Market Review
July 2, 2012

Indonesia's Insurance Market Looks to Life Business for Growth

Innovation, Distribution Are Critical for Life Writers.

Life insurance has emerged as a key driver for growth of Indonesia's total insurance market. Life insurance accounted for 60.4% of the insurance industry's total gross premium in 2010, according to figures from the country's insurance regulator. Solid economic fundamentals with rising domestic consumption, improving insurance regulation, product innovation and use of alternative distribution channels are bolstering prospects for life insurance to grow in Indonesia.

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 and a weak international environment.

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.

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 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.

Exhibit 1

Indonesia – Key Insurance Market Statistics (2007-2010)

Indicator	2007	2008	2009	2010
Population (Millions)	224.7	227.4	230.0	232.5
Gross Domestic Product (IDR/USD Billions)	IDR 3,950,893	IDR 4,948,688	IDR 5,606,203	IDR 6,436,271
	USD 420	USD 526	USD 595	USD 684
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 (IDR/USD Millions)	**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)

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Exhibit 2
Indonesia Life & Reinsurance – Total Companies (2006-2010)

Line/Segment	2006	2007	2008	2009	2010
Life Insurance	51	46	45	46	46
National Private	35	29	27	28	29
Joint Venture	16	17	18	18	17
Reinsurance	4	4	4	4	4
Nationanl 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
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)

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 all types of insurance, including life products with savings and investment functions.

Simplicity Is Key in Life Market

The life business in Indonesia is relatively less concentrated than the non-life sector. Indonesian customers' primary needs support growth of simple investment-linked and health care products. There were 26 life insurance companies selling investment-linked products in 2010, according to Indonesia's insurance regulator – the Ministry of Finance's Indonesia Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK). Agency forces dominate distribution, with the bancassurance channel emerging for new business, particularly investment-linked insurance.

The life industry reported gross premium of IDR 75.5 trillion in 2010, up 175% from 2006. Total assets amounted to IDR 188.5 trillion in 2010, up 165% from 2006, according to figures from Bapepam-LK. Increasing popularity of investment-linked products, along with the country's economic growth, favorable demographics and large middle class, have supported the life sector's robust development. However, life insurance penetration as a percentage of GDP remains low at about 1%, compared with the global average of 4%, due to lack of awareness of insurance.

Many insurers in emerging markets have focused on selling traditional products with some slight variations. Innovation is a key differentiator for insurers in Indonesia, given its large middle class and Muslim population. Takaful or Shari'a-compliant insurance and investment-linked insurance are two sources of new products during the past few years in Indonesia. In 2010, 419 of the 524 total new products Bapepam-LK approved were life products – 354 of them conventional and 65 Shari'a-based.

Foreign Insurers Lead Life Product and Distribution Growth

Top life insurer PT Prudential Life Assurance has focused on investment-linked insurance products to grow its top line and profits. The company has said its other product strategy is to pursue growing and important opportunities from Shari'a-compliant insurance.

Indonesia had 8.3 commercial bank branches per 100,000 adults in 2010, up from 5.8 in 2006, according to the World Bank. Fast-growing distribution through bank partnerships, combined with a well-established agency network, is a significant competitive advantage for life insurers in Indonesia.

Although agency distribution is relatively effective, the channel is costly, impacting insurance policy premiums. The regulator has a strategic focus to encourage the development of effective marketing channels such as bancassurance to improve "the ease of transaction."

Product innovation and alternative distribution do not come cheap for insurance companies, which ultimately will need higher capital to support this development. Foreign insurers with stronger financial positions and international experience therefore have been more competitive. This is reflected in the presence of five foreign joint-venture insurers in the top 10 life rankings in Indonesia.

In the life segment, the top three insurers are PT Prudential Life Assurance, PT Asuransi Jiwa Sinar Mas and PT Jiwa Mega Life, with market shares of 13.9%, 12.4% and 9.0%,

Exhibit 3

Indonesia Life – Top 26 Writers

Ranked by gross premiums written.

(IDR Millions)

Rank	Company	2010 GPW	% Growth	% Market Share	2009 GPW
1	PT Prudential Life Assurance	IDR 10,409,371.9	48.2	13.9	IDR 7,022,812.3
2	Jiwa Sinarmas	9,289,614.6	30.7	12.4	7,109,629.9
3	Jiwa Mega Life	6,734,192.3	-41.2	9.0	11,448,098.9
4	PT Asuransi Allianz Life Indonesia	5,160,785.8	46.3	6.9	3,527,626.3
5	PT Asuransi Jiwa Manulife Indonesia	4,995,686.4	62.0	6.7	3,083,128.4
6	Bumiputera 1912	4,956,500.0	10.0	6.6	4,506,530.1
7	Indolife Pensiontama	4,299,176.3	40.0	5.7	3,070,023.6
8	Jiwasraya	3,613,318.3	43.8	4.8	2,512,582.2
9	PT AIA Financial	3,567,550.8	10.0	4.8	3,244,265.7
10	PT Axa Mandiri Financial Services	2,820,212.8	77.4	3.8	1,589,696.5
11	Jiwa Adisarana Wanaartha	1,761,301.3	196.7	2.3	593,723.6
12	Avrist Assurance	1,728,162.2	17.6	2.3	1,469,465.3
13	Bringin Jiwa Sejahtera	1,558,781.4	15.4	2.1	1,350,189.4
14	Jiwa Sequis Life	1,431,822.8	24.9	1.9	1,146,335.1
15	BNI Life Insurance	1,390,779.3	33.4	1.9	1,042,256.5
16	Panin Life	1,357,699.8	30,739.1	1.8	4,402.5
17	Commonwealth Life	1,214,482.8	73.6	1.6	699,741.1
18	AXA Financial Indonesia	1,199,887.5	66.7	1.6	719,967.1
19	CIGNA	896,883.7	5.7	1.2	848,788.6
20	Jiwa InHealth Indonesia	811,010.8	299.2	1.1	203,162.3
21	Sun Life Financial Indonesia	778,953.1	17.9	1.0	660,684.7
22	Equity Life Indonesia	747,220.2	16.3	1.0	642,657.4
23	Great Eastern Life Indonesia	654,658.4	315.5	0.9	157,573.0
24	Jiwa Central Asia Raya	605,189.1	-4.2	0.8	631,987.2
25	AVIVA Indonesia	519,776.6	0.0	0.7	0.0
26	Jiwa Bumi Asih Jaya	368,722.0	-29.1	0.5	520,329.0
Total		**IDR 72,871,740.2**		**97.09**	**IDR 57,805,656.7**

Source: AXCO Life Company Statistics, 2010 respectively, in 2010. The remaining insurers in the top 10 ranks had market shares in the range of 3.8% to 7%. The market is fragmented, with insurers below the top 10 representing market shares of less than 2.3% (see **Exhibit 3**).

The government's promotion of both private and public pensions, together with foreign insurers' new products and marketing efforts, has boosted awareness of life insurance for long-term care and retirement protection.

The regulator has made diversification of nonbanking financial services such as voluntary pension programs a strategic objective for the financial industry. Promotion of pension products and long-term savings insurance will drive new products for life insurers. Life policies with additional components such as education, medical, pensions, long-term savings or investments have been marketed in the traditional as well as Shari'a-compliant insurance segments.

Stable Reinsurance Market

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

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. In addition, reinsurers have to meet increasing regulatory capital requirements.

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

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

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, within the ASEAN region, Indonesia's takaful market is smaller than Malaysia's, though it is growing faster. The Indonesian 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, Swiss Re has reported. 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, according to Bapepam-LK.

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 the regulator.

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 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

Exhibit 5

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

	2006	2007	2008	2009	2010
Shari'a Life Insurance Companies	2	2	2	2	2
Shari'a Unit of Life Insurance Companies	9	12	13	17	21
Shari'a Unit of Reinsurance Companies	3	3	3	3	3
Total	**30**	**37**	**38**	**42**	**51**

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

With nearly half the population living in rural areas, Indonesia shows great potential as a market for microinsurance. The government has promoted microinsurance through raising awareness and regulatory support. Life insurers are offering more microinsurance packages with affordable premiums for this mass population, as well as to gain business volume in the long term.

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.

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 regulation in 2008 to require insurers and reinsurers to increase minimum capital in three phrases 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 were already compliant, but the impacts are greater for 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%.

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.

Japanese Insurers Lead Recent M&A Deals

A stronger Japanese currency and existing corporate clients' business have prompted Japanese insurers' move into Indonesia's insurance sector. The biggest recent deal came from Mitsui Sumitomo Insurance Co. Ltd., which acquired a 50% stake in Indonesian life insurer PT Asuransi Jiwa Sinarmas for about USD 800 million in 2011.

In May 2012, Meiji Yasuda Life Insurance Co. Ltd. increased its stake in PT Avrist Assurance from 5% to 23%. The Japanese insurer seeks further growth for Avrist, with a focus on developing bancassurance channels and group insurance. The strategic focus on bancassurance also is intended to lay a foundation for a life insurance joint venture between Avrist and local banks in the future.

Market Consolidation Continues

Foreign insurers' joint ventures with local companies continue to have low market shares. In 2010, there were 17 life joint ventures out of 46 total life companies in Indonesia, according to Bapepam-LK.

Regulatory reform has accelerated market consolidation, which is viewed as a positive trend to strengthen the insurance industry. Numbers of life insurers decreased from 51 to 46 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.

As in other Southeast Asian countries, foreign insurers in Indonesia have been more dominant in the life than in the nonlife sector, given the relatively larger capital investment, product knowledge and distribution in life business. PT Prudential Life Assurance, a unit of U.K.-based Prudential plc., is the biggest life insurer, with a 13.9% market share on written premium of IDR 10.41 trillion in 2010 (see **Exhibit 3**).

A strong market position, particularly in investment-linked and takaful products, and multichannel distribution through agents and bancassurance have contributed to Prudential's lead in Indonesia's fragmented life segment. Most of the top five international life insurers in Indonesia also emphasized investment-linked insurance, which has delivered significant growth in the top line and profits.

Other foreign life insurers within the top 10 include PT Asuransi Allianz Life Indonesia, PT Asuransi Jiwa Manulife Indonesia, PT AIA Financial and PT Axa Mandiri Financial Services. These foreign players gained market shares ranging from 3.8% to 7%.

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.

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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