Market Review
June 25, 2012

Economy Boosts Indonesia's Insurers; Capital, Regulatory Challenges Loom

Solid Economy Fuels Insurance Growth.

Against a fragmented and competitive landscape, Indonesia's non-life insurance market holds substantial attractions. This is supported by stable growth of 5% to 6% in gross domestic product over the past five years; a young and large population; rising spending on personal property; and expanding government outlays. These fundamentals underpin demand for personal lines insurance such as motor, household property, medical and personal accident.

Indonesia's solid economy is fueling growth for a developing insurance market, well supported by domestic consumption and investment offsetting a weaker international environment. As a key economy in the Association of South East Asian Nations (ASEAN), Indonesia is refining its regulations to strengthen insurance development in line with international standards. The insurance sector is primed for further growth, as the industry has generally exhibited stable operating performance despite capital challenges for some players.

Exhibit 1

Indonesia – Key Insurance Market Statistics (2007-2010)

(IDR/USD Millions)

Indicator	2007	2008	2009	2010
Population (Millions)	224.7	227.4	230.0	232.5
Gross Domestic Product	IDR 3,950,893,200	IDR 4,948,688,397	IDR 5,606,203,400	IDR 6,436,270,792
	USD 419,638	USD 525,617	USD 595,454	USD 683,619
Change in Real GDP (%)	6.35	6.01	4.63	6.2
Insurance Penetration (Total) %	1.6	1.5	1.5	1.6
Insurance Premiums	**2007**	**2008**	**2009**	**2010**
Life	IDR 45,534,478	IDR 50,370,024	IDR 61,210,833	IDR 75,057,595
	USD 4,836	USD 5,350	USD 6,501	USD 7,972
Non Life	IDR 19,073,838	IDR 23,392,490	IDR 25,032,756	IDR 27,621,879
	USD 2,025	USD 2,485	USD 2,659	USD 2,934
Total	**IDR 64,608,316**	**IDR 73,762,514**	**IDR 86,243,589**	**IDR 102,679,474**
	USD 6,863	**USD 7,835**	**USD 9,161**	**USD 10,907**

Sources: Ministry of Finance and the General Insurance Association of Indonesia (AAUI)

As in other Southeast Asian countries such as Thailand, local players traditionally have dominated the Indonesian market, often linked to important families or state-owned corporations. The top five non-life insurers controlled 37.8% of market share in 2010, while more than 80 players compete for the remaining shares (see **Exhibit 3**).

Competition on price is fierce, particularly for property insurance, the second-largest non-life line. However, underwriting performance of motor insurance, the largest non-life line, has improved, with better loss ratios over the past five years. In addition, third-party liability motor insurance is still not compulsory in Indonesia, offering a substantial gap for further development.

An enhanced capital requirement is already in place ahead of full implementation of the ASEAN Free Trade Agreement in 2015. A number of undercapitalized local insurers face significant challenges, and one option for them may be merger or acquisition; otherwise, they have to surrender their licenses. The total number of insurance companies

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in Indonesia steadily decreased 10.2% to 142 in 2010 from 2006, but the country has yet to see a very active merger-and-acquisition market.

Foreign players have entered the market, driven by increasing foreign investments, infrastructure projects and new business ventures. Local insurers also are attracted to form foreign joint ventures as they seek international knowledge to develop new products and distribution; business models and operating systems; and most important, increased capital to fuel long-term development.

Takaful, or Shari'a compliant insurance – particularly family Takaful business – has been a key driver of growth in Indonesia, which has the world's largest Muslim population. Improved and additional regulation will be introduced progressively to establish a more comprehensive system and legal foundation for the Takaful industry. Currently, there is no separate licensing requirement for a Takaful operation, which usually is run as a unit of a conventional insurer. One regulatory change will separate each Takaful unit as a single entity.

Against these market challenges, Indonesia's insurance industry sees a brighter outlook through strong domestic consumption, rising household wealth and expanding infrastructure projects, which are creating demand for personal property and motor insurance, life products with savings and investment functions, and commercial and industrial insurance.

Non-Life Personal Lines Gaining Growth Momentum

The eventual development of compulsory third-party liability motor insurance is expected to be a driver for the motor line – which is the largest non-life segment – and hence non-life premium as a whole. As personal lines offer substantial potential for growth, many insurers are looking to expand in this retail segment rather than the more competitive commercial business.

Operating performance of the non-life sector has improved steadily. Gross premium for non-life insurance increased 19.5% to IDR 34.4 trillion in 2011, according to the General Insurance Association of Indonesia (AAUI). Gross claims increased 5.5% to IDR 12.78 trillion in 2011.

Net profit for the non-life insurance and reinsurance industry increased 29% to IDR 3.22 trillion in 2010, according to Indonesia's insurance regulator, the Ministry of Finance's Indonesia Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK). The industry's retention ratio stayed in the range of 44% to 50% for the five years through 2010.

Motor and property accounted for the bulk of non-life premium. As the largest non-life line, motor's net premium amounted to IDR 7.22 trillion in 2010, representing 45.8% of total non-life insurance and reinsurance net premium in Indonesia. Motor business saw a 106% rise in net premium from 2006 to 2010, according to Bapepam-LK. The motor line's incurred loss ratio improved to 46.4% in 2010 from 70.1% in 2006.

Property insurance is the second-largest nonlife segment with IDR 2.12 trillion in net premium in 2010, representing 13.4% of total non-life insurance and reinsurance net premium in Indonesia. Property insurance experienced a 25% rise in net premium from 2006 to 2010, with industrial and commercial businesses representing the majority of the property portfolio and little residential business written.

Indonesia's non-life market is crowded, with 87 companies in 2010, of which 69 were local insurers and 18 were joint ventures. This congested market has been a challenge for insurers to seize a piece of the business, leading to price competition, particularly for property insurance. However, the country's large consumer market, impending compulsory motor insurance and low insurance penetration are positive drivers for nonlife business.

The top five nonlife insurers accounted for 37.8% of market share in Indonesia. Only the top nonlife insurer, PT Asuransi Sinar Mas, managed to snatch a double-digit market share of 10.3% with written premium of IDR 2.85 trillion in 2010. Nonlife insurers below the top five took market shares in the range of less than 4% (see **Exhibit 3**).

Exhibit 2

Indonesia Non-Life & Reinsurance – Total Companies (2006-2010)

Line/Segment		2006	2007	2008	2009	2010
Primary Insurance		**97**	**94**	**90**	**89**	**87**
	National Private	78	73	70	69	69
	Joint Venture	19	21	20	20	18
Reinsurance		**4**	**4**	**4**	**4**	**4**
	National Private	4	4	4	4	4
	Joint Venture	-	-	-	-	-
Social Insurance and Workers Security Program		2	2	2	2	2
Insurance for Civil Servants/Police		3	3	3	3	3
Insurance Brokers		143	146	141	142	138
Reinsurance Brokers		23	23	21	22	25
Loss Adjusters		33	27	27	28	28
Actuarial Consultants		30	30	28	29	28
Insurance Agents		7	8	10	14	16

Source: Indonesia Capital Market and Financial Institution Supervisory Agency (Bapepam-LK)

Infrastructure Projects Boost Outlook

Indonesia has strong domestic demand, which cushions overall business conditions from global financial uncertainty. The market has the potential to raise its growth rate further over the medium term, supported by the government's plan to boost spending on infrastructure projects. Robust infrastructure investments drive commercial lines such as engineering, liability and property.

Indonesia needs to upgrade its infrastructure to ensure economic growth. Development in this area has been slow for the past decade and has relied heavily on government budgets. Infrastructure and road construction have extended beyond the main Java island to others, creating new commercial and industrial insurance opportunities. Indonesia is rich in natural resources, with coal mining areas such as Kalimantan and Sulawesi attracting local insurers to set up new offices there.

In 2011, Indonesia's manufacturing growth was 6.2%, which was the strongest annual growth since 2004. This was driven by the food, beverage, tobacco, transport equipment and machinery sectors, and construction also performed well, in line with strong investments, according to the World Bank.

Volatile global financial markets and declining exports pose some challenges, but Indonesia has weathered these difficulties well, given its stable economic growth after the global financial crisis in 2008.

Motor insurance in Indonesia offers ample opportunity, given robust car sales. Motor vehicles per 1,000 people were 79 in 2009, up 80% from 2005, according to the World Bank. Total vehicle sales increased 17% to 894,164 in 2011, and the rise was 106% com-

Exhibit 3

Indonesia Non-Life – Top 26 Writers (2009-2010)

Ranked by gross premiums written.

(IDR Millions)

Rank	Company	2010 GPW	% Growth	% Market Share	2009 GPW
1	Sinar Mas	IDR 2,845,297.4	9.8	10.3	IDR 2,591,475.4
2	Jasa Indonesia	2,381,617.2	-1.4	8.6	2,414,802.9
3	Astra Buana	2,340,286.1	22.1	8.5	1,917,233.0
4	Central Asia	1,459,642.4	11.5	5.3	1,308,757.3
5	Tugu Pratama Indonesia	1,422,283.7	-11.7	5.1	1,610,056.8
6	Adira Dinamika	1,027,148.0	40.7	3.7	730,284.1
7	Wahana Tata	985,227.7	27.5	3.6	772,759.6
8	MSIG Indonesia	940,511.5	19.1	3.4	789,489.0
9	Jaya Proteksi	886,056.3	38.6	3.2	639,299.0
10	Allianz Utama Indonesia	650,146.7	-19.5	2.4	807,899.2
11	Bina Dana Artha	640,374.4	46.1	2.3	438,265.5
12	Tokio Marine Indonesia	610,548.0	1.9	2.2	599,137.1
13	Chartis Insurance Indonesia	560,453.1	-27.0	2.0	767,651.8
14	Jasa Raharja Putera	546,123.3	12.4	2.0	486,000.8
15	Bangun Askrida	495,041.0	18.6	1.8	417,287.1
16	Raksa Pratikara	492,181.9	21.2	1.8	406,085.2
17	Ramayana	481,043.8	6.2	1.7	453,006.1
18	Ekspor Indonesia	479,412.1	61.9	1.7	296,058.1
19	Bumiputera Muda 1967	422,116.2	9.9	1.5	384,115.0
20	Zurich Insurance Indonesia	404,889.9	33.3	1.5	303,782.2
21	Tri Pakarta	379,579.0	15.9	1.4	327,636.0
22	Dayin Mitra Tbk	378,103.9	20.8	1.4	313,007.8
23	Indrapura	354,260.6	30.4	1.3	271,768.5
24	Kredit Indonesia	344,898.4	13.9	1.2	302,862.0
25	Lippo General Insurance Tbk	319,035.3	27.7	1.2	249,881.3
26	Multi Arta Guna	290,390.9	18.8	1.1	244,445.1
	Total	**IDR 22,136,668.8**		**80.1**	**IDR 19,843,045.9**

Source: AXCO Non-Life Company Statistics, 2010

pared with 433,341 car sales in 2007, according to the Association of Indonesia Automotive Industries (Gabungan Industri Kendaraan Bermotor Indonesia).

The Indonesian government created a third-party vehicle insurance program funded by a levy on vehicle registration fees, but it only covers bodily injury. This insurance is managed by PT Jasa Raharja (Persero). However, although this compulsory motor insurance offers substantial business potential, compulsory third-party insurance in other markets has produced critical lessons to consider on underwriting controls.

Robust growth for motor insurance is realistic because of the country's expanding economy. However, there are still challenges ahead in claims management, distribution, pricing adequacy and underwriting discipline in a fragmented and competitive market.

Stable Reinsurance Market

Indonesia's reinsurance industry has remained stable, with no major hits by natural disasters in recent years compared with other countries of the Asia-Pacific region, which experienced record levels of catastrophe events. Property rates increased in the range of 5% to 15% for the January 2012 reinsurance renewal amid an overall, regional upward pricing trend triggered by increased catastrophes, according to broker Willis Re.

Indonesia has four domestic reinsurance companies: PT Reasuransi Internasional Indonesia, PT Reasuransi Nasional Indonesia, PT Maskapai Reasuransi Indonesia and PT Tugu Reasuransi Indonesia.

The four local reinsurers play an important role in the market, particularly for smaller programs. Foreign reinsurers in the region offer capacity more for specialized and highly volatile classes such as natural catastrophe, aviation and offshore energy.

The low capital bases of local reinsurers restrain their ability to write coverage, and the market still relies heavily on overseas capacity. Therefore, local reinsurers are seeking to increase their capital to retain more premiums within the country amid increasing regulatory capital requirements.

The four local reinsurers offer life, nonlife and Shari'a reinsurance, with various areas of specialization. In 2010, the four reinsurers' total gross written premium and earned premium amounted to IDR 2.4 trillion and IDR 1.9 trillion respectively, up 14% and 13% from the previous year, according to *BestLink* data.

PT Reasuransi Internasional Indonesia (ReINDO), established in 1996 by the government, is the largest local reinsurer in terms of written premium. The public reinsurer reported gross written premium of IDR 1.1 trillion and earned premium of IDR 823.4

Exhibit 4

Indonesia Reinsurance – Market Share & Premium Growth by Company (2009-2010)

Description	PT Maskapai Reasuransi Indonesia Tbk	PT Reasuransi Nasional Indonesia	PT Tugu Reasuransi Indonesia	PT Reasuransi Internasional Indonesia	Total
Share of 2010 gross premiums	7%	26%	20%	46%	100%
Premiums Written Increase					
Gross	4%	6%	17%	21%	14%
Net	5%	1%	24%	25%	16%
Earned	5%	1%	29%	18%	13%

Source: BestLink

billion in 2010, up 21% and 18% from the previous year, respectively.

Indonesia has mandatory cession rules on property and earthquake risks for national reinsurers. The reinsurance market's growth is expected to be driven by proliferating infrastructure projects; expansion of primary non-life insurance business; and risk management for the country's high exposure to natural catastrophes.

Increasing Attention on Natural Catastrophe Insurance

Among the world's most seismically active regions and home of 13% of the world's active volcanoes, Indonesia is prone to natural catastrophes. Currently, the most common natural disaster insurance is earthquake insurance, but penetration is very low. Although there is greater awareness of catastrophe cover after the Aceh earthquake and tsunami in December 2004 and the Nias earthquake in March 2005, insurance demand remains low for natural disasters.

A National Earthquake Insurance Pool, known as PRGBI (Pool Reasuransi Gempa Bumi Indonesia), was set up by the insurance industry with the support of the Ministry of Finance in 2003. The pool was transformed into PT Asuransi Maipark Indonesia (Maipark) in 2004, which is funded by the insurance industry as the national catastrophe risk reinsurer. Shareholders of Maipark are all nonlife and reinsurance companies. Maipark's shareholders cede a compulsory 5% to 25% of sums insured to a maximum of USD 2.5 million for any one risk on all earthquake insurance policies, according to the company.

In Indonesia, the market insures earthquake risk by a stand-alone, standard earthquake policy with a predetermined earthquake tariff, covering property loss or damage and business interruption due to earthquake shock, fire following earthquake, volcanic eruption or tsunami. The tariff depends on risk zone, location, type of occupancy and building construction, within the range of 0.104% to 0.33% of the sum insured, according to Maipark.

Indonesia's government and insurance industry are seeking ways to mitigate risks of major disasters in light of growing urbanization and economic activity. The government has set disaster risk management as a high priority, with plans to implement a natural perils risk financial strategy within three years.

So far, Indonesia's generally low insurance penetration has limited the impacts of natural catastrophes on insurers' business performance. For example, the devastating tsunami in December 2004 that affected parts of Indonesia, Thailand, Sri Lanka and India caused total insured losses of USD 2.068 billion across the region, compared with total economic damage of USD 13.4 billion, according to Swiss Re's *sigma* report No. 2/2006.

Many insurance companies remain reluctant or slow to promote and develop catastrophe insurance because of current low demand, the absence of a government-backed scheme, lack of data and catastrophe modeling, and technical issues of rate adequacy for such enormous risks.

While government involvement only plays a small part in the insurance of earthquake and other natural perils, there has been discussion of developing a residential earthquake insurance scheme and extending coverage to other perils such as flood.

Takaful Shows Great Untapped Potential

Indonesia is an emerging, important market for Takaful, showing healthy growth but much room for improvement. Takaful gross premium only represented 2.2% of the insurance industry's gross premium in 2010, according to Bapepam-LK. The number of Takaful insurance and reinsurance companies in Indonesia increased to 51 in 2010, up 70% from 30 entities in 2006.

Still, Takaful's growth in Indonesia has lagged behind that of Malaysia in the ASEAN region. Indonesia's Takaful market is similar in size to those of Saudi Arabia and the United Arab Emirates, with direct Takaful contributions estimated at USD 400 million in 2010, compared with Malaysia's USD 1 billion, according to Swiss Re figures. Indonesia's Takaful contributions increased an average of 33% annually between 2007 and 2010, higher than Malaysia's growth rate of about 20% and the global average of 28%.

Fueling Takaful's growth will depend on strengthening the regulatory framework, developing Shari'a capital market products such as Sukuk or Shari'a bond and Shari'a-based investment funds, and participation of traditional insurers.

In neighboring Malaysia, the regulator plays an essential role in driving Takaful's development, demonstrated by the initiative of Bank Negara Malaysia, Malaysia's central bank and regulator, in laying out a regulatory framework. This includes new guidelines for valuation of liabilities, financial reporting and operational frameworks.

Indonesia's regulator also sees its role in driving Takaful development with the plan to create a regulatory framework. The minimal capital level for a Takaful company likely will increase, and there will be the spin-off of Takaful window units to encourage the establishment of pure Takaful companies.

One constraint for Takaful's growth is the limited range of products. In supporting products' introduction, the regulator said "it is also necessary to encourage the development of long term Shari'a investment products which can be used for managing funds that are financed by Shari'a-based insurance." This also needs regulatory support that allows Takaful operators to invest in these instruments.

The Shari'a capital market has grown, offsetting the challenge of limited investment options for the Takaful sector. Shari'a products in the capital market, comprising corporate Sukuk (Shari'a bond), government Sukuk and Shari'a-based investment funds, increased 79.5% to IDR 57.4 trillion in 2010, according to Bapepam-LK.

Indonesia's regulator strengthened its Takaful framework with a measure introduced in 2010 requiring companies to establish Shari'a control boards and to strictly separate

Exhibit 5
Indonesia Non-Life & Reinsurance – Shari'a-Compliant Companies (2006-2010)

	2006	2007	2008	2009	2010
Shari'a Non Life Insurance Companies	1	1	1	1	2
Shari'a Unit of Non Life Insurance Companies	15	19	19	19	22
Shari'a Unit of Reinsurance Companies	3	3	3	3	3
Total	**19**	**23**	**23**	**23**	**27**

Source: Indonesia Capital Market and Financial Institution Supervisory Agency (Bapepam-LK)

shareholder and policyholder funds.

Takaful contracts are based on the wakala model, which is a principal-agent arrangement, with premium divided into an administrator fund as a fee for insurers and a policyholder fund to settle claims. Conventional insurers are allowed to sell Takaful products in Indonesia, but companies can only offer either family (life) or general Takaful policies.

As with conventional insurance, diversification of Takaful plans from savings to protection solutions, at affordable prices, is a key product strategy. Distribution still focuses on agencies as the main selling network, particularly in reaching the untapped market in rural areas. Bancassurance is an important alternative channel to promote penetration.

Growing Importance of Microinsurance
High exposure to natural catastrophes, together with nearly half the population living in rural areas, makes Indonesia a potential market for microinsurance. Agriculture contributed 14.9% of gross domestic product in Indonesia in 2010. The government has promoted microinsurance through raising awareness and regulatory support.

Development of simple, affordable and easily distributed insurance products for the lower income class is encouraged. Potential products include micro credit, catastrophe, agriculture, personal accident and fire insurance. However, distribution and product development are key challenges because of Indonesia's diverse population, distributed across a vast archipelago.

Rising Private Health Care Protection

Health care insurance is another potential area for growth, driven by increasing awareness of these products and growing expenditures on private medical care in Indonesia. Also, a new national social security law, BPJS, would require workers to pay medical premiums, removing their current coverage provided by the public health insurance scheme.

As more companies have excluded medical coverage for their employees, private health care insurance shows prospects for growth. Total non-life and reinsurance net premiums for personal accident and health amounted to IDR 2.57 trillion in 2010. This insurance line posted a significant 225% jump in net premiums between 2006 and 2010, according to Bapepam-LK.

Evolving Regulations

Bapepam-LK is aiming to align its capital and solvency requirement to international standards. Regulatory development and broader government policy within Indonesia are strongly linked to wider regional integration with the ASEAN organization, which has its headquarters in Jakarta.

Indonesia was among the early adopters of the risk-based capital supervisory regime in 1999. The government introduced regulations in 2008 to require insurers and reinsurers to increase minimum capital in three phases ahead of full implementation of the ASEAN Free Trade Agreement in 2015.

Insurance companies' minimum capital has to increase to IDR 40 million in 2010, IDR 70 million in 2012 and IDR 100 million in 2014. The requirements for reinsurance companies are IDR 100 million in 2010, IDR 150 million in 2012 and IDR 200 million in 2014.

The majority of large companies should be well placed to meet the changes, because the regulator imposed stricter rules on capital adequacy and risk management after the Asian financial crisis in 1997. Increasing capitalization requirements will drive market consolidation.

In the first phase in 2010, five insurance companies surrendered their licenses after not meeting the deadline for the requirement. About 29 additional insurance companies may have to surrender their licenses by the end of the second phase of increasing capitalization.

"The government may review the deadline to allow for enough time for the industry to be integrated with other industry such as banking and leasing. This is to reduce the possibility of disruption to the industry," said Teddy Hailamsah, secretary general of the ASEAN Insurance Council.

Indonesia's regulator is reviewing the International Association of Insurance Supervisors' Insurance Core Principles, which are an internationally developed set of principles, standards and guidance serving as a benchmark for insurance supervision in all jurisdictions. There have been discussions over enhancements in risk management and investment.

Under Bapepam-LK's 2010-2014 master plan, one goal of the regulator is "to realize a stable, resistant and liquid industry." Strategies to be implemented in the next five years include increasing market players' quality and encouraging good corporate governance, as well as improving the risk management industry's capabilities; supervisory capacity over industry players; and the domestic investor base and long-term funds.

Convergence to International Financial Reporting Standards is ongoing, with the latest implementation of IFRS 4 Phase 1 in January 2012. Insurers are adjusting their accounting and systems. IFRS 4 has not affected international insurers in Indonesia, as most already complied, but the impacts are greater on local insurers.

OJK to Take Independent Supervisory Role

In 2011, Indonesia passed a bill to create a new, independent financial regulator, Otoritas Jasa Keuangan (OJK), to supervise and regulate financial services. OJK ultimately will replace Bank Indonesia and Bapepam-LK as supervisor for banking and insurance, respectively.

Commissioners for OJK are being chosen. It will take time for the new regulatory body to be up and running, with an initial transition for the banking sector first.

OJK will help to implement insurance regulations more actively. The regulator will support the insurance industry's efforts to seize opportunities arising from the ASEAN Free Trade Area.

Takaful Regulatory Change to Foster Development

Indonesia's regulation of Takaful business is expected to evolve further. The regulator is opting for equality between Shari'a-compliant and conventional financial products in a balanced and healthy competitive environment, enabling Shari'a to grow in line with the conventional sector. In 2010, the Ministry of Finance set out a plan to develop regulatory principles, such as basic principles of a company and separation of assets and liabilities, for Shari'a insurance and reinsurance companies.

Indonesia now allows both full-fledged Takaful companies and window-based operations. Capital requirements for Takaful operations have been set lower than for conventional insurers to support Takaful's development.

In general, Indonesia's regulation is in its refining stage, principally under risk-based capital supervision. Regulatory reform is subject to numerous changes while taking a more integrated approach for the ASEAN region.

A More Open Policy for Foreign Participation

Indonesia has adopted an open regulatory policy for foreign investments, with relatively less restricted operating conditions for foreign insurers. However, local competition is the biggest issue for global players, as the domestic companies have a strong hold on local customers through their established agency forces and brand recognition.

Foreign insurers' shareholdings in joint ventures are capped at 80%. This level is flexible, however, provided that the Indonesian partner's aggregate paid-up capital is maintained. Then, the foreign insurer can increase its stake beyond 80%.

Japanese Insurers Lead Recent M&A Deals

Regulatory reform with increased capital requirements has driven merger-and-acquisition activities of foreign insurers in Indonesia, which appears to be a hot spot among emerging Asian countries. The sheer size of the country and population, with a fast-expanding and diverse insurance environment, are major attractions for foreign insurers. Immediate capital injections, along with insurance experience and stronger financial positions, have lured local companies to seek foreign investors as well.

Japan has the biggest foreign non-life ventures in Indonesia. Most recent deals came from Japanese insurers, while Japan is Indonesia's biggest export country. A stronger Japanese currency and existing corporate clients' business have prompted Japanese insurers' move into Indonesia's insurance sector. Major Japanese non-life insurers already have built their presence with joint ventures, including PT Asuransi Aioi Indonesia, PT Asuransi MSIG Indonesia, PT Asuransi Permata Nipponkoa Indonesia, PT Sompo Japan Insurance Indonesia and PT Asuransi Tokio Marine Indonesia.

Nipponkoa Insurance Co. Ltd. invested IDR 67.43 billion to boost its equity stake in its Indonesia non-life venture, PT Asuransi Permata Nipponkoa Indonesia, to 80% from 49%, making the joint venture a subsidiary of Nipponkoa in 2011.

Market Consolidation Continues

Foreign non-life insurers' joint ventures with local companies continue to have low market shares. In 2010, there were 18 non-life joint ventures out of 87 total non-life companies, according to Bapepam-LK.

Regulatory reform has accelerated market consolidation, which is viewed as a positive trend to strengthen the insurance industry. Numbers of non-life insurers decreased from 97 to 87 between 2006 and 2010. However, these numbers are still considered excessive. The reduction will continue, influenced by pressures for increasing capitalization; stronger competitive positions; and expansion to reach untapped potential.

A.M. Best's Rating Perspective

Indonesia's economic strength comes from its strong domestic consumption and well-balanced economy incorporating manufacturing, services and agriculture. A.M. Best expects its economic growth to be about 6.2% in 2012.

Indonesia is classified under A.M. Best's "CRT-4" (Country Risk Tier 4) category, which is assessed under three categories: economic, political and financial system risk. CRT-1 is the lowest tier, denoting a stable environment with the least proportion of risk, while CRT-5 is the highest tier, for countries considered to face the most risk. A.M. Best categorizes the majority of countries in Southeast Asia as CRT-3 or CRT-4.

Indonesia has a moderate level of economic risk but high levels of political and financial system risk, according to A.M. Best. Although Indonesia's government has strengthened financial sector regulation to comply with international standards since the Asian financial crisis of 1997-98, progress toward compliance has been slow.

Social and political instability, coupled with natural disasters, have limited the amount of capital investment being undertaken in Indonesia. Also, A.M. Best considers the country to be vulnerable to exchange-rate volatility and speculation by currency traders.

Indonesian companies have exposure to three risk categories: catastrophe risk, underwriting risk and financial risk. Indonesia is prone to natural catastrophes. A.M. believes it becomes important for companies to assess their gross and net exposure to catastrophe risks, given strong economic growth and demand for insurance. Companies have to integrate catastrophe risk management into their underwriting processes to safeguard their capital position from catastrophes.

A.M. Best considers profitable underwriting to be a challenge in Indonesia's competitive and fragmented market. The risk-based capital framework requires capital to include components reflecting potential deficiencies in loss reserves and pricing. In Indonesia's competitive market, insurance companies that show consistent deficiency in loss reserves or premium rates have a higher need for a capital buffer to withstand potential impacts from unprofitable insurance operations.

A.M. Best believes Indonesian companies need to manage financial risk related to their operations. Although Indonesian companies have benefited from favorable investment returns in recent years, any turnaround in investments could negatively impact their capitalization, driving them to greater reliance on underwriting profit. Volatility in local currency is also a financial risk, with some policies written in foreign currencies.

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