2013 Outlook: Indonesian Insurance
Strong Industry Growth Prospects Amid Strengthening Regulatory Requirements

Outlook Report

Rating Outlook

**Stable Outlook for 2013:** Fitch Ratings maintains a stable outlook on Indonesian life and non-life insurance sectors, based largely on the view that most insurers are likely to maintain their financial fundamentals in 2013. This is supported by a developing domestic market, sustainable growth in premiums and strengthening regulatory requirements.

**Room for Growth:** Fitch expects steady premium growth in the coming year, driven by: the Indonesian population’s greater affluence; the vast, underpenetrated market; and increasing catastrophe awareness. Serving a huge population of over 230 million, Indonesia’s insurance market demonstrates vast potential, with insurance penetration at a low 1.7% of gross domestic product in 2011. The industry reported 15.5% yoy premium growth in the first half of 2012, with nominal premiums of IDR68.9tn.

**Market Consolidation:** The increase in insurance companies’ minimum capital requirement to IDR70bn by 2012 and IDR100bn by 2014 should encourage market consolidation. Fitch believes the number of market players is likely to reduce, considering the increased likelihood that smaller and weaker insurers will be forced to exit the market or merge with other companies to meet the new capital requirement. In the long term, this regulation could lead to greater risk awareness and better ability to manage capital sources among insurers.

**Challenging Operating Environment:** Indonesia’s operating environment remains constrained by limited levels of institutional transparency, public disclosure and risk management. Strengthening regulatory requirements and increasing foreign investor interest are likely to see the national insurance industry gradually developing into a more established market.

**Mergers and Acquisitions:** Fitch believes that more M&A activity may be seen in the short- to medium-term as companies struggle to meet the increased minimum capital requirement. In September 2012, it was reported that nine life insurers and 22 general insurance companies had not met the new minimum capital requirement of IDR70bn.

**Foreign Ownership:** Indonesia’s open-market policy caps foreign ownership of insurance companies at 80%. This limit is much higher than those in other developing Asian countries such as India and Thailand and therefore plays a key role in attracting foreign investors to Indonesian insurance companies.

**What Could Change the Outlook**

**Catastrophe Losses:** The Indonesian insurance industry, especially the non-life sector, might come under pressure should there be a significant, unexpected rise in insured losses from catastrophe events in Indonesia. Given the country’s exposure to natural disasters, the agency highlights the importance of Indonesian insurance companies’ continuous prudent management of their catastrophe exposure.

**Market Conditions:** An economic slowdown, while unlikely at the moment, could hold back growth in the Indonesian insurance market. Material losses in investments, potentially resulting from an escalation of the euro crisis, may also lead to the outlook being revised to negative.

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Key Issues

Premium Growth to Remain Steady

Fitch expects steady premium growth to be maintained considering Indonesia’s low level of insurance penetration. Based on Swiss Re Sigma estimates for 2011, Indonesia’s total insurance premiums amounted to a low 1.7% of its gross domestic product, compared with 8.1% for the US and 11.8% for the UK. The market shows huge potential compared with insurance penetration levels in neighbouring countries such as Singapore, Malaysia and Thailand, which are above 4% with much lower population numbers and more mature markets.

Greater Catastrophe Risk Awareness

Fitch has observed increasing catastrophe risk awareness among the general population over the years. This is driven by the rise in insurable assets brought about by greater population affluence and historical loss experiences of major catastrophes in the last decade. Less than 1.5% of the estimated USD4.5bn damage caused by the Aceh Tsunami in 2004 was insured, while about 6% of the damage caused by Bengkulu in 2004 was insured.

Considering the country’s exposure to natural disasters such as earthquakes and floods, the agency emphasises the importance of insurance companies continuously improving their catastrophe risk management. Fitch sees the new regulation, which will require general insurance companies to have actuary certification from 2013, as having the potential to strengthen reserving techniques among Indonesian insurers. The agency believes there is room for Indonesian insurers to strengthen their risk management practices further.

Developing Domestic Market to Offer Growth Opportunities

The Indonesian economy is supported by strong domestic consumption, which accounted for over half of the nation’s economic activity as of end-Q212. To stimulate economic growth, President Susilo Bambang Yudhoyono has proposed raising the infrastructure spending budget to IDR194trn (roughly USD20bn) in 2013 from this year’s target of IDR169trn. The funds will be used to improve 4,431km of roads, add 380km of railway lines, and finance the construction of 15 new airports and the expansion of another 120.

The Indonesian Ministry of Public Works has also planned to build 840km of new roads in the next year. Motor sales reached 714,152 units in the first eight months of 2012 according to Gaikindo statistics, a 23% rise on the same period last year. The industry shows little sign of slowing down despite regulation increasing the minimum down-payment for car purchases on credit to 30% in mid-June.

Fitch believes the Indonesian insurance industry has ample growth opportunities, supported by the growing domestic market and government initiatives to spur economic growth through infrastructure enhancements. Indonesia posted economic growth of 6.3% in the first half of 2012, the second-highest rate among the G20 economies.
Operating Environment Remains Under Constraint

Levels of corporate governance, market transparency and public disclosure are generally limited in Indonesia compared with developed markets. While this could hamper the development of Indonesia’s insurance sector into a more established market, strengthening regulatory requirements and increasing foreign ownership may gradually enhance transparency in the operating environment.

Figure 2

M&A Deals, 2011-2012

<table>
<thead>
<tr>
<th>Date announced</th>
<th>Acquirer</th>
<th>Target</th>
<th>Sector</th>
<th>Amount of stake (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 2011</td>
<td>Mitsui Sumitomo Insurance (Japan)</td>
<td>PT Asuransi Jiwa Sinarmas</td>
<td>Life</td>
<td>50</td>
</tr>
<tr>
<td>May 2011</td>
<td>Bank Mandiri &amp; AXA (France)</td>
<td>PT Asuransi Dharma Bangsa</td>
<td>Non-life</td>
<td>60/40 (Mandiri/AXA)</td>
</tr>
<tr>
<td>Dec 2011</td>
<td>SHC Capital Ltd. (Singapore)</td>
<td>PT Asuransi Parolamas</td>
<td>Non-life</td>
<td>55</td>
</tr>
<tr>
<td>Mar 2012</td>
<td>Tokio Marine HD (Japan)</td>
<td>PT MAA Life Assurance</td>
<td>Life</td>
<td>80</td>
</tr>
<tr>
<td>June 2012</td>
<td>ACE Limited (Bermuda)</td>
<td>PT Asuransi Jaya Proteksi</td>
<td>Non-life</td>
<td>80</td>
</tr>
<tr>
<td>June 2012</td>
<td>Zuellig Group (Hong Kong)</td>
<td>PT Asuransi Indrapura</td>
<td>Non-life</td>
<td>80</td>
</tr>
</tbody>
</table>

Source: Fitch

Evolving Operating Landscape Through M&A Activity

The frequency of mergers and acquisitions (M&As) is set to increase – albeit not significantly as Indonesian insurance companies do not typically have an M&A culture. The increase is likely to be driven by the increased capital requirement, which may force insurers having problems raising capital internally to seek capital from external sources, such as M&As. As of September 2012, it was reported that nine life and 22 general insurance companies had not met the new minimum capital requirement of IDR70bn.

Fitch believes that the shift could be positive for the industry in the long run through the consolidation of market players. M&As could solidify insurance companies’ capital, providing a higher buffer for claim settlements while developing greater risk awareness and better ability to manage capital sources among insurers.

Increasing Foreign Ownership

Compared with life insurance companies, foreign ownership among Indonesia’s non-life insurance companies is much lower due to the highly competitive nature of the market. Indonesia’s free market policies cap foreign ownership of insurers at 80%, a much higher level than in other countries in the region, such as India and Thailand (26% and 49% limits, respectively), which plays a key role in attracting foreign investors to the industry.

Many foreign investors also see potential in Indonesian insurance companies, based on the market’s underpenetration and slowing growth in maturing markets such as the Americas, Japan and Korea.

Vast Untapped Takaful Market

As a country with the largest Muslim population in the world, Indonesia has a vast untapped takaful or sharia market. In 2011, gross premiums of total sharia insurance were reported to be less than 5% of total insurance market premiums. Despite the low market share, Indonesia is one of the world’s fastest-growing sharia markets. Based on preliminary industry estimates, gross premiums in the sharia insurance industry were reported to have grown almost tenfold from IDR498.9bn in 2006 to IDR4.97tn in 2011.

Fitch believes the national takaful sector will benefit from further growth due to the vast untapped market. In addition, the increase in minimum downpayments in conventional credit financing businesses to 30% for both new and used cars may spur growth in sharia-based general insurance companies as consumers shift to sharia-based credit financing options. Minimum downpayments for Islamic car financing remain 20% for new cars and 15% for used
cars, although they may eventually be brought into line with the conventional minimums. Growth in the takaful sector is likely to be moderated by Indonesia’s limited regulatory environment compared with that of a more established market such as Malaysia.

**Concurrent Regulatory Developments**

**New Independent Supervisory Role**

The Indonesian parliament passed the Financial Services Authority or Otoritas Jasa Keuangan (OJK) Law in November 2011, establishing a new independent government agency known as OJK. The agency will take over the authority and obligation to supervise activities in the financial sector, including insurance, which was previously regulated by The Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK), the Ministry of Finance, and Indonesia Deposit Insurance (LPS).

OJK’s main objectives are to ensure a transparent financial services sector, create a sustainable and stable economy, and protect consumer and public interests. It was in the development stage as of the third quarter of 2012.

**IFRS Adoption and Alignment**

The IFRS convergence 2012 programme was launched by The Indonesian Institute of Accountants at the end of 2008 to eliminate the significant gap between Indonesian GAAP and IFRS accounts. Financial statements prepared under PSAK (local GAAP) for the year beginning 1 January 2012 are expected to be substantially similar to IFRS financial statements.

This convergence is expected to reduce the premium income of the life insurance industry in 2012 as transactions are separated into pure protection premiums and investment-linked premiums. The decline in premium income will affect the financial statements, not necessarily the value of premium income received by companies. Companies that rely more on sales of unit-linked products tend to be most affected by the decline. Meanwhile, no major implications for non-life insurers are foreseeable from this adoption.

**Increased Paid-Up Capital Requirement**

The Ministry of Finance has issued regulation requiring insurance companies to have minimum paid-up capital of IDR70bn by 2012 and IDR100bn by 2014. Insurers with sharia business will need additional capital of IDR25bn. This regulation may lead to a reduction in the number of market players in the coming years due to the increased likelihood that smaller and weaker insurers will be forced to exit the business or merge with other companies to meet the new capital requirement.

The number of general insurance companies dropped from 97 to 82 between 2006 and 2011. There were 45 licensed life insurers and four reinsurers in Indonesia as of end-September 2012. Fitch believes that this regulation could benefit the industry in the long run by developing greater risk awareness and better ability to manage capital sources, while creating a higher buffer for claims settlements among insurers.

**2011-2012 Review**

Gross premiums from the life and non-life insurance sectors have continued to grow steadily. Based on the latest available statistics from Bapepam-LK, Indonesia’s insurance industry recorded solid 15.5% yoy premium growth in the first half of 2012, with nominal premiums at IDR68.9trn. Most of the premiums came from life insurance, with premiums rising 16.4% yoy to IDR47.97trn, while general insurance premiums rose by 13.6% yoy to IDR20.93trn.

Total claims increased by 18.2% to IDR39.88trn. Additionally, the average density or public insurance spending level rose to IDR564,130 per individual from IDR517,830 a year earlier.
The Indonesian life sector has been dominated by unit-linked products. According to the latest statistics from the Indonesian Life Insurance Association, unit-linked products continued to dominate regular premiums in Q212, growing by 37.7% to IDR9.5trn from IDR6.9trn in Q211. Meanwhile, new business premiums were led by traditional products whose premiums rose by 48.6% yoy in Q212 to IDR18.7trn, while premiums for unit-linked products declined by 6.5% to IDR16.2trn over the same period.

The life sector’s concentration on single-premium, unit-linked products may pose a challenge in terms of business sustainability should competition intensify or liquidity dry up. The industry may benefit from a shift toward more regular-premium, traditional life insurance products, which are less volatile in nature and contribute to higher premium sustainability. Nonetheless, the agency believes that unit-linked products will retain their prominence in the short to medium term as the public has generally been geared toward savings-type products. The portfolio may be more balanced in time to accommodate the public’s increasing insurance awareness and protection needs.

In terms of distribution channels, bancassurance is playing a growing role, which contributed to IDR20.1trn, or around 40.6% of life premiums at end-H112. This was the first time bancassurance has surpassed the agency channel as the dominating distribution line. (The latter contributed to IDR19.5trn or around 39.2% of premiums, based on AAJI statistics). Fitch expects bancassurance to continue to grow and the agency channel to remain another key means of distribution, given the growing number of licenced agents in Indonesia.

Motor vehicles premiums have dominated the Indonesian non-life sector for more than five years, with its market share rising to 30.1% at end-H112 from 29% a year earlier. At the same date, property insurance contributions increased by 3.5% yoy to IDR5.1trn, garnering a market share of about 27.4% according to the latest available statistics from AAUI. Strong motor vehicles sales in Indonesia led to a dominance of motor vehicle premiums. Total gross claims for the first half of 2012 grew by 18.1% to IDR7.28trn from the same period last year.
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### Table: Fitch’s Ratings for Indonesian Insurers

<table>
<thead>
<tr>
<th>Name</th>
<th>Insurer Financial Strength Rating</th>
<th>Rating Outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>PT Asuransi Adira Dinamika</td>
<td>AA(idn)</td>
<td>Stable</td>
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<td>PT Asuransi Jiwa Sinarmas MSIG</td>
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<td>PT Tugu Reasuransi Indonesia</td>
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Source: Fitch