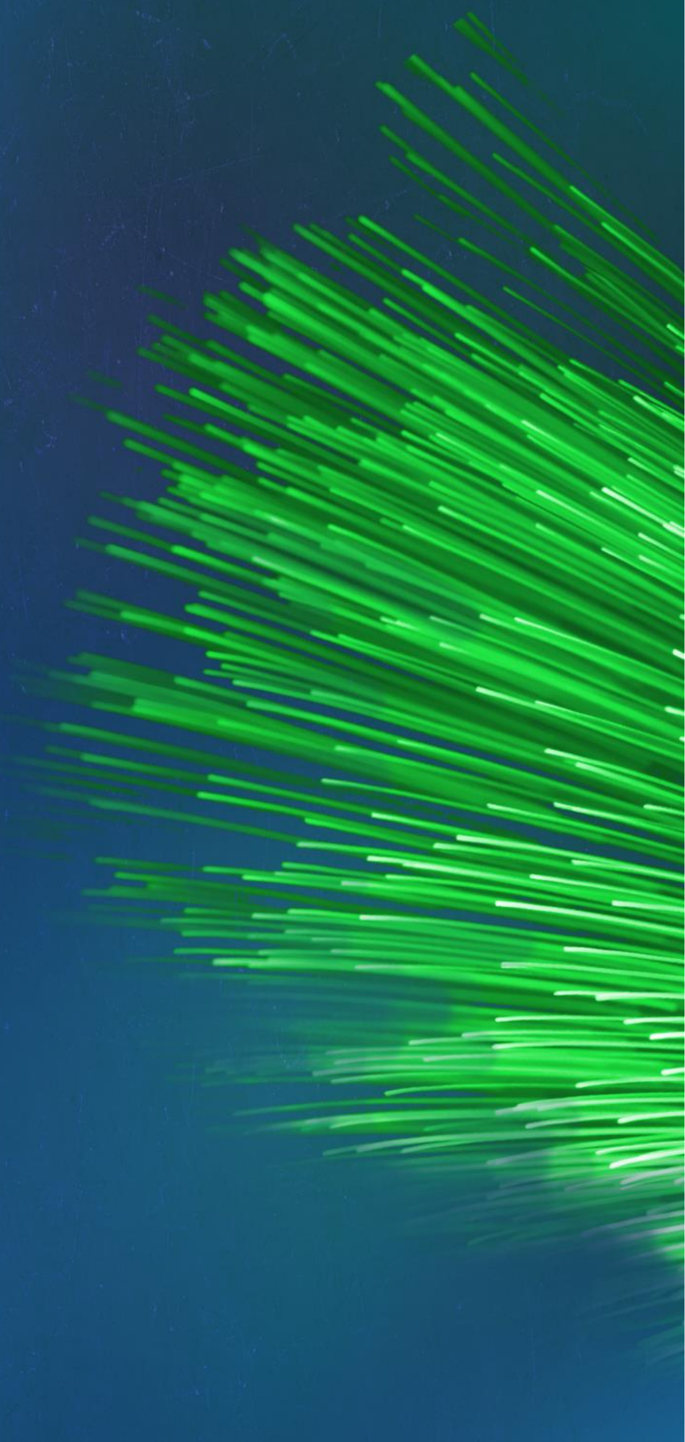
At KPMG we think, Sri Lanka has the required resources to take start-ups such as InsureMe to the level of a globally recognized brand. Recruiting the proper individuals with IT, Marketing and Finance skills would help to sustain and develop Sri Lankan start-ups. The likes of InsureMe serve multiple purposes in the economy by directly and indirectly increasing GDP as well as improving the welfare and social security system of the country, and should be incentivized and encouraged to grow.

"The insurance industry in Sri Lanka leaves a lot of room for growth, especially in the manner of how services are provided."

Vipula Dharmapala
CEO – InsureMe

Regulatory Outlook

in Sri Lanka



The IASB's proposed amendments to IFRS 17

The proposed amendments to IFRS 17 target the concerns and challenges which have arisen over the new standard's implementation in seven important areas. They also propose a one year deferral on IFRS 17's effective date to 1st January 2022 and a one year extension of the exemption from applying IFRS 9 Financial Instruments granted to insurers meeting certain criteria.

Suren Rajakarier, the Insurance Head of KPMG in Sri Lanka noted "There's a lot here for insurers to be pleased about. The extra year would give much needed time to complete their IFRS 17 implementation projects and the amendments would provide practical solutions for Sri Lankan companies to significant challenges that may be encountered during the implementation stage of IFRS 17."

But it's crucial to remember that even with the amendments implementing IFRS 17 will still be a huge challenge requiring changes to the data that you gather and your systems, processes and controls. The table below states the seven key areas that will be amended by the International Accounting Standards Board (the Board)

Area	Key facts	Key impact
Scope	Preparers of financial statements would no longer be required to apply IFRS 17 to certain credit cards and loans that provide insurance	Reduces IFRS 17 implementation costs for many credit card issuer and lenders.
Allocating insurance acquisition cash flows	Insurers would be required to allocate part of the insurance acquisition cash flows that are directly attributable to newly issued contract to expected contract renewals.	Newly issued contracts with high insurance acquisition cash flows e.g. initial commissions – are less likely to be onerous.
Accounting for acquired claims liabilities on transition	The Board is proposing to amend the transition requirements for claims by an entity in a business combination or portfolio transfer.	Provides practical relief by eliminating the challenge of recording claims liabilities in two different ways – as IFRS 17 currently requires – if the information is not available.
Accounting for investment services in an insurance contract	The profit recognition pattern for insurance contracts would be amended to reflect the provision of insurance coverage and any investment services.	Better aligns the accounting with the services provided.
Reinsurance of onerous contracts	The accounting would change for proportionate reinsurance contracts held that cover losses on underlying insurance contracts that are onerous on initial recognition.	Addresses accounting mismatches that arise on initial recognition when an insurer reinsures onerous contracts using proportionate reinsurance coverage.

Risk mitigation for direct participating contracts	The risk mitigation option applicable to direct participating contracts would be expanded, allowing insurers to use it when reinsurance contracts held – as well as derivatives – are used to mitigate financial risk.	Reduces accounting mismatches that arise when reinsurance contracts held are used to mitigate the financial risk of direct participating contracts.
Presentation of assets and liabilities	Insurance contracts would be presented in the statement of financial position at the portfolio level – a higher level than is currently required.	Provides practical relief to insurers that may find it difficult to allocate cash flows to individual groups of insurance contracts.

One of the proposals that may be of benefit for the Sri Lankan companies is amending IFRS 17 so that insurers would be required to allocate part of the insurance acquisition cash flows that are directly attributable to a group of newly issued contracts to expected renewals of that group of contracts that are outside the contract boundary.

Consequently, insurance acquisition cash flows allocated to future renewals would be recognised as an asset until the expected renewals are recognised. However, the expectations of future renewals, the allocation of acquisition costs and the recoverability test that would be required under the Board's proposal may need to be performed at a more granular level than current practice – i.e. at the level of groups of insurance contracts.

Another key change to note is that the Board proposes amending the profit recognition pattern for insurance contracts to reflect the provision of insurance coverage and any investment services.

The CSM is currently recognised in profit or loss by allocating the balance to coverage units, which are determined by assessing:

- the quantity of benefits provided under the insurance contracts to which it relates ; and
- their expected duration.

Under IFRS 17 as originally issued, the quantity of benefits and contract duration relate only to insurance coverage (for both direct participating insurance contracts and all other insurance contracts). Any investment services provided under the contract are not taken into account.

The Board is proposing to amend the profit recognition pattern for insurance contracts to reflect the provision of both insurance coverage and any investment services.

The proposal include a new definition of 'insurance contract service', which includes insurance coverage, Investment related service and Investment return services.

The following criteria were proposed in order to establish investment return service in an insurance contract; investment component or the policyholder has the right to withdraw an amount, and the investment component or the amount the policyholder has a right to withdraw, is expected to include a positive investment return that is generated by the insurer's investment activity.

IFRS 17 requires insurers to present groups of contracts that are assets and liabilities. The method is the same in terms of presenting reinsurance contracts. Insurers have highly aggregated information on the claims payables and premiums receivables for management purposes. System limitations may cause problems in trying to allocate cash flows into individual groups. The board has therefore proposed to present the carrying values of insurance contract assets and liabilities aggregated but at a portfolio level only for presentation purposes. Offsetting could also be applied among groups in the same portfolio for presentational purposes. The amendment has provided a relief to insurers in respect of presentation, however there maybe challenges in terms of allocating cash flows among reinsurers portfolios and allocation of cash flows which are settled on the liability for remaining coverage.

The implementation of IFRS 17 has its benefits especially in terms of increased clarity, comparability and integrity of the statements. The concerns raised by most insurers have arisen during the implementation of the standard. The proposed amendments and the one year extension may grant insurers further preparation time.

Insurance Sector

in Sri Lanka

2nd half 2018 (Analysis)

Sector at a glance

During 2018, the Insurance industry in Sri Lanka grew at a moderate rate of 10.03% with overall GWP reported at LKR 181.5Bn. This indicates a lower growth rate compared to 15.30% recorded in 2017, due to many uncertainties that prevailed during the year which included delayed implementation of structural reforms and heightened political tension during the latter part of the year.

Furthermore Sri Lanka's weakened currency and the higher tax liabilities of insurers may cut down the overall profit of insurers in the near term. The rupee depreciated by a significant 16.4% against the USD in 2018, which had an impact on the claims paid by non-life insurers related to imported automotive components.

Life insurers paid lower taxes in the previous tax regulations compared to 2018 where life insurance surpluses were taxed at a rate of 28%.

The insurance sector in Sri Lanka is expected to showcase a modest growth in the near term, due to the reduction in motor insurance premiums driven by the increased tax rates on imported vehicles, dampened economic growth as well as the highly competitive price wars in the non-life sector is expected to further hinder the growth rate of the insurance industry.

However, in the long-term, we are optimistic about the industry driven by the rising disposable income, increasing trend of insurance penetration, rising awareness of insurance technological impact and a gradual increase in the contribution from general insurance segments such as health and property.

Insurance Companies of Sri Lanka as at 31st December 2018

Life Insurance

Company	Total Assets (LKR Bn)
1) Ceylinco Life Insurance PLC (CINS)	118
2) AIA Insurance Lanka PLC (AIA)	54
3) Union Assurance PLC (UAL)	49
4) Janashakthi Insurance Company PLC (JINS)	21
5) HNB Assurance PLC (HNB)	19
6) Softlogic Life Insurance PLC (SHL)	17
7) LOLC Life Assurance Limited (LOLC)	5
8) Allianz Life Insurance Lanka Ltd (ALLI)	5
9) Amana Takaful Life PLC (AMA)	3
10) Life Insurance Corporation Lanka Ltd (LIC)	3
11) Cooplife Insurance Limited (Cooplife)	2
12) Arpico Insurance PLC (Arpico)	3

General Insurance

Company	Total Assets (LKR Bn)
1) Ceylinco General Insurance Ltd (CINS)	28
2) Fairfirst Insurance Limited (Fairfirst)	15
3) National Insurance Trust Fund (NITF)	12
4) People's Insurance PLC (PINS)	8
5) Allianz General Insurance Lanka Ltd (ALLI)	31
6) LOLC General Insurance Ltd (LOLC)	5
7) Cooperative Insurance Company Ltd (Co-op)	5
8) HNB General Insurance Ltd (HNB)	5
9) Continental Insurance Lanka Ltd (CONT)	5
10) Amana Takaful PLC (AMA)	3
11) Orient Insurance Limited (Orient)	2

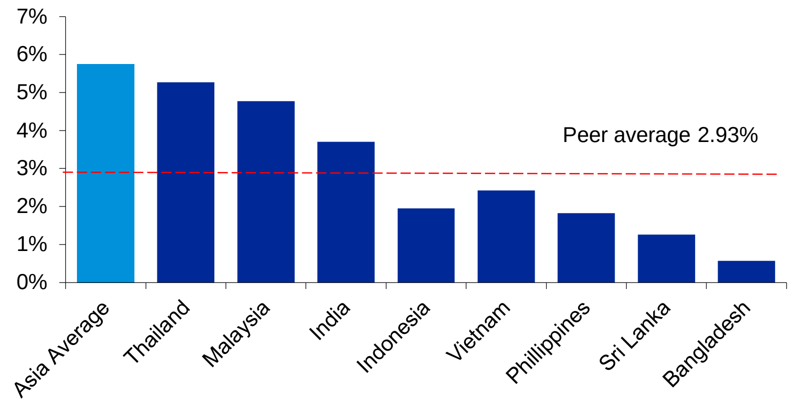
Composite Insurance

Composite (Life and Non life) companies	Total Assets (LKR Bn)
1) Sri Lanka Insurance (SLIC)	197
2) Sanasa Insurance Co. Ltd (Sanasa)	3

Source: Insurance Regulatory Commission of Sri Lanka (IRCSL)

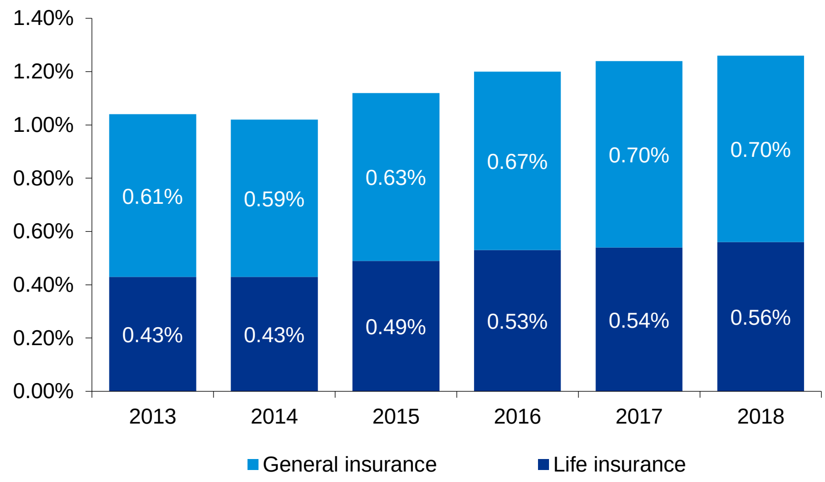
Insurance penetration

Penetration of peer countries



Source-:Swiss Re sigma No. 3/2018

Insurance penetration – Sri Lanka



Source: IRCSL

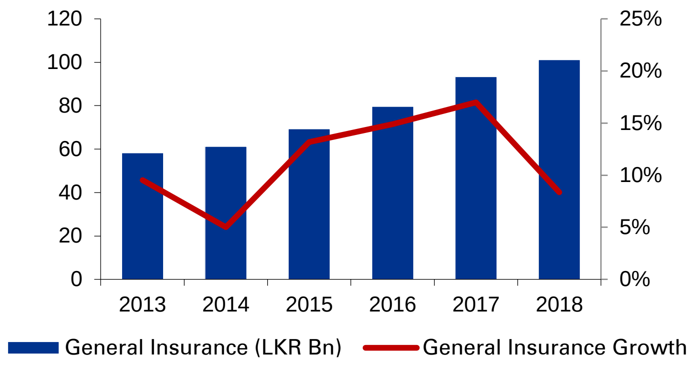
The penetration of insurance towards the GDP of Sri Lanka grew up to 1.26% as of end 2018 compared to 1.24% at the end of 2017. The positive growth is notably low compared to other peer countries. The demand for insurance is directly impacted by the level of disposable income of the general public. Sri Lanka's low disposable income level, negative perceptions on insurance and social security benefits, has contributed towards a decreased desire to invest in a life term insurance policy among the locals. However, with changes in the country's demographic factors such as the aging population (currently at 12%, which is expected to rise to 16% and 25% in 2021 and 2041, respectively) the Government of Sri Lanka may need to consider initiatives to promote awareness of life insurance policies as an alternative to the increasing social security cost burden.

Moreover, Sri Lanka is comparatively under-penetrated in comparison to peers such as Thailand and Malaysia, despite a sophisticated clientele for other financial services products. Technology has the potential to become one of the major drivers of the insurance sector in the future. Insurers believe that the adoption of new methods of marketing, distribution and payment will help generate sales while at the same time keeping premiums in check.

In Thailand currently, not much coverage is sold online, as the products that can be sold on the internet must be simple, with lower premiums.

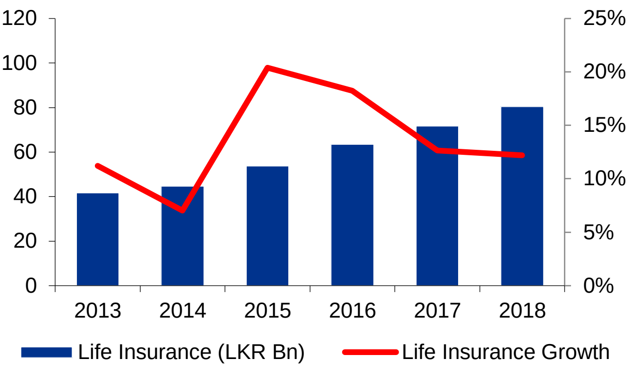
Gross written premiums (GWP)

Gross Written Premium - General Insurance



Source: IRCSL

Gross Written Premium - Life Insurance



Source: IRCSL

Total Gross Written Premium (GWP) of overall insurance companies grew at a 5 year CAGR of 12.67% over the period 2013 to 2018 to reach LKR 181Bn. General insurance accounted for a higher GWP in absolute terms with a major contribution from mandatory motor insurance schemes.

The life and general insurance GWP grew at a 5 year CAGR of 14.02% and 11.67% respectively for the period from 2013 to 2018.

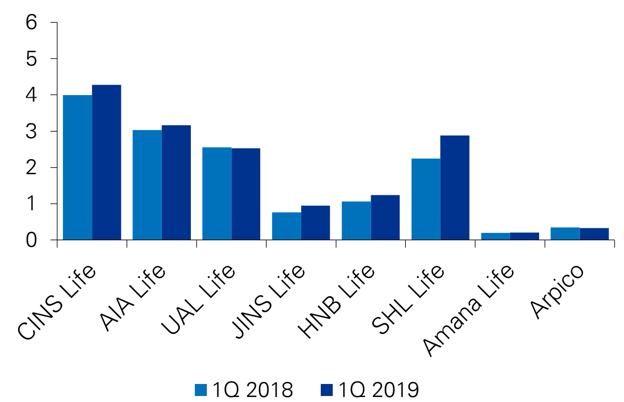
The general insurance sector grew at a lower YoY rate of 8.37% in 2018 due to reduced growth in motor, fire and miscellaneous sectors and the negative growth in health insurance.

Sri Lanka's general insurance market was competitive with new opportunities and challenges in the motor segment such as the increase of vehicle registrations in motor cars due to favorable duty fees applicable to vehicles with smaller engine capacity and decline in construction businesses respectively. However compared to previous years, there were less adverse effects on the general insurance sector due to unfavorable weather conditions in 2018.

Furthermore in the life insurance sector, the market sustained its growth by improving operational processes to assure quality service, re-engineering existing products, introducing innovative life insurance products to dynamic consumer needs, and increase customer awareness that contributed towards a growing demand for life insurance.

GWP - First Quarter (1Q) 2019

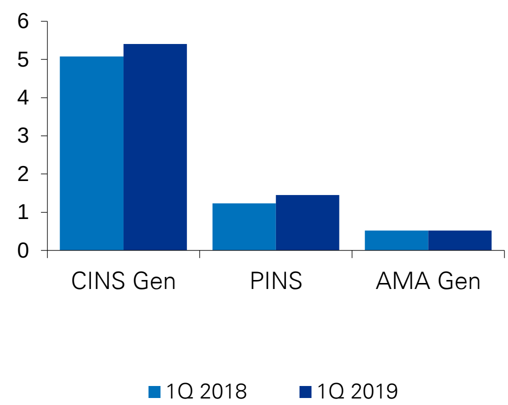
GWP - Life Insurance (LKR Bn)*



*Includes listed companies only

Source: CSE

GWP - General Insurance (LKR Bn)



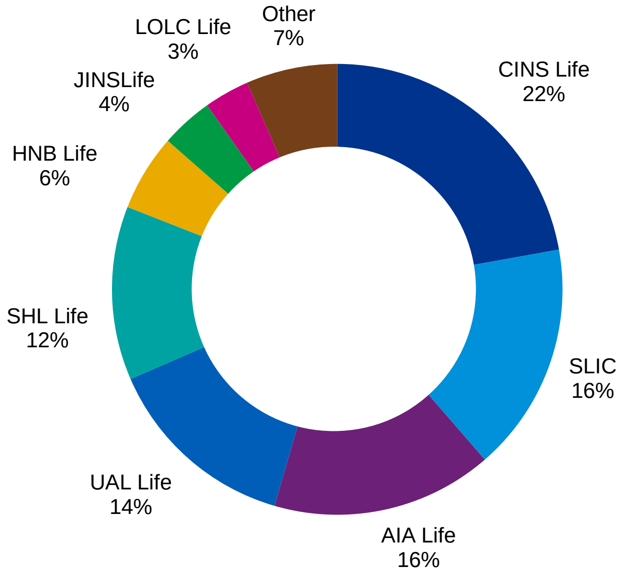
Source: CSE

GWP earned by life insurers grew by 9.71% in Q1 2019 compared to the corresponding period in 2018. SHL Life reported the highest GWP growth of 28.0% in this period.

GWP earned by general insurers grew by 7.9% in Q1 2019 compared to the corresponding period in 2018. PINS reported the highest GWP growth of 17.5% in this period.

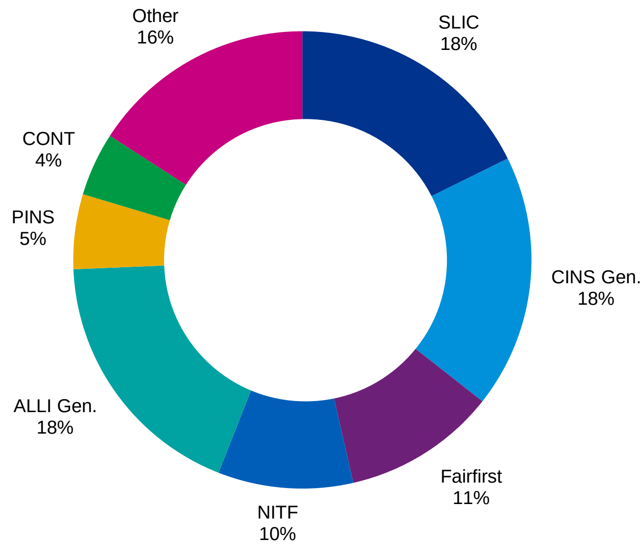
Market share by GWP

Market Share based on GWP - Life Insurance



Source: IRCSL

Market Share based on GWP - General Insurance



Source: IRCSL

The life insurance industry in Sri Lanka was dominated by few large players as at 31 December 2018. Ceylinco Life Insurance held the largest market share of 22% in terms of GWP, followed by the state owned insurer SLIC with 16.45% and AIA Life with 15.86% of the market. The aforementioned companies owned 54.49% of the market in 2018 compared to 55.60% in 2017.

Union Life and Softlogic Life earned GWP of LKR 11.2 Bn and LKR 10.0 Bn respectively. All Life Insurance providers except for Ceylinco Life, Softlogic Life, Arpico Insurance and Sanasa reported a loss in market share. A significant growth rate in market share of above 30% was showcased by Arpico Insurance and Softlogic life. LOLC Life had reduced its growth rate in market share down to 5.82% in 2018 compared to 30.09% in 2017.

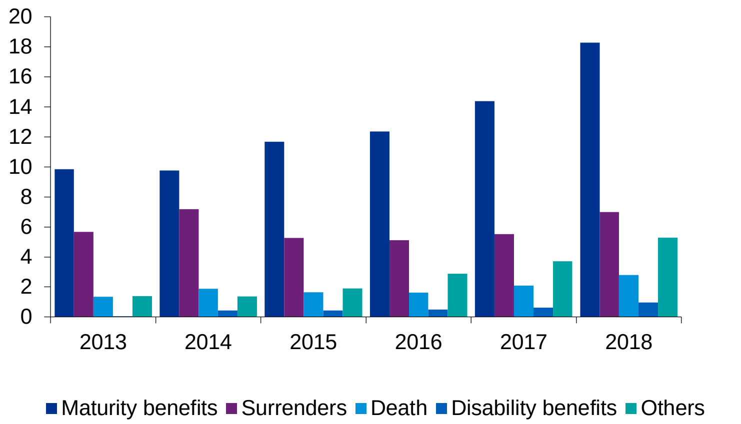
Sri Lanka general insurance industry was also highly concentrated by few large players as at 31 December 2018. Three players controlled a total of 46% of the market. The amalgamation of Allianz General and Janashakthi General enhanced the competition within the industry, having impacted the top market share holders.

The combination of Allianz General and Janashakthi General has made ALLI the market leader surpassing SLIC. Allianz General achieved 18.39% of the market meanwhile Ceylinco general maintained its second place with a market share of 17.92%. SLIC's market share reduced by 1.96% to 17.69% (2017: 19.65%). Sanasa and Cooperative General recorded a growth rate above 20% except for the growth rate that was recorded by Allianz general due to the amalgamation with Janashakthi General. The market share increased for all general insurance companies has slightly increased in 2018 except SLIC, Ceylinco General and MBSL.

ALLI surpasses SLIC becoming the market leader in General Insurance sector with the acquisition of JINS in 2018

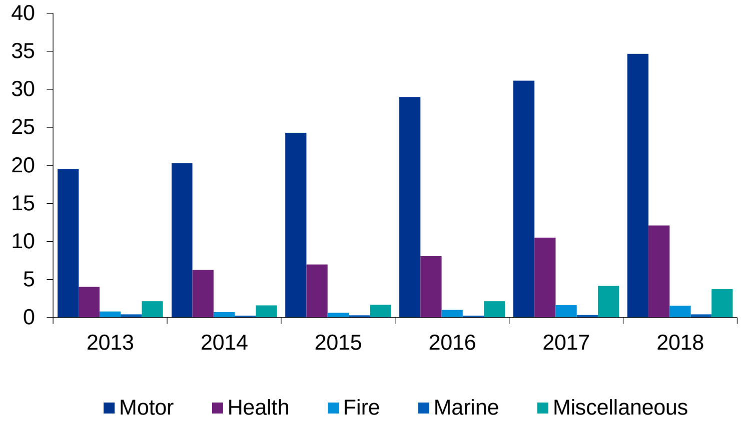
Claims incurred

Claims incurred - Life Insurance (LKR Bn)



Source: IRCSL

Claims incurred - General Insurance (LKR Bn)



Source: IRCSL

Total claims of life insurance companies grew at a 5 year CAGR of 13.4% over the period of 2013 to 2018 recording to LKR 34.3Bn.

2018 recorded the highest claims in the life insurance business over the last five years. Maturity benefits represented the majority of the claims incurred during this year. Out of the total claims, maturity benefits totaled up to 53.24%.

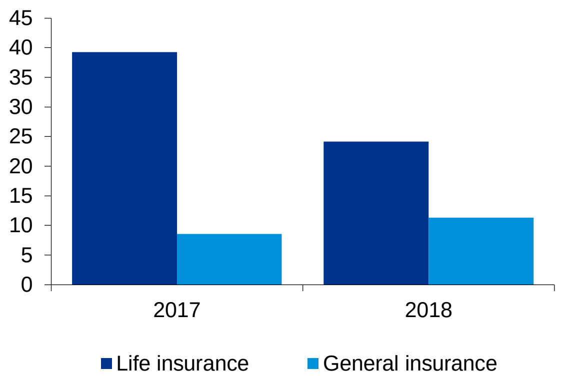
The total of maturity benefits increased in 2018 due to a few large companies settling maturity benefits. Disability and death benefits increased by 51.67% and 32.98% respectively, during the year. Surrenders were represented by a proportion of 20.37% of total claims which amounted to LKR 7.0Bn.

General insurance claims incurred over the year 2018 displayed a moderate increase which amounted to LKR 52Bn compared to LKR 47Bn in 2017. Total claims of general insurance grew at a 5 year CAGR of 14.28% over the 5 year period.

Motor insurance remained the largest sub sector incurring net claims over the year which amounted to LKR 34Bn which represented 66.05%of total claims incurred. Second highest claims were recorded in the health insurance sector with of 23.06% of total claims amounting to LKR 12Bn. High cost of health insurance business was also a challenge for all insurance companies and recorded highest net claim ratio of 95.39% in 2018 (2017: 91.92%).

Claims incurred for fire amounted to LKR 1.56Bn which shows a reduction of 4.81% compared to LKR 1.64Bn recorded in year 2017.

Profitability of insurance sector (LKR Bn)



Source: IRCSL

The insurance industry reported a 24.6% decline in profit before tax in LKR 37.0Bn compared to LKR 49.1Bn in 2017. However, excluding one off surpluses, the decline in PBT overturns to a growth of 10.29%, reporting a overall profit of LKR 36.6Bn and LKR 33.2 Bn in 2018 and 2017, respectively.

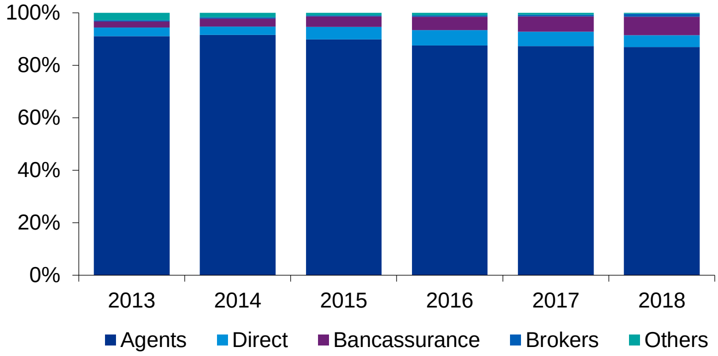
The life insurance sector reported a profit of LKR 24.1 Bn in 2018 (38.68% decline from LKR 39.3Bn in 2017) which was mainly due to aforementioned surpluses that inflated the profit in the preceding year. It is noteworthy that much of the profitability earned in 2018 was supported by Janashakthi Life which earned a significant amount of profit by disposing its' subsidiary Janashakthi General Insurance.

As for General Insurance, the PBT grew by 19.59% to LKR 11.3Bn from LKR 9.5Bn in 2017.

Distribution channels

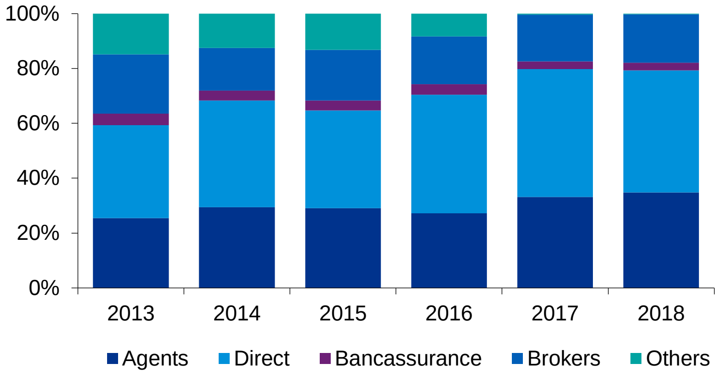
Distribution Channels of Insurance Companies

Life Insurance



Source: IRCSL

General Insurance



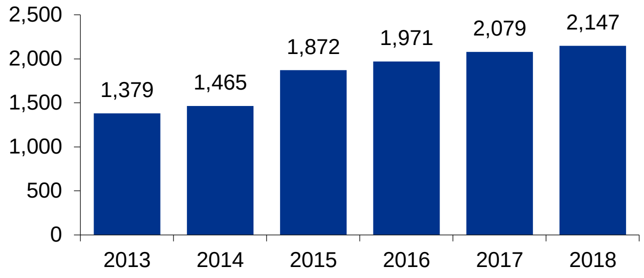
Source: IRCSL

Similar to historical trends, a higher portion of the life insurance channels remained dominated by agents, followed by a marginal increase in contribution from Bancassurance (7.14% 2018 from 5.92% in 2017). Bancassurnace is currently an underutilized channel in the industry and the positive performance in its' growth indicates the industry players' growing tendency to provide a wider array of services to customers through the extensive and expanding banking network in the country.

As for General Insurance, the contribution of the dominating - broker segment noted a marginal reduction in contribution (41.67% in 2018 from 43.72% in 2017) followed by a marginally higher contribution from Agents (34.76% in 2018 from 33.19% in 2017).

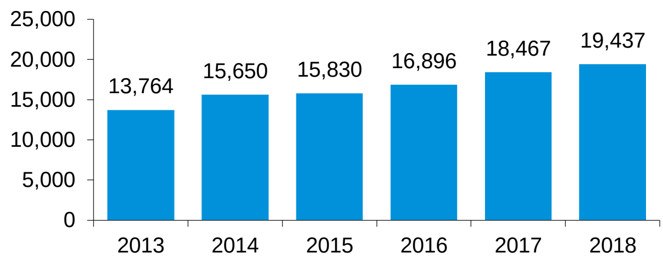
Further, the overall industry growth was widely supported with increased access to customers through expansion of company branch network. In 2018, a total of 68 new branches were added to the insurance sector with notable additions from the Central (27) and Eastern (13) provinces.

No. of Branches



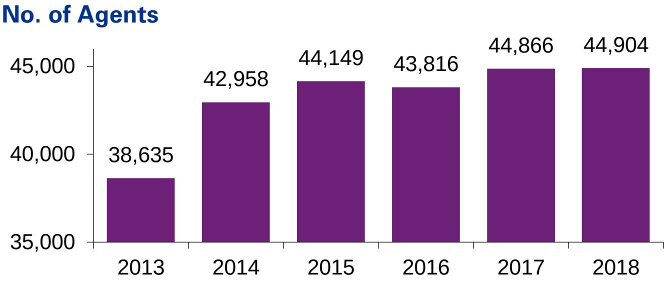
Source: IRCSL

No. of Employees



Source: IRCSL

No. of Agents

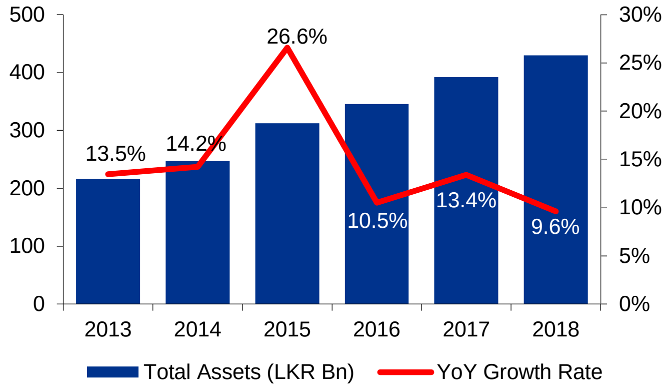


Source: IRCSL

Assets

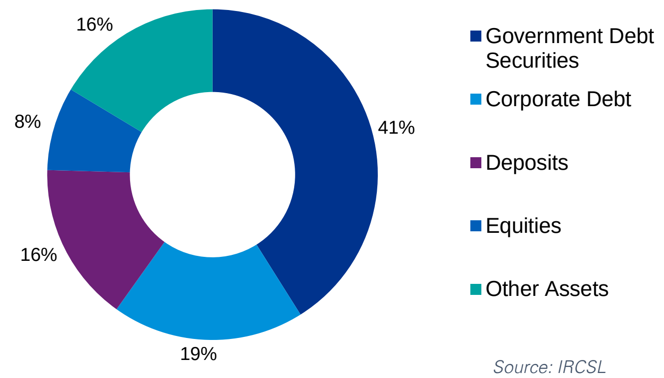
Life Insurance

Total Assets



Source: IRCSL

Concentration of Assets (4Q 2018)



Source: IRCSL

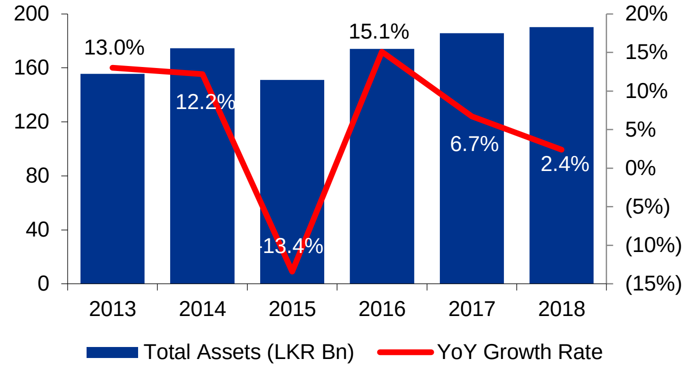
Total assets of life insurance companies grew at a 5 year CAGR of 14.72% over the period of 2013 to 2018. A slower growth in assets were noted in 2018 due to the increased vulnerabilities in the economy including political set backs and other global and local economic factors.

Similar to last year, government debt securities contributed to a higher composition of the total investment portfolio due to the regulatory requirements and the lower risk involved.

Notable increase in deposits were observed the year compared to 2017 (10%) due to rising interest rates. Similar factors have also influenced in resulting higher investments on corporate debt.

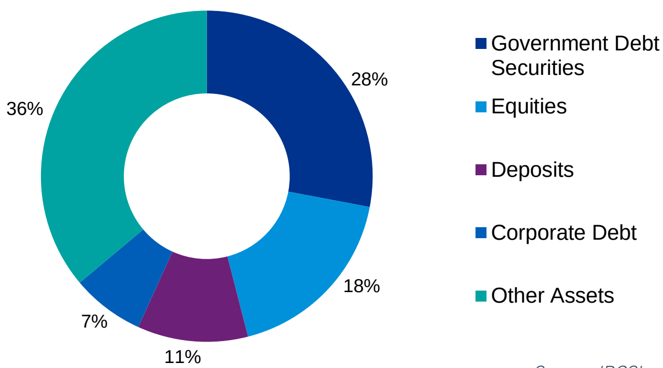
General Insurance

Total Assets



Source: IRCSL

Concentration of Assets (4Q 2018)

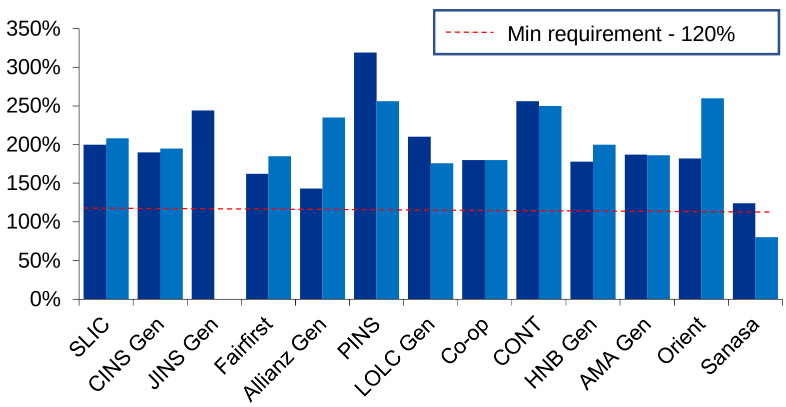


Source: IRCSL

Total assets of the general insurance sector grew at a 5 year CAGR of 4.08% over the period of 2013 to 2018. Similar to Life Insurance sector, higher composition of the asset portfolio was invested in government debt securities due to similar regulatory and risk factors. Investments in deposits were also comparatively higher than 2018 due to the prior mentioned positive rise in interest rates.

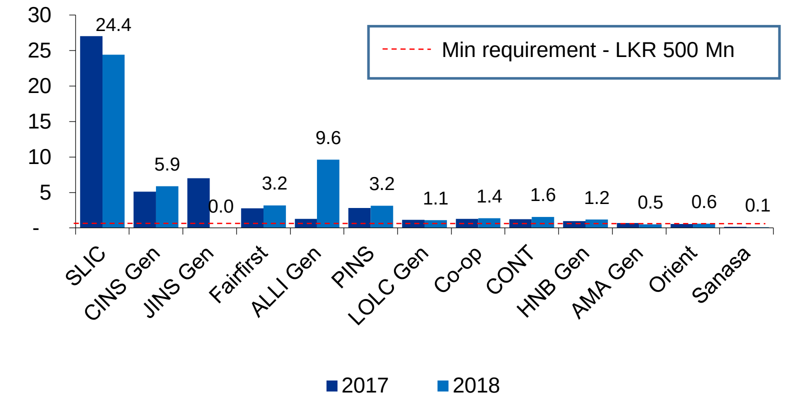
Risk Based Capital

Capital adequacy ratio



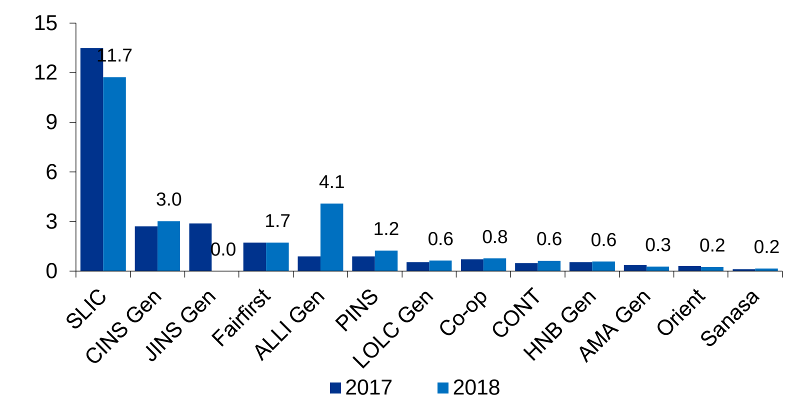
Source: IRCSL

Total available capital (LKR Bn)



Source: IRCSL

Risk based capital (LKR Bn)



Source: IRCSL

Risk Based Capital (RBC) framework was implemented in Sri Lanka with effect from 01 January 2016 onwards, which replaced the Solvency Margin Rules.

The RBC methodology measures the amount of available capital relative to the risks inherent in liabilities and the adequacy of capital to absorb unforeseen losses.

The risk based formula introduced to Sri Lanka includes credit risk, concentration risk, reinsurance risk, market risk, insurance liability risk and operational risk.

RBC imposed 2 main requirements

1. Capital Adequacy Ratio (CAR) above the 120% level
2. The Total Available Capital (TAC) of minimum of LKR 500 million

RBC requirements are expected to minimize the risk of defaulting on policy holders.

Global Perspective

01

Challenges in embedding technology for insurers

02

Security in a cyber world

How can Insurers address deeply embedded technology challenges to offer competitive advantage?

Why have insurance IT departments been unable to lead innovation across their organizations?

IT departments have become bogged down in managing ageing, costly legacy systems and an increasingly complex IT supply chain. IT departments have also become overwhelmed by high-risk regulatory demands and tactical delivery rather than strategic business support. We see six common pain points around the world grouped around the themes of service quality, cost and risk management. As a result of these pressures, IT often provides unreliable, poor day-to-day service quality, lacks transparency, and is unable to support the strategic business agenda.

Company boards and business leaders see IT as an operational cost rather than a center of value creation or innovation. By identifying the specific pain points we are able to identify solutions to help our clients move their business forward.

How can the IT function reverse this situation?

The IT department must take practical steps to create transparency and rebuild credibility with leadership by improving, measuring and reporting on service delivery and quality. This means refocusing on their core capabilities and becoming a business enabler. They must rebuild skills and expertise, reassert consistent methodologies, define and mandate standard processes and demonstrate service and financial transparency to internal clients and suppliers.

We have identified six practical tactics to address each of these pain points.

Developing an IT road map

CIO pain point	Solution
SERVICE	**Service transformation**
Unreliable, poor-quality day-to-day IT services IT unable to support strategic business agenda (the CIO might be the problem)	**Service integration — design and implement IT** to deliver more efficient and reliable IT organizations and **assist transformation**, including transition services to up-skill and embed new ways of working. **IT effectiveness — 360° 'IT health check'** (e.g. on behalf of the CIO, CFO or COO) to assess IT and IT supplier's capability to support the business.
RISK	**IT sourcing and supplier strategy transformation**
High costs to operate due to ageing/legacy IT estate Business perceives IT to be too expensive or there is a lack of IT cost transparency	**IT infrastructure transformation —** construct, plan and manage portfolio of IT cost reduction to transform IT infrastructure and create more agile, lower cost IT environment. This extends to data center facilities and the assets within them. **IT benchmarking and cost-effectiveness —** assess **IT and IT supplier costs** against industry; **design and implement IT cost model** to create transparency of IT costs and to better manage business demand.
COST	**Infrastructure transformation and IT benchmarking**
Managing IT risk in a highly regulated environment (Cloud) Demonstrating ability to manage IT supplier portfolios and IT supply chain risk in a regulated environment	**IT sourcing strategy —** assess planned or existing outsourcing arrangements for risks specific to the regulated environment in which insurers and brokers operate addressing both financial services and data privacy regulation. **IT supplier strategy —** assess supplier portfolio to create redundancy in the IT supply chain and enhance competitive tension. Design and implement processes to monitor and manage supplier risk across IT.

When implementing strategic IT change, five mistakes that are vital to avoid

01 Inadequate focus on the challenges of change

Which can lead to passive-aggressive — "I'll say I'll do it, but I won't really try" behaviors and unanticipated barriers to success.

02 Absent or unsophisticated governance

Lack of strong governance — which continues to be frequently given lip service yet often neglected in practice in many transformational programs — can result in failure to drive the right accountabilities and pace of execution. At its core, an organization's governance model defines how decisions are made and enforced, consistent with clearly defined policies and expectations.

03 Inexperienced planning and execution teams

A major IT transformation is a once-in-a-career experience for most executives. Too often, future designs end up looking quite similar to past designs, with some adaptations and updates.

04 Insufficient resourcing

The time and cost to achieve a successful IT transformation is often underestimated.

05 Inadequate risk management or monitoring

This can quickly lead to potentially irreversible and costly errors, loss of key stakeholders' confidence, and substantial business disruption.

We have summarized certain mitigating steps to overcome the 5 deadly sins of IT Transformation

1

Inadequate focus on the challenges of change

Mitigating these issues requires early assessment of readiness and issues, active and honest communication addressing specific stakeholder group concerns and needs, early human resources (HR) involvement, and assurance to key employees that their interests and needs are a priority

2

Absent or unsophisticated governance

Transformational governance must clearly articulate ownership for transformational results, and decision- making to achieve and reinforce those results. What's called for is early definition of an appropriate governance model and structure, involvement of executive leadership, and direct, active and ongoing participation of key stakeholders in what, by necessity, may be an entirely new and different governance model.

3

Inexperienced planning and execution teams

True transformation benefits from professional objectivity and experience leveraged from previous lessons learned.

4

Insufficient resourcing

Achieving success requires an honest assessment of the hard dollar costs and the people resources needed to execute, full consideration of the inherent challenges, and appropriate accommodations for contingencies.

5

Inadequate risk management or monitoring

Actions to mitigate these issues include building risk management into the process, actively monitoring risks, and agreeing on appropriate fixes and accountabilities

Source: KPMG in the US

Security in the Cyber World and Cyber Insurance

Today to save all the data created in 2018, 660 billion Blu-ray discs would be needed.

The amount of data created in 2018 (33 zettabytes) equals to;

660 Bn x the storage of a standard Blu-ray disc (50 gigabytes)

330 Mn x the capacity of the world's currently largest hard drive (100 terabytes)

375 Mn x the internet's size in 1997 (88 terabytes)

33 Mn x the storage of a human brain (1 petabyte)

132,000 x the currently fastest supercomputer's storage (250 petabytes)

73 x the capacity of one gram of DNA (455 Exabyte)

Source: Statista, 2019

The internet has accelerated innovation exponentially. Today, physical location is not a determiner of success for a business and the way we conduct business has changed exponentially. This has created million of new jobs in certain industries that did not even exist a couple of decades ago whilst making millions of jobs elsewhere. This development comes at a cost. By nature, digital systems are vulnerable to cyber-attacks by malicious groups and this sometimes has serious repercussions around the world. Although the threat grows daily many CEOs remain unaware and unarmed.

As per a KPMG and Lloyd's joint survey, the estimated global cost of cybercrime a year is USD 400 Billion, which puts cyber risks among the top issues in continuity planning and resilience. The same study compares cybercrime to narcotics in terms of economic impact globally. In this light insurance comes to the fore. In the USA it is estimated that American companies spend around USD 150 Million on cyber insurance annually and it is growing, opening up a lucrative avenue for insurers. In Sri Lanka this would be a new industry to tap into especially with the Cyber Security Act and Data Protection Act in formulation expected to be released within the year. Few multinational insurers have begun to seriously consider this as a market segment.

Lloyd's pioneered cyber insurance and has a comprehensive understanding of cyber risk mitigation.

A joint report done by Lloyd's and KPMG shortlist 4 findings which can be used as primer for setting up cyber insurance.

01 Understand the unique risk profile and share it.

02 Prepare for today's risks and tomorrow's as the risk changes quickly.

03 Company culture is a new dimension considered by underwriters. Companies that demonstrate a culture of cyber security awareness and have in place the right cyber security technologies could benefit from lower premiums.

04 Certain aspects of cyber threats may be covered under existing policies such as business interruption schemes. Therefore, it is always best to speak to have a dialogue between the insurance company and the client and understand where the gaps are in your policy.

These are factors that Sri Lankan companies should consider soon as the costs of cyber threats would continue to rise with the proliferation of the internet and the enactment of new laws would add penalties to this as well. Insurance is part of the solution but would be an important part to hedge the risks to a certain degree.

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About KPMG

KPMG Global

KPMG is one of the world's top global networks of professional services firms. We provide, audit, tax and advisory services with quality, integrity and excellence as fundamental pillars that have marked our work over our more than 140 years of history.

Global Revenue

28,960 million USD

Financial sector services	Rest of services
9,090	19,870

Revenue figures 2017/2018

153 Countries

985+ Offices

207,050 Professionals

KPMG Sri Lanka

KPMG is one of the largest professional services firms in Sri Lanka and is also the oldest Chartered Accountancy firm in the country spanning over a century since inception in 1897.

6 Offices
Including one in Maldives

Over 1,400 Professionals
Our clients value the breadth of skills and experience KPMG professionals bring to every client engagement

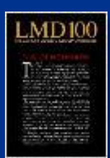
Audited 45% of Listed Entities in Sri Lanka
As indicated in the LMD Auditors League 2016.

683 Professionals in **Audit**

178 Professionals in **Tax**

272 Professionals in **Advisory**

Recognition | KPMG in Sri Lanka



First in the Auditors League in Sri Lanka

LMD 100 - 2017

Recognized for Professionalism and Integrity

LMD Most Respected 2017

Best Deal Advisory Firm in Sri Lanka

Global Banking and Finance Review 2015

Best Advisory Firm in Sri Lanka

The International Finance Magazine 2016

Sri Lanka Tax Firm of the Year

Asia Tax Awards 2017

Highlighting the significance of KPMG's impact in the marketplace, KPMG in Sri Lanka received a number of accolades including being the 'Best Deal Advisory Firm in Sri Lanka' by The Global Banking and Finance Review for its outstanding achievements in Deal Advisory, being ranked among the 'Most Respected' entities in the country for 2016 and being ranked first in the 2015/2016 Auditors League as indicated in the LMD 100. Recently the firm also won the Tax Firm of the Year at the Asia Tax Awards 2017.

KPMG service offerings

Audit

High quality, independent financial statement audits are essential to maintaining investor confidence.

Our audit professionals are committed to the public interest. They seek to challenge assumptions and unlock valuable insights based on a thorough understanding of an organization's business and industry, and innovative audit methodologies and approaches.

Understanding the financial performance of any business must be placed in the context of strategic priorities, risk appetites and competitive positioning. Our technology-enabled audit approach applies extensive data analytics to provide the necessary evidence confirming that critical controls and disclosures uphold the highest level of integrity.

- Audits of financial statements
- Audit-related services
- Audit data & analytics
- Accounting Advisory

Management Consulting

Our high capability teams offer deep industry and technical knowledge, and market-leading tools to deliver solutions across every business and industrial sector.

Our consultants assist clients to make better decisions that may reduce costs, enhance organizational effectiveness and develop appropriate technology strategies.

- People & Change
- Customer & Analytics
- Financial Management
- Operations
- Strategy & Economic Advisory
- IT Advisory
- Supply Chain

Risk Consulting

Our risk consulting practice combines the knowledge and expertise of over 50 partners, directors and professionals. We help organizations transform risk and compliance efforts into competitive advantage by applying a risk lens to corporate strategy. This improves risk intelligence and decision making, protects financial and reputational assets, and enhances business value.

- Forensic
- Business Process Management
- Accounting Advisory Services
- Internal Audit & Risk Compliance

Deal Advisory

Our experienced investment professionals skilfully assess how opportunities to buy, sell, partner, fund or fix a company can add and preserve value. Our teams combine a global mind-set and local experience with deep sector knowledge and superior analytic tools to support clients. From assisting to plan and implement strategic change to measurably increasing portfolio value, we deliver tangible results.

- Valuations
- Debt Advisory
- Transaction Solutions
- Mergers & Acquisitions
- Corporate Restructuring
- Real Estate Advisory

Tax

A business's approach to tax is increasingly subject to public scrutiny and is now a major reputation driver. From company set-up to cross-border and transfer pricing solutions, we work with a wide range of national and multi-national organizations to deliver effective tax solutions. Our tax professionals combine international experience with local knowledge to provide leading edge commercial tax strategies tailored to specific client needs.

- Inbound & indirect taxes
- International tax services
- Transfer pricing
- Tax management consulting
- Global mobility services
- Automatic exchange of information

KPMG Leadership - Insurance

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