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Appraising the Performance of Indian Reinsurer

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Abstract

Indian insurance sector encompasses about 54 primary insurers and a single specialist public reinsurance company i.e., GIC Re. GIC Re has a very prominent status in the Indian insurance market. As a reinsurance company it insures insurance companies. Reinsurance is one of the most important tools in the hands of insurers to transfer the risk that is beyond their financial boundaries. General insurers in India are obliged to cede 5 percent of their business to GIC Re. With the historical changes undergoing in the Indian reinsurance market coupled with the undying importance of reinsurance for the insurance sector and the economy as a whole, the need is felt to appraise the performance of GIC Re-The Indian Reinsurer. For this, various ratios selected meticulously from the well accepted CARAMELS model have been employed on the secondary data obtained from the annual reports of GIC Re from 2006-07 to 2015-16. It was discovered that the company has performed quite well in the past, however improvement in its combined ratio and liquidity would be appreciated.

Keywords: CARAMELS Model, GIC Re, Reinsurance

1. Introduction

Insurance sector is of paramount importance for the growth and development of the economy of any country and India is no exception to it. Insurance companies create conducive investment environment by providing the backup to the various developmental activities and entrepreneurial ventures taking place in the country. These companies boost such activities by pledging to undertake the risk involved in them.

Insurance companies transfer the risk that they cannot handle to the reinsurance companies. So, failure of reinsurance companies could be fatal for the insurance companies[10]. And in case the insurance sector collapses, it would be disastrous for the economic growth of the country. Reinsurers are important. It has been seen that the insurers of the countries with weak domestic reinsurance arrangements depend more on the foreign reinsurers. This leads to the drain of foreign exchange from the country and reduces the contribution of the insurance industry to the economy of the home country[14].

Basically, reinsurers are believed to manage the risks better as they follow updated risk monitoring and risk modeling techniques. With a broad underwriting experience they effectively undertake even complicated risks. They are presumed to be professional, technically expert and competent financially. IRDA i.e., Insurance Regulatory and Development Authority of India stipulates that every insurance company in India must have an appropriate reinsurance programme in order to keep its solvency intact.

There are 30 general insurance companies and 24 life insurance companies in India. India has been served by a single domestic reinsurance company in the past i.e. GIC Re. This company has a kingly and unique standing in the Indian insurance domain. Till the end of 2016, GIC Re was the only reinsurance company of India. At present, this is the only specialist public reinsurance company in India. The company reinsures the insurance companies. What a primary insurance company is doing for the general public is exactly what GIC Re does for the primary insurers. General Insurers in India are obliged to cede 5 percent of their business to GIC Re.

The unparalleled standing of GIC Re in the Indian insurance sector induces us to evaluate the performance of the company.

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Indian reinsurance sector has undergone historical changes in the recent past. Insurance Laws (Amendment) Bill, 2015, has been approved by Indian Government as a result of which international reinsurance companies are allowed to open their full-fledged branches in India. Earlier they were operating through their representative houses only. Branches of international reinsurance companies namely Swiss Re, SCOR SE, Hannover Re, RGA Life Reinsurance Company of Canada and Munich Re have got registered in India w.e.f. 21.12.2016. Also the first private reinsurance company of India that is ITI Reinsurance limited has come into existence w.e.f. 30.12.2016.

So considering the present scenario an attempt is made to evaluate the performance of GIC Re- the only domestic public reinsurer. This holds importance as the company holds a distinguished reputation not only in the domestic market but also in the overseas market. Also, now GIC Re has to face the competition given by the newly opened branches of the mighty foreign reinsurers in India.

This study would help us to comprehend the performance of GIC Re and come up with better strategic solutions.

2. Literature Review

This section involves the review related with the study.

Naik[8], Gajek & Zagrodny[5], Vedenov et al.,[12], Cummins et al.,[3] held that reinsurance holds special importance for insurers. It brings several advantages for not only the primary insurers but for the economy as a whole.

Bhattacharya & Gandhi[2] and Nema & Jain[9] evaluated Indian reinsurance business with special emphasis on the performance evaluation of GIC Re from 2003 to 2008 and 2005-2010 respectively. Key variables were scrutinized to evaluate the performance of GIC Re which was found to be quite satisfactory.

Studies namely Simpson & Damaoh[13], Darzi[4], Ghimire[6], Ansari and Fola[1], Kumari and Dorthy[7], Sinha[11] etc. where CARAMELS MODEL was employed were taken as the base to select the ratios under Earning and Profitability. This model is recommended in the Handbook of Financial Sector Assessment by World Bank and IMF to evaluate the financial performance of the insurance and reinsurance companies.

3. Need and Objectives of the Study

With GIC Re holding approximately 65 per cent of the market share of reinsurance in India, it would not be an exaggeration to say that the company possesses kingly status in the Indian insurance sector.

The ever rising importance of reinsurance for the insurance sector and the distinguished status of GIC Re in the Indian market has encouraged us to conduct a study on the performance evaluation of the only specialist public reinsurer of India i.e., GIC Re.

Indian reinsurance industry is undergoing key changes. With foreign reinsurers permitted to operate via their branches in India, and increase in the limit of FDI in insurance to 49 percent from 26 percent post the Insurance Amendment Bill 2015, we need to be assured about the performance of our own reinsurer. With satisfactory performance the company can well handle the competition by new reinsurers entering in the Indian market. However adequate strategies are required to be framed in case any undesirable scenario is discovered.

4. Objective of the Study

To evaluate the performance of GIC-Re from 2006-07 to 2015-16.

5. A Brief Description of the Ratios Used

The present study involves the evaluation of performance of GIC Re. For this, the required data have been collected from the Annual Reports of the company for a period of ten years i.e., from 2006-07 to 2015-16.

Ratio analysis has been done to assess the performance of GIC Re. Following ratios have been evaluated.

- Loss Ratio,
- Expense Ratio,
- Combined Ratio,
- Investment Income / Net Premiums,
- Return on Equity,
- Investment Income / Investment Assets.
- Solvency Ratio

- Liquidity Ratio
- Risk Retention Ratio

5.1 Loss Ratio

This ratio indicates the claims paid out of the premiums held by the company. Loss Ratio or Claims Ratio is calculated as Net Claims/Net Premium. It hints the appropriateness of pricing policy. The lower is the ratio, the better it is.

The ratio exceeding 100 percent shows that the claims paid are exceeding the premiums held and such situation is not desirable. It signals the inefficient underwriting by the company and the need for the company to maintain better resources.

5.2 Expense Ratio

This ratio is calculated as the sum of Operating Expenses and Net Commission paid by the Company/Net Premium. This ratio tells us what part of the net premium is used by the reinsurance company in acquiring, writing and serving the business acquired from the insurance companies. In other words it is calculated to check whether the operating expenses of the company are reasonable or not.

As per Insurance Regulation 1993, Insurers (or reinsurers) should not let their management expenses exceed 30 percent of their net premium.

5.3 Investment Income/Net Premium

Income through investment though constitutes relatively a small portion of the reinsurers' portfolio but is an important source of earning for them. This ratio unveils the extent of income a company makes from investments. It shows that the company is earning not only through the business it does but also from the investments it makes. There is no particular benchmark for this ratio but effort should be made to earn reasonably well from the investments.

5.4 Combined Ratio or Operating Ratio

This ratio is calculated as the sum of Operating Expenses + Net Commission Paid + Claims Incurred/Premiums Earned. It is often referred as a sum of Loss Ratio and Expense Ratio. It is often considered as the best indicator of the underwriting performance of an insurer. It does not take into consideration the investment performance. A ratio of more than 100 percent indicates that the company is paying more than what it is earning through premiums. Regular combined ratios over 100 percent are a danger to the capital levels of the company.

5.5 Investment Income/Investment Assets

This is another ratio calculated to ascertain what percentage of income is earned from the assets invested by the company . The investment assets here comprises the sum of investments, loans and deposits. The more is the ratio the better icome is the company generating out of the assets invested by it.

5.6 Return on Equity (ROE)

This ratio is calculated by dividing Net Profit (After Tax) with Net Worth. This ratio reflects the overall position of profitability. It indicates how well the funds of shareholders are utilized by the company. As per Standard and Poor, most reinsurers should target 13 percent to 15 percent return on equity. Higher ratio would be considered better as it signals the fair capacity of the company to make money through the investments it is making, and hence it can deliver better dividends to the shareholders and retain them.

5.7 Solvency Ratio

This ratio is an indicator of the capacity of the company to pay its long term debts and hence very crucial for investors. It is calculated as a ratio of available solvency margin to the required solvency margin. Solvency margin is the excess of total assets of a company to its total liabilities. IRDA stipulates Indian reinsurer to have the minimum solvency ratio of 1.5.

5.8 Liquidity Ratio

This ratio gives us the idea how prepared is the company to pay its short term liabilities. It shows how readily the assets of the company can be converted into cash. It is calculated using current/assets/current liabilities. As a rule of thumb this ratio is expected to be 200 percent. Liquidity management is not a fundamental issue with the reinsurers. But still inadequate liquidity position of reinsurers can shake the confidence of its policyholders and may compel it to infuse more capital to serve the needs of its claimants.

5.9 Risk Retention Ratio

This ratio denotes the risk that is retained by the company and hence shows its risk bearing capacity. Or in other words it is the amount of loss that the company can willingly afford to pay. It is calculated as the ratio of Net Premium/Gross Premium. Higher ratio indicates better risk retention capacity of the company. It shows that the company relies on its own capacity and is less reliable on outsiders.

6. Findings and Discussions

This section shows the analysis of the different ratios calculated.

Table 1 shows the values of the different ratios calculated for GIC Re from 2006-07 to 2015-16.

Loss Ratio: As observed from Table 1, fluctuating loss ratio has been observed for the period of the study. Ratio has been above 60 percent throughout. It has been higher in the years where huge claims have been paid. The highest loss ratio has been paid in 2015 being 88.44 percent. Although the picture is not that gloomy, still efforts should be made to keep this ratio as low as possible.

Expense Ratio: Clearly from Table 1 we can see that only a small percentage of the premium has been used for expenses in each year ranging between 17.28 to 26.76 which is worth complementing. Ratio has not exceeded the benchmark of 30percent in any of the years which is an acceptable condition.

Combined ratio: Table 1 shows that more than 100 percent ratio is seen throughout the decade which shows that the company is undergoing underwriting losses. The claims incurred and the expenses made are exceedingly high in comparison to the earned premiums. This scenario suggests that GIC Re must be cautious while selecting and pricing the risks in order to avoid such situation.

Investment Income/Net Premium: As per Table 1 a ratio ranging between 17.32 to 30.18 is observed for GIC Re which shows that the company has been able to maintain a satisfactory ratio over the years. It indicates that the investment portfolio is well managed and the investments made by the reinsurance company have been giving satisfactory returns.

Investment Income/Investment Assets: From Table 1 we can observe that the ratio has been about 10 to 11 percent throughout the period of study . It is found to be satisfactory for GIC Re.However more increase in the ratio would be welcomed as well.

Return on Equity: Table 1 shows that return on equity has been above the standard of 13 to 15 percent as prescribed by Standard & Poor in all the years except the year ending 2012 where it declined to an unacceptable level of - 32.1 percent. This shows that the company is giving adequate returns to its shareholders. However years like 2012 which are hit by major catastrophes can affect the profitability of the company.

Solvency Ratio: As per the ratio depicted by Table 1, it is unwrapped that the company has a reliable status in terms of settling the long term claims of the investors. Throughout the ten years the ratio has surpassed the benchmark of 1.5 which avows the brilliant credibility of the company.

Liquidity Ratio: As a rule of thumb, 200 percent ratio is desirable current ratio i.e., the condition attained if current assets are twice the current liabilities of the company. We can observe from Table 1 that the ratio has not been satisfactory. But we should not be scared as GIC Re is a going concern and hence the very situation of winding up which requires the realization of the current assets to

Table 1. Values of the different ratios calculated for GIC Re from 2006-07 to 2015-16 (in percentage)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Loss Ratio	62.20	68.28	70.82	69.47	63.83	64.89	65.98	81.39	88.44	70.27
Expense Ratio	26.76	25.48	24.48	22.81	19.05	17.28	21.91	19.88	21.24	22.42
Combined Ratio	101.5	112.8	102.9	109.7	111.4	142.8	104.8	108.3	109.4	109.2
Investment Income / Net Premium	28.88	24.44	24.17	23.25	22.25	17.32	20.96	25.16	30.18	25.5
Investment Income/ Investment Assets	12.92	12.78	10.69	11.67	11.83	9.81	11.05	11.59	13.62	12.26
Return on Equity	25.83	14.84	18.11	19.43	10.41	-32.1	24.28	20.54	20.71	19.21
Solvency Ratio	4.1	3.36	3.67	3.71	3.35	1.59	2.39	2.73	3.04	3.48
Liquidity Ratio	54.58	66.07	72.22	76.87	83.35	76.04	80.27	78.51	80.3	82.48
Risk Retention Ratio	86.72	89.22	91.83	90.14	89.99	92.21	91.29	90.00	91.27	88.82

(Source: Annual Reports of GIC Re from 2006-07 to 2015-16) meet the current liabilities is not foreseen. However effort must be made to improve this ratio.

Risk Retention Ratio: From Table 1 we can clearly observe smashing ratios in all the years which speak volumes about the superb risk bearing capacity of GIC Re. Adequate Assets, Capital and Free Reserves of the company have helped it to retain more and more business. This clearly shows that GIC Re has been retaining maximum risks itself. Hence it has successfully saved its transaction costs and kept its premium income with itself only rather than sharing it with retro cessionaries.

7. Conclusion and Suggestions

With almost 15 years of experiences as the sole reinsurer with reverential goodwill, skilled manpower and cordial relations with valuable clients in India and abroad, GIC Re has brighter prospects for future as well. At present GIC Re is among the top 20 global reinsurers. It is rated as a reinsurer of prestige by topmost rating agencies like A. M. Best, Standard and Poor's, and CARE.

Broadly we can see that the company has performed well in the past years. Loss ratio has been under control but efforts can be made to reduce it. Combined ratio has not been according to the standards laid down. Every year it has failed to pass the test of acceptable ratio i.e. below 100 percent. However with a satisfactory expenses ratio we can say that expenses of GIC Re have been under complete control. Income generated through investments has been satisfactory but improvement in them will be welcomed. As per the ratio of return on equity, it could be concluded that the funds of the shareholders have been used wisely to give a satisfactory return on equity in all the years. Solvency and Retention of the company have been up to the mark; however liquidity needs to be honed.

Even though the company is making handsome profits but its unsatisfactory combined ratios show that it is suffering from underwriting losses. Seeing this, it is suggested that the pricing of the risks, especially catastrophic must be taken seriously. Careful selection of markets for business is also a prerequisite for the company to perform better. This would also improve claims ratio for the company.

Training and Education of the reinsurance staff must be seriously taken care of. This will certainly enhance their decision making skills which could do wonders for the company.

More active role of the regulatory authorities for better supervision and control is the need of the hour as per the recent scenario of the Indian Reinsurance Industry.

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