

Near-Term Growth to Moderate; Long-Term Fundamentals Intact

Sri Lanka's insurance industry expansion is likely to moderate in the near term, based on Fitch Ratings' expectations of slower motor-insurance premium growth due to sustained tax rises on imported vehicles, intense price competition in the non-life market and a slower recovery in economic activity. However, long-term momentum should be helped by Sri Lanka's low insurance penetration, rising awareness of insurance and a gradual increase in the contribution from non-motor lines, such as property, health and micro insurance.

Industry premiums rose by 13% in 2018, moderating from 15% in 2017, due to the slower growth of motor premiums, delays in renewing the state-sponsored health insurance policy for school children and subdued consumer affordability affecting life-insurance growth.

What to Watch

Profitability Pressure: Fitch expects Sri Lanka's weakened currency and the higher tax liabilities of life insurers to cut insurers' net profit in the near term. The rupee depreciated by around 19% against the US dollar in 2018, which increased the claims paid by non-life insurers, particularly in relation to the higher cost of imported automotive components. In addition, life insurance surpluses were taxed at an effective rate of 28% from April 2018; most life insurers paid lower taxes under the previous tax regime due to a lower tax base.

Catastrophe Risk: We expect the increased frequency of weather-related events to remain the main source of long-term risk to non-life insurers' capital. However, most non-life insurers continue to moderate volatility in their profitability by using reinsurance protection and maintaining risk-based capitalisation ratios above the 120% regulatory minimum.

Softer Investment Yields: The Central Bank of Sri Lanka imposed an interest-rate cap on bank deposits in April 2019. This was followed by a 50bp cut in policy rates in May 2019 to stimulate economic growth. We expect this to somewhat increase insurers' reinvestment risk, especially for non-life insurers with short portfolio duration.

Continued M&A Activity: We regard Sri Lanka's non-life market as crowded and ripe for consolidation due to intense price competition, which has kept the industry's combined ratio high at around 100% in recent years. There have been four M&As since 2014.

Ratings Impact: Neutral

Fitch expects the credit profiles of rated insurers to remain stable in the near term, supported by sustained capitalisation and financial performance.

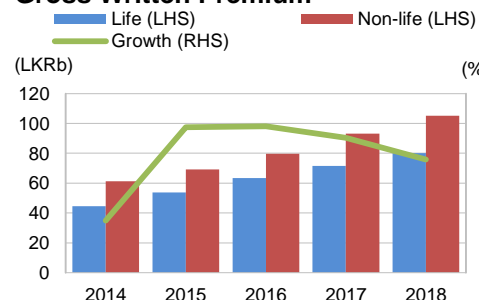


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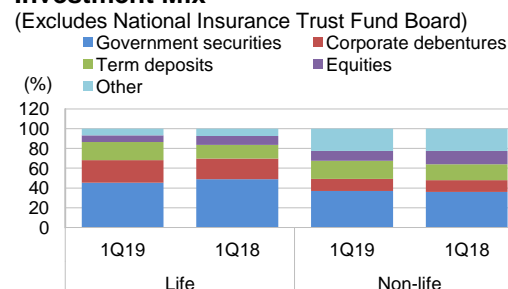
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Gross Written Premium



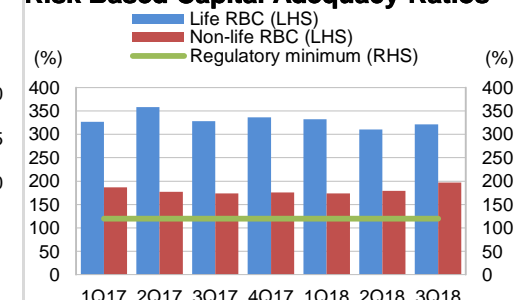
Source: Fitch Ratings, Insurance Regulatory Commission Sri Lanka, Insurance Association of Sri Lanka

Investment Mix



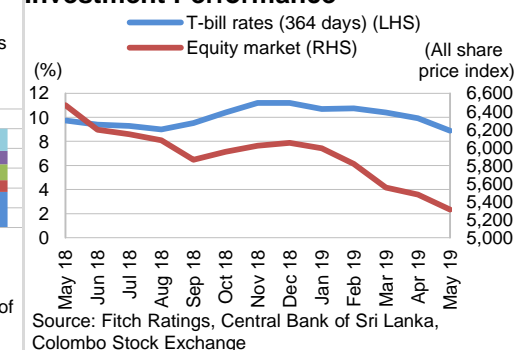
Source: Fitch Ratings, Insurance Regulatory Commission of Sri Lanka

Risk Based Capital Adequacy Ratios



Source: Fitch Ratings, Insurance Regulatory Commission of Sri Lanka

Investment Performance



Source: Fitch Ratings, Central Bank of Sri Lanka, Colombo Stock Exchange

Recent Regulatory Developments

| Regulatory area | Effective Date | Implications for Insurers |
|----------------------|------------------|---|
| Corporate governance | 1 July 2019 | Guidelines on corporate governance practices, including recommended adherence to the Code of Best Practice on Corporate Governance (2017), issued by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka. |
| Taxation | 1 April 2018 | Life insurers liable to pay an effective tax of 28% on life surpluses. |
| One-off surplus | 20 March 2018 | Guidelines for life insurers on the identification, transfer, maintenance and distribution of surplus created from a 2016 change in solvency regime. |
| Life fund management | 16 February 2018 | Guidelines on appropriate attribution of life insurance funds, assets, liabilities and expenses. |

Source: Fitch Ratings, Insurance Regulatory Commission of Sri Lanka, Inland Revenue Department of Sri Lanka

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