Indonesia's Reinsurance Growth is Constrained by Limited Capitalization

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PEFINDO views the Indonesian reinsurance sector as having great growth potential, supported by steady premium production increases of 20% to 25% annually for the last five years. The number of local reinsurance companies is relatively small, resulting in a moderate competition level. However, PEFINDO views that the growth of Indonesian reinsurance companies is still constrained by their limited capital capacity to absorb business growth. This has resulted in a low percentage of reinsurance premiums absorbed by local reinsurers, at around 20%, while overseas reinsurers capture the rest.

Potential to grow, but challenged by small capitalization

As there are only four reinsurers in Indonesia, we view the competition level as relatively moderate compared to the insurance industry as a whole. Each reinsurer has its own aims and target market. PT Reasuransi Nasional Indonesia (RENI, rated $_{id}$A/stable) and PT Tugu Reasuransi Indonesia (TURE) focus on the non-life segment, with a captive market of their parents' business in the general insurance segment. PT Maskapai International Indonesia Tbk (MREI, rated $_{id}$A/stable) has a strong life insurance presence, mainly due to affiliations with the largest local life insurance company, Asuransi Jiwa Bumiputera 1912. PT Reasuransi Internasional Indonesia (REII, rated $_{id}$A+/stable), as the largest reinsurer, focuses on both segments.

At end 2013, the reinsurance industry's gross written premiums (GWP) represented a small market share of the total insurance industry (including life, non-life, civil and armed forces, and social insurance) at 7%. Given this, we view there is a good opportunity to increase reinsurance penetration going forward. In addition, reinsurance companies have a slight advantage courtesy of the regulator (Otoritas Jasa Keuangan or OJK) that requires insurance companies to place their reinsurance for the life and general segments (health, vehicle, personal accident, credit insurance, and suretyship) with local reinsurers. We also view that the premium tariff adjustment in some insurance segments will have a positive impact on the reinsurance industry's performance as insurance industry underwriting results mirror those of their direct counterparts. We expect reinsurance companies to manage the growth momentum in the medium term, given the regulations that favor the industry.

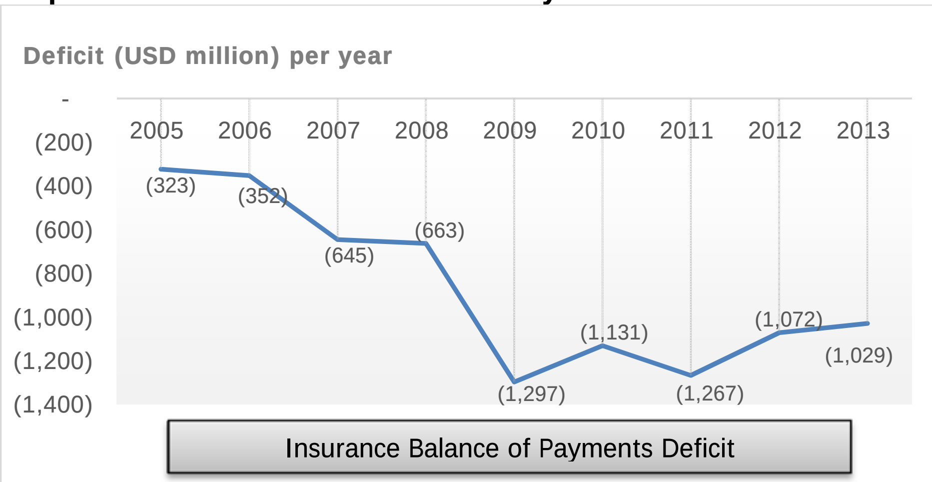
Although reinsurance offers strong potential to grow further, the reinsurers' capacity to tap those opportunities is constrained by equity size of. In our view, the total equity of IDR1.6 trillion at end of December 2013 is not adequate to absorb higher risk businesses, rather than pledge to larger reinsurers overseas. The difference in capacity is clearly illustrated by the low portion of premiums retained by local reinsurance companies. On average, the retention rate of local premiums is 40% for life and 20% for non-life or general insurance. Undercapitalization is an issue among Indonesian insurance players, where lack of capital capacity has resulted in the majority of GWP flowing overseas, triggering a balance of payment deficit in Indonesia's premium payments.

Merger plan of state-owned reinsurers

From Graph 1, we can see that the balance of payments deficit in the insurance sector almost doubled from USD645 million in 2007 to USD1,029 million in 2013. The reinsurance transaction deficit contributed around IDR9 trillion in 2013. Without any action from reinsurance companies to increase their capacity, the transaction deficit will continue to rise.

We view the government has a strong intent to reduce the insurance balance of payments deficit and increase the local retention rate. The most recent initiative was to merge government-related reinsurance companies (REII, RENI, and TURE) and establish a giant local reinsurance company. However, we believe the merger process should be accompanied by an additional capital injection from shareholders to increase the reinsurer's capacity to capture high sum business, and this additional capital requirement is a major issue given the government's limited budget. We also see the capital strengthening of the reinsurance industry as very important in the face of the ASEAN Economic Community at end 2015.

Graph 1: Insurance Sector Balance of Payments



Source: Bank Indonesia

Outlook for reinsurance industry to remain stable

PEFINDO views the outlook of the reinsurance industry will remain stable in the medium term. In our opinion, the industry has above average performance supported by stable premium growth, in line with overall insurance industry growth. It has the large potential for demand growth as reflected by a low insurance penetration rate.

Furthermore, we expect that reinsurers' performance in the general insurance segment will gradually improve following the implementation of the OJK regulation regarding premium tariff adjustments for vehicles and property. In terms of capital, all reinsurers have already met the minimum capital requirement of IDR200 billion. However, some face tight risk-based capital (RBC) profiles (RENI and TURE) that could constrain their business growth in the near term.

Table 2: Selected Key Financial Indicators of Indonesian Reinsurance Companies

		Business	Capital Ratios		Operating Ratios		Liquidity Ratio
Companies	**Rating/ Outlook**	**GWP (IDR billion)**	**Equity (IDR billion)**	**RBC**	**Combined Ratio**	**ROAA**	**Liquid Assets/Total Liabilities**
REII	A+/Stable	1,591.9	501.9	160.4%	94.1%	5.8%	108.6%
RENI	A/Stable	1,296.5	386.4	128.0%	87.2%	5.1%	95.3%
MREI	A/Stable	807.8	408.0	171.5%	87.5%	11.8%	147.2%
TURE	Not rated	1,049.6	255.6	126.7%	84.9%	5.1%	110.4%

Source: PEFINDO database and published financial statements (As of December 31, 2013)
GWP (gross written premiums); RBC (risk-based capital); ROAA (return on average assets)