

INSURANCE | RUSSIA

# INSURANCE SECTOR CONTINUES TO GROW AMID CONSISTENT FINANCIAL AND REGULATORY RISKS

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- **Insurance premium dynamics have returned to a trajectory of growth.** As of nine months of 2021, the total volume of premiums had increased by 19% y-o-y. ACRA predicts that total premiums in 2021 will amount to RUB 1.8 tln, which is a 17% increase compared to 2020.
- **ACRA's base case scenario involves maintaining insurance market growth at a level of up to 15%.** High growth will remain in the credit insurance segment. ACRA forecasts significant growth for life insurance, voluntary health insurance (VHI), personal property insurance, and obligatory motor third-party liability insurance (OMTLI).
- **There are strong regulatory risks in the life insurance and credit insurance segments.** Amid high growth rates in these insurance segments, clients and the regulator are dissatisfied with the low returns received by policyholders under life insurance contracts, violations during the sale of policies, and high commission fees.
- **The revival of activity in the auto insurance market is related to the rising cost of cars and announced changes to the law.** Higher vehicle prices have resulted in an increase in the average insurance premium per policy, which has allowed insurance firms to considerably increase the volume of premiums, despite a falling number of contracts. An increase in the sum insured for risks to life and health, coupled with the increased cost of spare parts, is expected to lead to an increase in OMTLI rates. From ACRA's point of view, it is advisable to increase the sum insured for risks to life and health as early as 2022, which is taken into account in the Agency's forecast for the current year.
- **VHI and personal property insurance continue to drive the market.** Both segments have grown consistently over the past few years. According to our forecasts, this growth will continue in 2022. The corporate property insurance segment continues to stagnate.
- **The profitability of insurers' assets and capital have been on a downward trend over the past four quarters.** Higher inflation and a declining stock market do not yet allow us to hope for a change in this situation. At the same time, continued regulatory risks and the risks of new lockdowns, as well as an expected increase

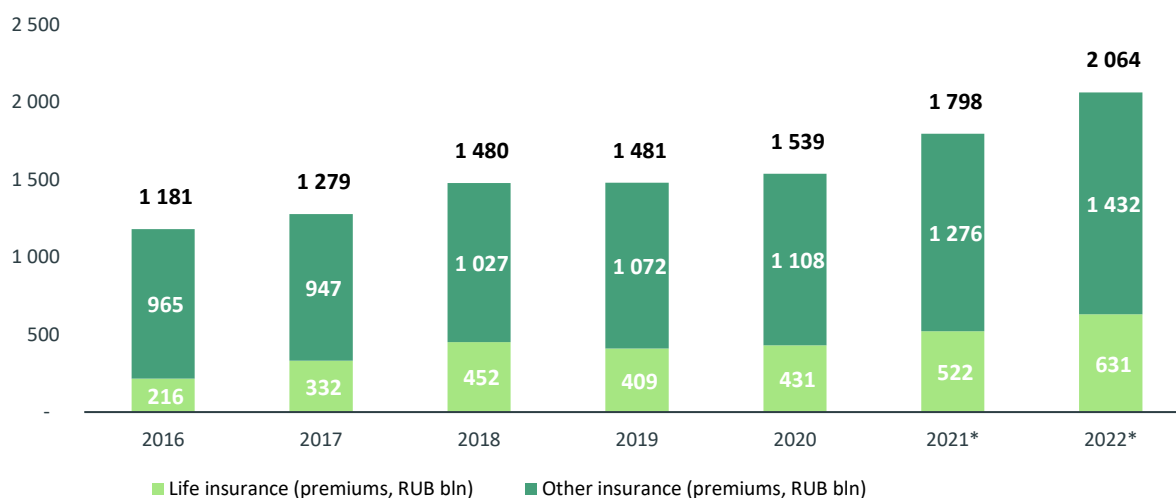
in capital adequacy ratios, may threaten the creditworthiness of individual insurers.

## THE RUSSIAN INSURANCE MARKET HAS RETURNED TO A PATH OF GROWTH

Results for 9M 2021 show that the total volume of insurance premiums increased by 19% compared to the same period in 2020. The most growth (44%) was recorded by the credit insurance segment, in which we include borrower life insurance, as well as All. In addition, strong growth was observed in non-lending life insurance and motor hull insurance, with premiums increasing by approximately 20% over 9M 2021 compared to the same period in the previous year.

The assessment of the results of the fourth quarter and, accordingly, 2021 as a whole was affected by the noticeable increase in the Bank of Russia's key rate. In particular, we expect weaker performance in the life insurance segment as the growth in deposit interest rates may have temporarily dampened the population's interest in investment and endowment insurance policies. Nevertheless, these changes are not significant enough to have a major impact on market growth for the year compared to actual data for nine months.

**Figure 1. After slowing down in 2019–2020, insurance premium volumes started growing again in 2021**



\* 2021 is an estimate (including data for nine months), 2022 is a forecast.

Sources: Bank of Russia, ACRA

When forecasting how the market would perform in 2022, ACRA used a base case scenario that takes into account the following conditions:

- GDP growing by 2.7%, inflation falling to 4.2%, and the key rate declining to 6.75% by the end of 2022 (in line with ACRA's macroeconomic forecast);
- No additional regulatory restrictions on life insurance and credit insurance;
- No long quarantine restrictions.

Taking into account these conditions, ACRA forecasts continued growth in most segments of the Russian insurance market in 2022. Under the base case scenario, the highest growth is expected in the credit insurance segment. In addition, we predict considerable growth of life insurance, VHI, personal property insurance, and OMTLI.

Premiums for corporate property insurance and motor hull insurance should be unchanged from last year.

If the conditions of the base case scenario do not materialize, then a significant decline in the volume of premiums may take place, the size of which is difficult to determine. At the same time, we cannot see any factors that could have a significant positive impact on the total volume of insurance premiums compared to our base case forecast.

## **LIFE INSURANCE IS BECOMING MORE POPULAR, BUT REGULATORY RISKS REMAIN**

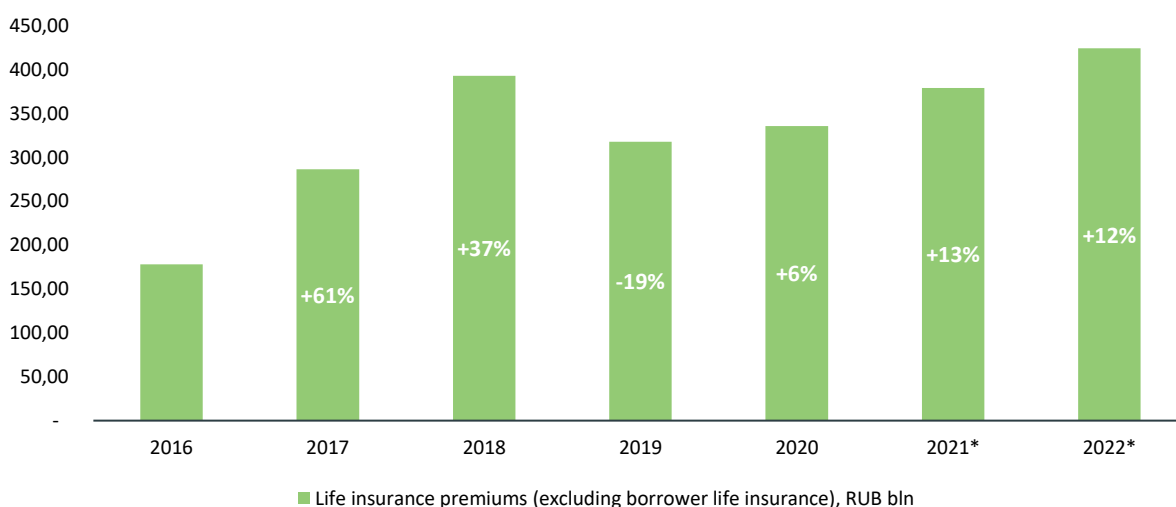
In ACRA's opinion, life insurance has the most potential for long-term development among the segments of the Russian insurance market. From 2015 to 2020, the volume of premiums in this area grew by 3.3 times, while premiums for all other types of insurance only grew by 24%.

For the purposes of analysis, it makes sense to separate borrower life insurance from other types of life insurance because these categories are considerably different in terms of target client groups and factors determining demand for insurance services. The rest of this section will focus on life insurance, with the exception of borrower life insurance, which will be covered separately. With this in mind, life insurance in the Russian market can be divided into the following categories:

- Endowment life insurance (ELI);
- Investment life insurance (ILI);
- Risk life insurance;
- Pension insurance.

Premiums for risk life insurance and pension insurance are insignificant, and, according to ACRA's estimates, they account for less than 5% of the total volume of life insurance premiums. ILI and ELI generate the bulk of insurance premiums and occupy similar shares of the market. Besides this, in 2022 a new insurance product is expected to appear — unit-linked insurance, which may partially or completely replace ILI in the Russian market.

**Figure 2. ACRA's base case scenario assumes continued growth of life insurance premiums in 2022**



\* 2021 is an estimate (including data for nine months), 2022 is a forecast.

Sources: Bank of Russia, ACRA

According to the Bank of Russia, over the first nine months of 2021, premiums from life insurance contracts increased by 20% y-o-y. A significant increase in the key rate, according to our estimates, constrained growth of life insurance in Q4 2021. At the same time, ACRA assumes that at the end of 2022 the key rate will be lower than its current level. Accordingly, its reduction may once again support the growth of this type of insurance. Thus, in the absence of significant regulatory restrictions, which is part of the Agency's base case scenario, life insurance premiums will continue to grow in 2022. The total amount of insurance premiums (excluding borrower life insurance) will amount to more than RUB 420 bln, which is 12% more than the value of this indicator for 2021.

At the same time, ACRA continues to consider the risks of regulatory changes to be significant. In its overview of the insurance market for 9M 2021, the Bank of Russia noted low returns on ILI contracts and a high number of complaints made by policyholders regarding the about misselling of ILI and ELI. Due to this, the regulator is forced to introduce additional requirements that the rules of activity in the life insurance market must comply with. In particular, at the end of 2021, the Bank of Russia increased the cooling-off period for ILI and ELI contracts with premiums of less than RUB 1.5 mln, and made other changes that improve the position of policyholders. Nevertheless, in our opinion, if a large number of policyholders continue to be dissatisfied, in order to protect their interests, the regulator may impose considerable restrictions that significantly reduce premiums, as was the case in 2019. Then regulations were introduced for selling ILI policies, which resulted in life insurance premiums declining by 19% compared to the year before.

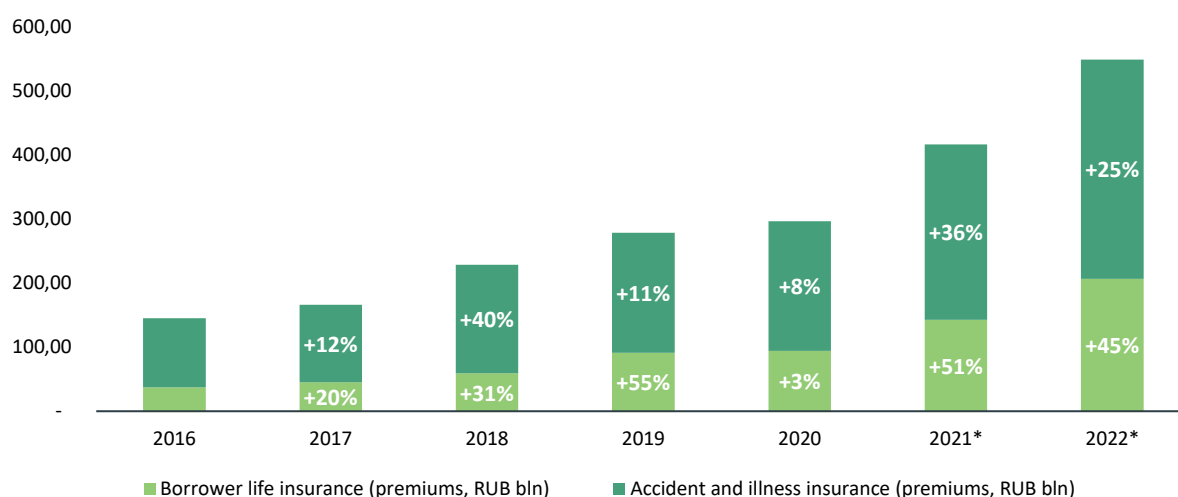
## CREDIT INSURANCE IS GROWING AMID A RETAIL LENDING BOOM

Borrower life insurance and accident and illness insurance (All) have demonstrated high rates of growth over the past few years. The lion's share of insurance premiums for All comes from contracts with bank borrowers. Due to this, ACRA considers these types of insurance jointly as credit insurance.

High demand for retail loans continues to be the main factor determining the dynamics of credit insurance. According to ACRA's projections, the volume of retail lending at the end of 2021 was approximately 25% higher than it was at the end of 2020. This year, ACRA **expects** retail lending to grow by a further 20% compared to 2021.

Based on this forecast, our base case scenario involves credit insurance continuing to record strong growth this year.

**Figure 3. Credit insurance premiums continue to grow in 2022 in ACRA's base case scenario**

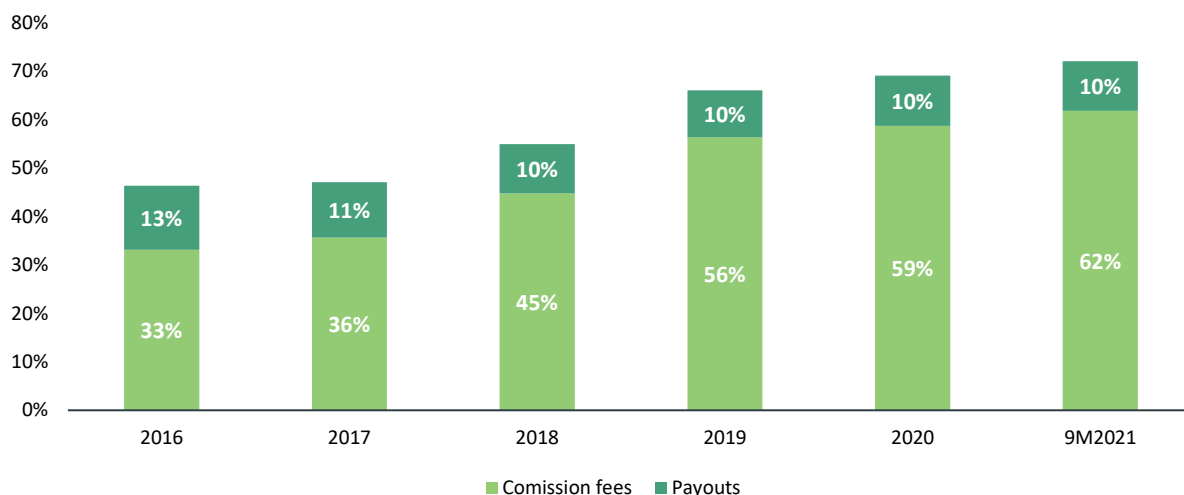


\* 2021 is an estimate (including data for nine months), 2022 is a forecast.

Sources: Bank of Russia, ACRA

At the same time, an increase in the volume of credit insurance premiums is associated with an increase in the risks of intervention by the regulator. The financial authorities and many independent commentators are dissatisfied with the high commission fees charged by intermediaries, mainly banks, and the extremely low level of payouts. In the first nine months of 2021, the ratio of commission fees received by intermediaries to the amount of insurance premiums reached 62%, while the average commission fee outside of credit insurance is about 15%. At the same time, payouts for insured events over the past four years do not exceed 10% of the insurance premium.

**Figure 4. The main share of credit insurance premiums are used to pay commission fees, while payouts for insured events are insignificant**



Sources: Bank of Russia, ACRA

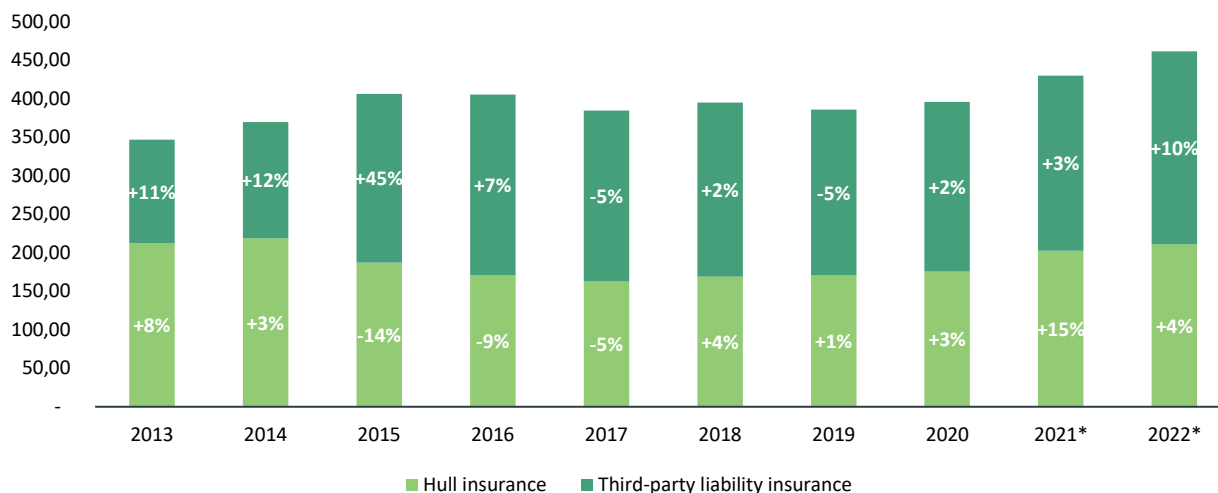
Taking the above into account, a rational question arises regarding the necessity of this sort of insurance for borrowers. In essence, these policies are an addition to loan agreements that allow banks to receive non-interest income on loans. There are many examples of banks increasing loan interest rates after borrowers have bypassed them when taking out insurance. In our view, the imbalance between payouts and commission fees is a serious threat to the future of credit insurance. The Federal Anti-Monopoly Service's initiative to remove some of the limitations that restrict insurers' access to bank clients may increase competition between companies and lead to a certain decline in rates. However, in our opinion, this is unlikely to solve the problem at hand.

## GROWING CAR PRICES HAVE DRIVEN THE AUTO INSURANCE INDUSTRY

The auto insurance segment, including hull insurance and voluntary and compulsory third-party liability insurance, showed a strong positive trend in 2021. According to ACRA's estimates, the total volume of auto insurance premiums grew by 9%, which is rather high for a segment that stagnated in 2016–2020. Growth was driven by a significant increase in motor hull insurance premiums (+15% compared to 2020), while liability insurance premiums grew by only 3%.

The main reason for the growth of auto hull premiums was the increase in car prices against the backdrop of limited supplies to the Russian market. In the first nine months of 2021, the average premium per policy went up by 23% y-o-y, therefore, the total volume of premiums also soared despite a downward trend in the number of concluded contracts.

**Figure 5. In 2021, hull insurance premiums grew; in 2022, third-party liability insurance premiums are expected to grow as well**



\* 2021 is an estimate (including data for nine months), 2022 is a forecast.

Sources: Bank of Russia, ACRA

According to ACRA's forecast, in 2022, the increase in auto hull premiums will be less impressive at about 4%. The following factors that previously constrained the growth in this segment will persist in the short term:

- Weak dynamics of the car market — ACRA does not expect an increase in the number of new car sales amid 9% average price growth;
- Strong competition among auto insurers, which constrains the rates.

At the same time, the Agency expects a significant increase in premiums in the third-party liability insurance segment, which is evidenced by multiple factors. Unlike motor hull insurance, the average liability insurance premium almost did not change in the nine months of 2021 compared to the same period last year, despite the increase in the prices for spare parts. At the end of 2021, the Bank of Russia once again expanded the boundaries of the OMTLI rate corridor. Combined with higher insurance payouts, this should lead to a gradual increase in rates. An even more significant factor that is expected to contribute to the increase in rates will be the change in the conditions and procedure for calculating OMTLI payouts announced at the end of 2021, which implies a fourfold increase in the maximum coverage for risks of death and injury of road users from RUB 500,000 up to RUB 2 mln. In addition, depreciation ratios are expected to be excluded from the calculation of payouts for damaged property.

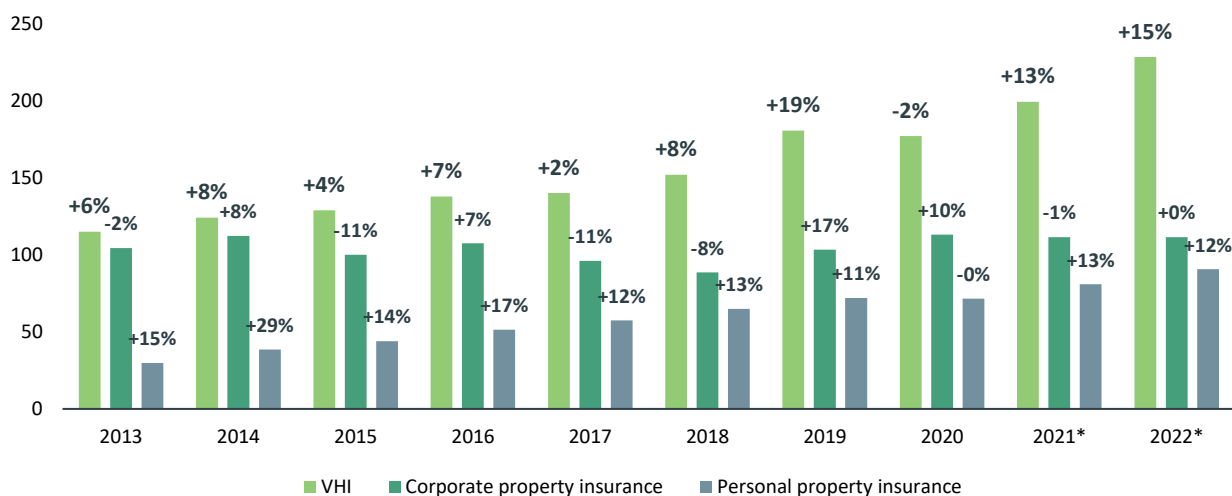
Despite that the specific dates for these changes have not yet been announced, it is assumed that first of all, the coverage for risks of death and injury will change, and secondly, the depreciation ratios will be cancelled. If there are serious grounds for the implementation of the first of these changes, with which, according to the media, almost all market participants agree, we expect that the increase in the coverage will occur as early as 2022. The second change is expected no earlier than 2023 and will not affect the insurance premium forecast for 2022.



## VHI AND PERSONAL PROPERTY INSURANCE CONTINUE TO DRIVE THE MARKET

The life insurance, credit insurance and auto insurance segments occupy about two-thirds of the Russian insurance market in terms of premiums. Among the remaining types of insurance, the largest segments are VHI, corporate property insurance, and personal property insurance.

**Figure 6. VHI and personal property insurance segments have been growing steadily; the corporate property insurance segment has been stagnating**



\* 2021 is an estimate (including data for nine months), 2022 is a forecast.

Sources: Bank of Russia, ACRA

ACRA continues to consider the VHI segment one of the most promising in the medium and long term. In the first nine months of 2021, the volume of premiums in this segment increased by 11% y-o-y. Next year, we expect growth to accelerate to 14–15%.

In the corporate property insurance segment, ACRA expects that in 2022, the volume of premiums will remain at the level of the previous year. The situation in this segment looks like stagnation. The volume of premiums for this type of insurance has remained virtually unchanged over the past 10 years. Individual surges are generally associated with large contracts and do not change the overall picture.

A totally different situation has developed in the segment of personal property insurance, where premiums demonstrate a steady upward trend. According to ACRA's estimates, premiums in this segment grew by 13% in 2021 compared to the previous year. The Agency's base case scenario assumes that the growth rates of premiums will continue to be high in 2022.

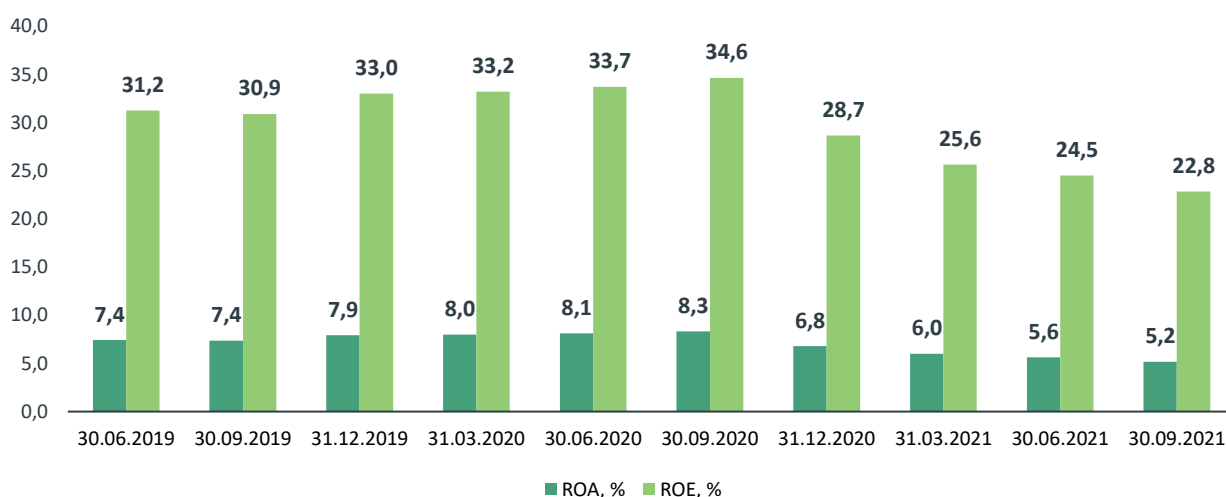
Other types of insurance, including various types of liability insurance, insurance of transport, agricultural, financial and business risks, and some other types showed a fairly strong positive trend in 2021. According to data for the first nine months of 2021, the amount of premiums in these types of insurance grew by 23% y-o-y. This growth was driven by a variety of factors. When forecasting the total premium for this diversified segment, ACRA takes into account the overall significant potential of the

Russian market and predicts that insurance premium will grow in 2022 at the average market rate (excluding credit insurance).

## DECLINING RETURNS MAY BE A SERIOUS THREAT

According to the Bank of Russia's data as of September 30, 2021, the return on assets and the return on equity demonstrated by Russian insurers have been declining over the past four quarters. This means that the assets and capital of insurance companies are growing faster than their profits. An analysis of the profit profiles of various insurers, except life insurers, shows that a significant negative impact on their financial performance results in a steady increase in their operating costs. Since the beginning of 2019, operating costs have increased from 25% to 33% of net premium. Until Q3 2020, the impact of this factor was compensated by strong investment results, which allowed ROA and ROE to grow to their maximum values. Tighter monetary policy in 2021 led to a fall in bond prices and a reduction in investment income, which pushed returns down.

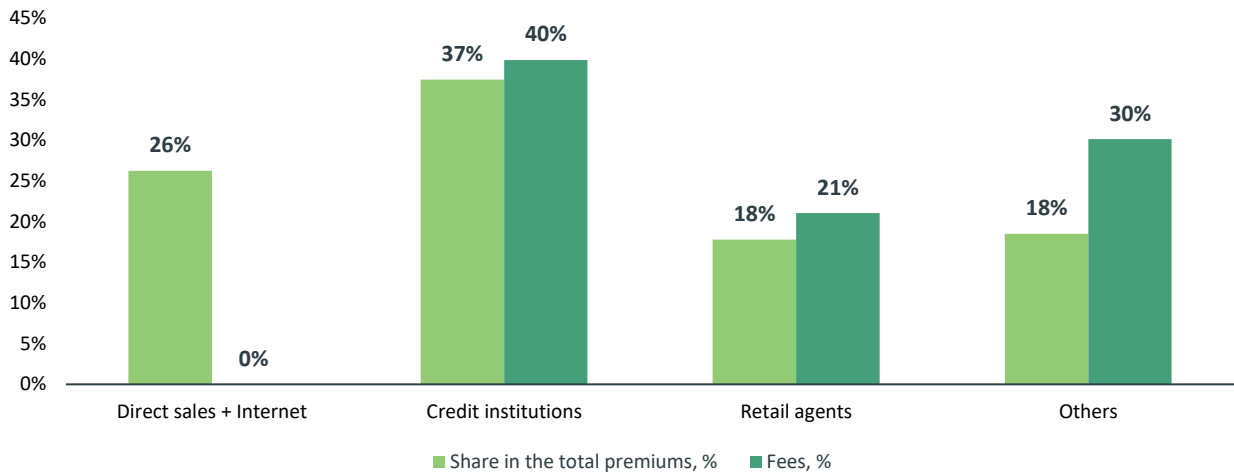
Figure 7. ROA and ROE have been declining over the past four quarters



Source: Bank of Russia

Growing insurance operating costs indicate a significant problem of the Russian insurance market — the high dependence of insurance companies on agents who earn about three-quarters of all insurance premiums. This is not critical in itself. The actual problem lies in the fact that the largest agents are credit institutions, which have vast opportunities in choosing partner insurers. Insurance companies are forced to compete for access to bank customers and offer higher fees. As a result, insurance premiums are largely withdrawn from insurance services but rather diverted as agent fees, which is contrary to the economic sense of insurance contracts.

The most significant disproportions in insurance payments and fees are observed in the credit insurance segment. High fees are also the reason for low yields on ILI policies.

**Figure 8. Banks are the largest and most expensive sales channel**

Sources: Bank of Russia, ACRA

Although the average returns of insurance companies are still high, their decline cannot but cause certain concerns among rating agencies. Currently, there are some factors contributing to a further decline in insurers' returns. In particular, earnings may experience some pressure from the major falls in the Russian stock market that occurred in Q4 2021 and January 2022. As of September 30, 2021, the value of securities held by insurance companies exceeded RUB 2 tln. At the same time, their total yearly profit before taxes is about RUB 250 bln. If the negative revaluation of securities amounts to a few percent of their value, the profits of insurers may decline drastically. Moreover, another factor in the further decrease of returns may become insurance payouts that grew due to higher prices. Combined with the regulator's intentions to tighten asset and equity ratios, regulatory risks, and continued risks of new lockdowns, weaker financial performance may impair the creditworthiness of some insurers.

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