

## **Overview of Insurance Sector in Pakistan during the economy instability and Global Financial Crisis**

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### **Abstract**

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*Insurance companies play an important role in the economic development of any country. Furthermore, the events which occur in the national and international environment also effect the insurance companies. The perfect examples of these events are the economic instability in Pakistan during period 2007 to 2009 and global financial crises 2008. Both events which occurred almost at the same time had put insurance companies in Pakistan in financial difficulty position. Consequently, significant number of insurance companies were delisted and suspended from Pakistan Stock Exchange (PSX). The current study applied a descriptive approach to explore the condition of insurance companies during economic instability in Pakistan and global financial crises.*

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**Keywords:** Insurance, Crises, Economic instability, Pakistan

### **1. Introduction**

The services sector of the global economy has become more vibrant due to globalization and advancement in the information technology (Barkur, Varambally, & Rodrigues, 2007). Furthermore, in term of world' economy, services sector is the largest, as well as, the fastest growing sector (Ahmed & Ahsan, 2011). According to the world bank (2015), services sector contributed about 69 percent towards total world's Gross Domestic Products (GDP).

Within the services sector, the services provided by insurance sector are linked to the overall economic development of a country (Ahmed, Ahmed, & Usman, 2011) and sophisticated insurance sector promotes investment and trade (Baur, Birkmaier, & Rustmann, 2001). For example, insurance companies help other companies to reduce investment risk. If a company do not have insurance protection, it is very difficult for the company to raise capital. On the other side, insured companies reduce their cost of raising capital by having insurance protection. Specially, in the emerging economies, shortage of capital is one of the major issue which companies face in their investment decisions. Therefore, insurance companies help such companies by reducing their investment cost.

The importance of insurance is also linked to infrastructure investment. Big infrastructure projects such as airports, railways and power plants are difficult to survive without the help of insurance. This is due to the unavailability of funds which can cover the losses for such projects if unexpected event occurred (Baur et al., 2001).

Insurance companies are also major players in the financial system (Malik, 2011). They act as a risk buffer and provide support to the overall business environment. Insurance companies, as a financial institution, provide aid to overall financial system in two ways. First, they are a source of transferring the risk from insured person to insurer. Second, they play a role of financial intermediary by connecting the borrowers and savers (Asghar & Afza, 2010a). In addition, insurance companies also provide stability to the overall functioning of stock market through the large number of investment made in stock market by insurance companies (Baur et al., 2001).

In Pakistan, the form of investment made by insurance companies are mainly in securities which traded in the stock exchanges. Evidently, the total investment in securities and properties was recorded about 70 percent of the insurance companies' total assets (State Bank of Pakistan, 2014).

Insurance sector plays an important role in the economic development of any country (Emamgholipour, Arab, & Mohajerzadeh, 2017). Moreover, its contribution towards overall business environment is highly imperative. Without insurance, businesses must maintain high level of liquidity which results in higher cost and less availability for investment (Asghar & Afza, 2010b). For example, companies will never have the opportunities to invest in new production facilities or companies if the risk of losses is place on their part (Baur et al., 2001). Furthermore, the discontinuity of the insurance operation will affect the overall sector of the economy, as other businesses are facing higher level of risk (Ahmed, Ahmed, & Ahmed, 2010). That is why, due to utmost importance of insurance sector, the availability of insurance is sometimes considered as factor of production (Baur et al., 2001).

Insurance companies also provide support to the overall economy by playing a role as information provider. Insurance companies' premiums level serve as an indicator for existing level of risk and probability of loss. Furthermore, insurance companies also provide advisory and consultancy services to improve the quality and safety of product and services (Baur et al., 2001).

## **2. Insurance Sector in Pakistan**

Pakistan has experienced rapid expansion in the insurance sector due to the favorable economic outlook in the last few years (Malik, 2011). The total insurance premiums of insurance industry of Pakistan have increased from PKR 87.42 billion to PKR 263.96 billion from year 2009 to 2016 (State Bank of Pakistan, 2016). The rapid growth in the insurance sector was supported by several factors.

The first factor is the increase in trade and industrial activities in Pakistan. The Industrial Production Index (IPI) reached PKR 37.4 billion in year 2013 from PKR 33 billion in year 2006. Such increased resulted in expansion of general insurance industry of Pakistan and its assets increased to PKR 154028.622 billion in year 2013 from PKR 53903.89 billion in year 2006. Second, the growth in auto-sales due to the increased credit availability to private sector resulting in huge demand of motor-insurance. The sales of motor vehicles, trailers and auto parts sector reached PKR 275.13 billion in year 2014 from PKR 162.89 billion in year 2006. Third, the booming real-estate market is creating demand for insurance in terms of fire insurance policies. In addition, mortgage insurance also provides a favorable environment for investment in housing sector (Ministry of commerce, 2016). Finally, the increasing numbers of private and multi-national organizations in Pakistan are resulting in more demand for insurance products (Asian Development Bank, 2008).

## **3. The Regulatory Framework of the Insurance Sector in Pakistan**

The prime supervisory authority of the insurance sector of Pakistan is the government of Pakistan which establishes further institutions, and passes some ordinances to regulate the insurance sector

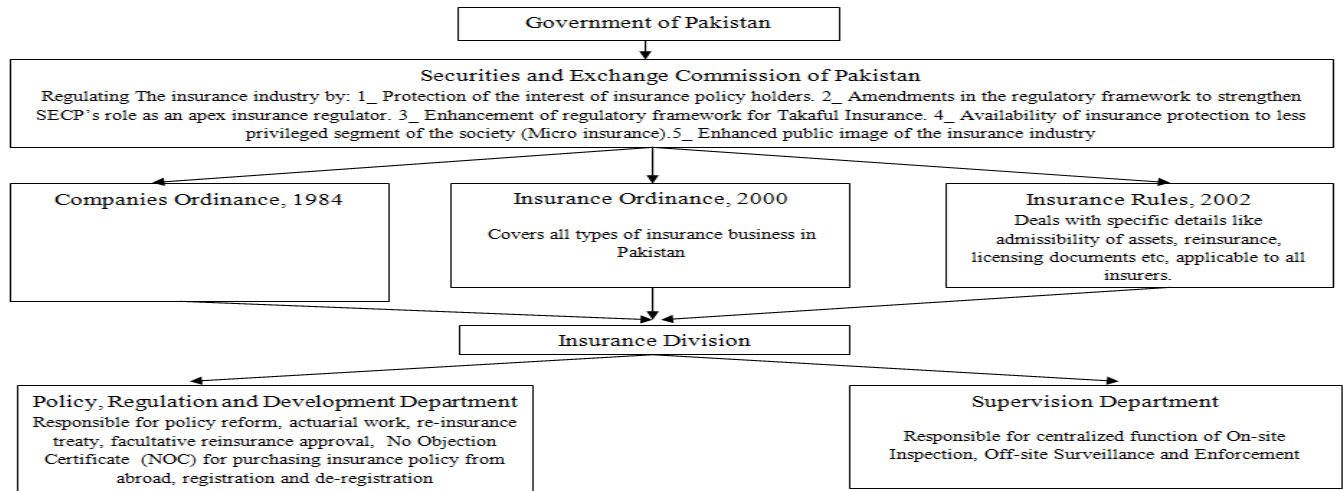


Figure 1  
Regulatory Framework of the Insurance Sector in Pakistan

Source: Author's Own Compilation Based on the Securities and Exchange Commission of Pakistan Reports (2016) and Pak Qatar Website (2007)

Figure 1 explains the regulatory framework of the insurance sector in Pakistan. The responsibility of the SECP (Under Government of Pakistan) is to ensure smooth functioning of the insurance sector of Pakistan. SECP exercise its powers through the companies’ ordinance 1984, insurance ordinance 2000 and insurance rules, 2002. Furthermore, insurance division (under the supervision of SECP) also monitors the insurance sector through policy, regulation and development department and supervision department.

The establishment of insurance cooperation in 1952 by the government of Pakistan is to regulate the insurance sector and promote the insurance companies. Further initiative made by the government of Pakistan is the formation of National Insurance Corporation (NIC) in 1976. The NIC is formed to undertake the general insurance business of any public property (EFU Insurance, 2016).

The insurance sector of Pakistan, prior to the year 2000, was placed under the regulation made by Federal Ministry of Commerce (FMC). During that period, the insurance industry was fragmented and facing operational inefficiencies, low unacceptable ethical standards and lack of professionalism. In the year 2000, the insurance act 1938 was replaced by the insurance ordinance 2000. The purpose of this new law is to provide safeguard to the insurance policyholder’s interest and to promote the development of insurance sector in Pakistan. Furthermore, in the year 2001, the regulatory responsibilities of insurance industry in Pakistan were transferred to the SECP from FMC prosperity (Securities and Exchange Commission of Pakistan, 2008).

Currently, the strategic priority of SECP is to strengthen the regulatory environment for insurance sector (Securities and Exchange Commission of Pakistan, 2008), however, Asian Development Bank (2008) highlighted that SECP capacity needs to be enhanced with respect to regulating the insurance sector.

**4. Global financial crises 2007-09, economic instability 2007-09 and insurance sector of Pakistan**

Insurance sector plays a key role for overall development of economy. Insurance companies manage and indemnify the financial risk, as well as, strengthen the capital market by working as a major institutional investor (Higher Education Commission of Pakistan, 2017). The insurance sector of Pakistan Stock Exchange (PSX) consists of 32 insurance companies with a total market capitalization of 187 billion in year 2015 (Pakistan Stock Exchange, 2016).

### Market Capitalization of Insurance Sector of PSX (In Billion Rupees)

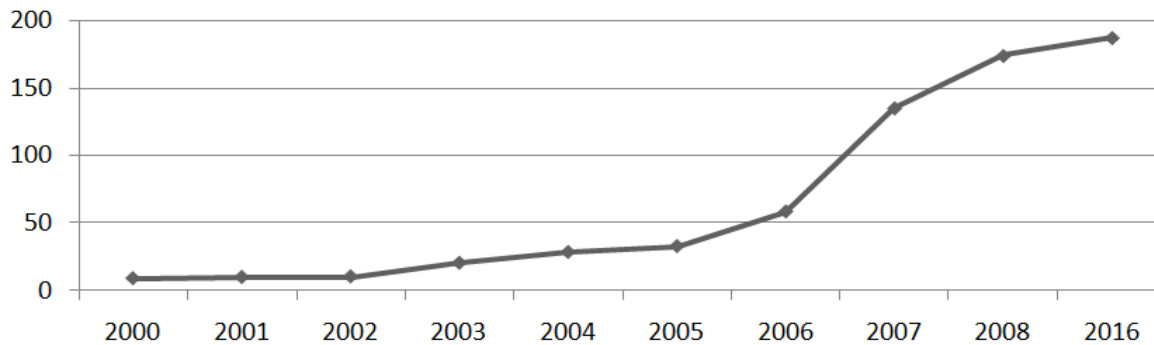


Figure 2

*Market Capitalization of Insurance Companies of Pakistan Stock Exchange (PSX)*

Source: State Bank of Pakistan (2016) and Pakistan Stock Exchange (2016)

Note: The data related to insurance sector market capitalization available from year 2000 to 2008. Afterward, the state bank of Pakistan did not update the data on their portal. That is why, the table contains the data till year 2008. However, the data for year 2015 is available on PSX website

Figure 2 shows the market capitalization<sup>1</sup> of insurance sector from year 2000 to 2015. The market capitalization of insurance companies showed gradual increase from year 2003 to 2005 and reached PKR 32.83 billion from PKR 8.94 billion. The rapid increase in the market capitalization of insurance sector occurred between the year 2005 to 2007 and it reached 135.05 billion from 32.83 billion. The growth rate during this period was 43 percent and 56 percent respectively. However, the growth rate in 2008 reduced to 22 percent and its market capitalization reached 173.91 billion. In year 2016, the market capitalization of insurance company stands at 187 billion. The overall increase in the market capitalization from year 2008 to 2016 (173.91 billion to 187 billion) is not satisfactory as compared to period 2000 to 2008.

The insurance industry in Pakistan is not in a favorable condition after 2008. This is due to the increasing number of companies delisted from PSX. During 1971 to 2008, only one insurance company has been delisted, however, the number of delisted insurance companies seems to increase to 7 during the period of 2012 to 2015.

Furthermore, PSX also suspended three insurance companies due to violation of various regulations during 2007 to 2008. The ratio of suspended companies from insurance sector was much greater than any other sector in PSX. Subsequently, from 2009 to 2016, further 4 insurance companies were suspended by PSX management. Thus, it is very difficult to point out a single reason behind such huge instability from insurance sector of PSX. However, during the last decade, several factors contributed to this alarming condition.

One of the factor which effected the insurance sector of Pakistan was the Global financial crises which occurred in 2007 to 2009. It was the worst economic meltdown of current century (Harrington, 2009) which resulted in the downfall of world largest insurance corporation, AIG (American International Group). The causes of global financial crises and its transmission to various firms, sectors and borders have been discussed largely in literature (Harrington, 2009). At the same time, Pakistan economy are also faced difficulty due to the crisis (Securities and Exchange Commission of Pakistan, 2012). During global financial crises, the insurance sector was largely at the surface level of risk. Most shocking event of global financial crises was the collapse, bailout and quasi-nationalization of AIG. The structure of AIG is complex which consist of about 70 percent of insurance companies, as well as, 170 non-us companies which are working in different countries (Harrington, 2009).

<sup>1</sup> Market capitalization is calculated by multiplying share price by number of shares

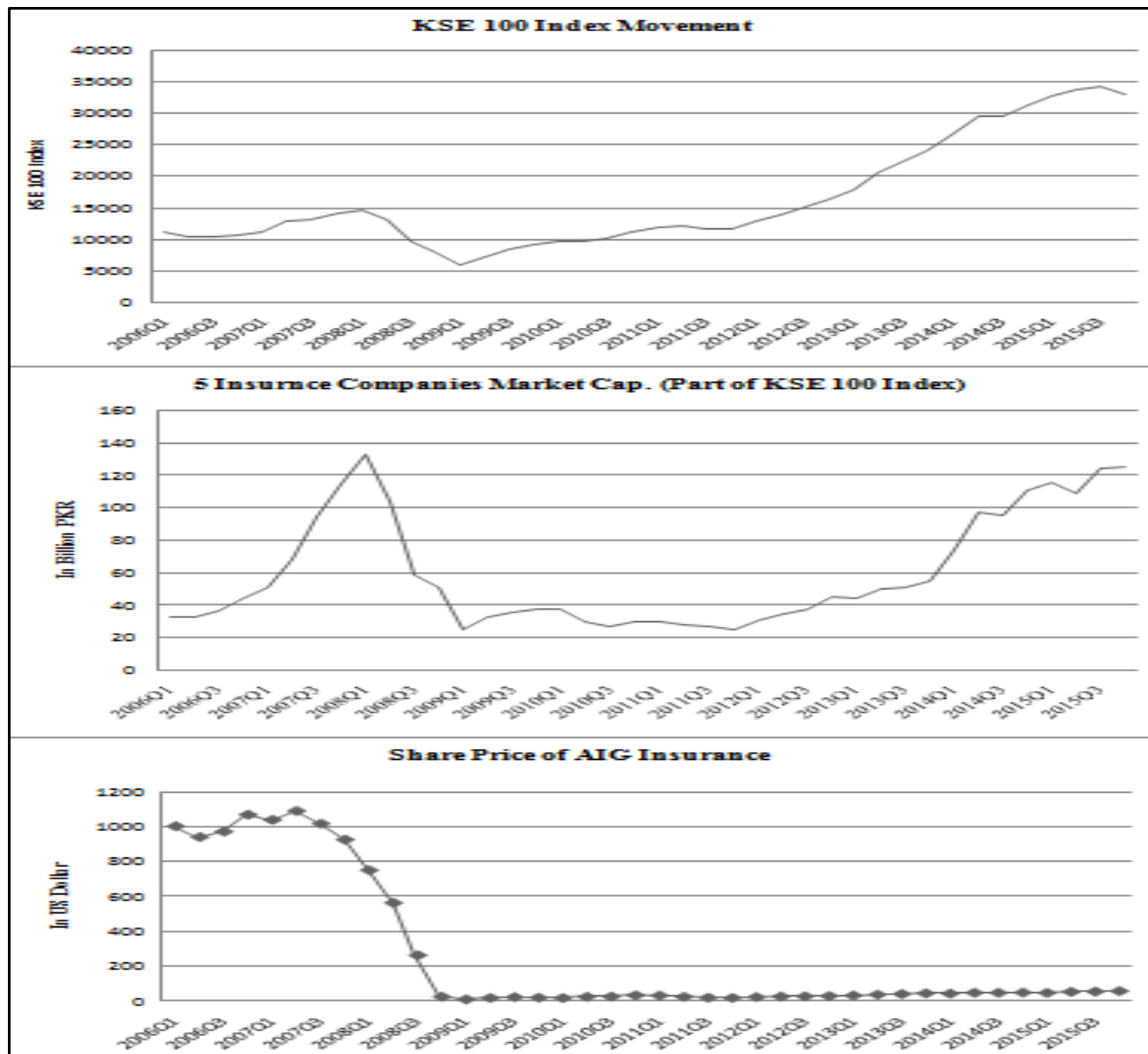


Figure 3  
 Movement of Share Prices of KSE 100 Index, 5 Selected Insurance Companies (Part of KSE 100 Index) and AIG Insurance During Period 2006-15  
 Source: Yahoo Finance (2016) and Business Recorder (2016)

Figure 3 exhibits the movement of KSE 100 index, 5 selected insurance companies<sup>2</sup> share prices and AIG insurance company share price during the period of 2006 to 2015. AIG insurance share price was most affected by the global financial crises 2007-09. Its share price decreased to US Dollar 29 in last quarter of year 2008 from US Dollar 929 in the last quarter 2007. Rapid declining trend was also observed in the stock prices of 5 selected insurance company and KSE 100 index movement respectively. KSE 100 index decreased to 5988 points in first quarter of the year 2009 from 14132 points in the last quarter of year 2007. At the same time, the market capitalization of 5 selected insurance companies decreased to PKR 24.68 billion in the first quarter of the year 2009 from PKR 114.61 billion in the last quarter of year 2007.

The investment income and net profits of insurance industry also decreased during the period of 2007 to 2008 and investment income of insurance companies turned into investment loss.

<sup>2</sup> The five selected insurance companies (Adamjee Insurance Company Limited, EFU General Insurance Limited, Jubilee General Insurance Company Limited, IGI Insurance Limited and Jubilee Life Insurance Company Limited) are the representative of insurance sector in KSE 100 Index. KSE 100 index is the key performance indicator of Pakistan Stock Exchange (PSX).

The loss was due to overall decline in the performance of PSX (Afza and Asghar, 2012). Apparently, during the period of 2006 to 2013, 70 percent of total asset of insurance companies in Pakistan were in securities and properties (State Bank of Pakistan, 2014).

Nevertheless, the global financial crisis is not the only factor which proved to be harmful for insurance sector in Pakistan. During last decade, huge fluctuations in the macro-

### Movement of Inflation and Interest Rate

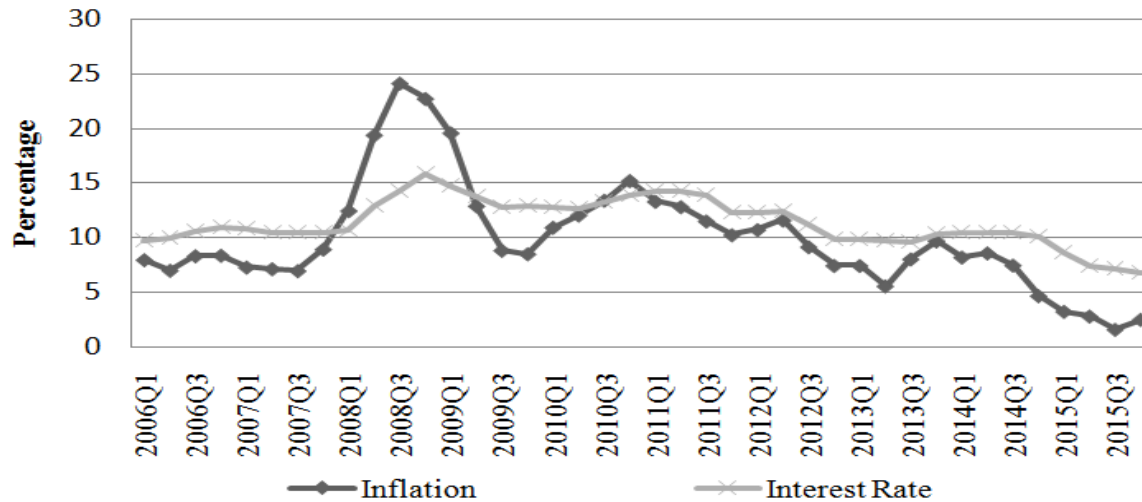


Figure 4  
 Movement of Inflation Rate and Interest Rate in Pakistan During Period 2006-15  
 Source: World Bank (2016) and State Bank of Pakistan (2016)

economic indicators like inflation and interest rate were also observed to affect the insurance sector in Pakistan. As indicated in figure 4, there was also a price instability in the country and inflation rate rapidly reached to 24 percent in the last quarter of year 2008 from 8.9 percent in last quarter of year 2007. Then, during the year 2009, inflation rate rapidly reduced to 8.50 percent. In order to compensate the price instability in Pakistan during period 2007 to 2009, huge fluctuations were also observed in the level of interest rate. Interest rate rose to 16.11 percent in the last quarter of year 2008 from 10.4 percent in last quarter in 2007. In the middle 2010, the interest rate showed the declining trend and reached to 12.2 percent. The year 2007 to 2009 was also a crises period in Pakistan due to the assassination of the former Prime Minister, Madam Benazir Bhutto in the year 2007 and the collapse of PSX in year 2008. These factors also contributed in the abnormal movement of inflation rate and interest rate during period 2007 to 2009.

### 5. Conclusion

This study has shown that the global financial crises during period 2007 to 2009 proved to be very harmful for the insurance sector of Pakistan. In addition to global financial crises 2007-09, high level of economic instability was also observed in Pakistan. Because of global financial crises 2007-09 and economic instability in Pakistan during period 2007-09, a significant number of insurance companies were delisted and suspended from PSX.

Despite the global financial crises 2007-09 and economic instability in Pakistan during period 2007-09, during last few years, insurance sector shows the sign of recovery. It is because of increase in demand of insurance products in Pakistan which is supported by multiple factors for example increase in auto mobile sale, mortgage insurance demand and number of private and multinational firms.

To make insurance sector more resilient in case of any future global economic crises or national economic instability, it is recommended in this study that the capacity of SECP should strengthen to ensure the continuous prosperity of the insurance sector in Pakistan.

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