

## Nepal Reinsurance Company Limited: Rating reaffirmed

May 15, 2023

### Summary of rating action

Facility/ Instrument	Rated Amount	Rating Action
Issuer Rating	NA	[ICRANP-IR] AA-; reaffirmed

### Rating action

ICRA Nepal has reaffirmed an issuer rating of **[ICRANP-IR] AA-** (pronounced ICRA NP Issuer Rating double A minus) to Nepal Reinsurance Company Limited (NRIC), indicating a high degree of safety in the timely servicing of financial obligations. Such issuers carry very low credit risk. The sign of + (plus) or – (minus) appended to the rating symbol indicates the entity’s relative position within the rating categories concerned. The rating is only an opinion on the general creditworthiness of the rated entity and is not specific to any debt instrument.

### Rationale

The rating reaffirmation continues to factor in NRIC’s strong ownership profile with ~44% stake by the Government of Nepal (GoN). The rating also factors in the company’s strong solvency profile (3.26 times for FY2022) and liquidity, adequate retrocession arrangement and its strong reinsurance partners, which remains a comfort against any near to medium term probable obligations. Given NRIC’s relatively longer track record, its traction with different stakeholders and its economies of scale, it is likely to remain a major beneficiary of the recent regulatory provision supporting Nepalese reinsurers<sup>1</sup>; which remains a rating positive. The generally good underwriting performance of the domestic insurance companies, despite recent moderation (mainly general insurers) is also likely to support NRIC’s performance as it sources its major business from Nepal market. This is also reflected in NRIC reporting underwriting surplus in each of the past five years ended FY2022 with exception of FY2021 due to settlement of Covid-19 related claims. The underwriting performance remains supported by the adequate return on investment, resulting in a good overall profitability (average return on equity-RoE of ~7% and average return on assets -RoA of 6% in the past five years). Moreover, the sovereign ownership of NRIC is also likely to support its acceptability among foreign insurance companies and is likely to help it secure overseas businesses; which also remains a positive from the future scalability perspective.

However, the rating remains constrained by NRIC’s limited track record of operations (operating since November 2014). While the company’s conservative risk retention policy and strong retrocession cover offers comfort, its ability to honour its obligations arising from major events/catastrophe remains untested so far. Rating concerns also arise from NRIC’s significant dependence on domestic general insurers (79% of FY2022 gross premium was sourced from domestic general insurers) and the gradual moderation in the underwriting profits (rising combined ratio) of domestic general insurers which is, therefore, likely to put pressure on the underwriting profitability of NRIC as well. NRIC also remains exposed to regulatory changes. Moreover, with over 94% of its business sourced from Nepalese insurers, the company remains exposed to the geographical concentration risk; albeit partly mitigated by adequate reinsurance coverage, including catastrophic coverage taken by the company. The rating also remains constrained by the expected competitive pressure

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<sup>1</sup> As per the circulars released by the Nepal Insurance Authority in May 2022, domestic insurers have to directly cede 10% of their business each to the two domestic reinsurers viz. NRIC and Himalayan Reinsurance Limited; in addition to setting aside 15% of the treaty share in reinsurance each to the domestic reinsurers till FY2023. For FY2024 and onwards the proportion of direct cession is to be progressively lowered by 2% every year while for treaty reinsurance the share for both domestic reinsurers are to be increased to 20% each.

from newly established private sector domestic reinsurance company as well as other established foreign reinsurers offering their services in Nepal.

Going forward, regulatory changes, NRIC's ability to check sustained erosion in underwriting performance and maintain adequate solvency/liquidity profile would remain key monitorable.

## Key rating drivers

### Credit Strengths

**Strong ownership profile** – The company is promoted by the Government of Nepal (GoN) with a ~44% stake, 17 non-life insurance companies (~27%) and eight life insurance companies (~6%) among others. Two out of five members on the board of directors are from the GoN. NRIC being the first Nepalese reinsurance company and the only one with sizeable sovereign ownership is likely to remain strategically important to the GoN. Sovereign ownership also reflects positively in the company's acceptability by foreign insurers/reinsurers as reflected in NRIC securing businesses originating from over 16 countries in Asia and Africa as of mid-July 2022, with major portion of the foreign business premium coming from treaty reinsurance led by established global reinsurers. Moreover, NRIC has also obtained cross-border reinsurance certificate from IRDA, India, allowing it to participate in the Indian insurance market.

**Policy support for the domestic reinsurers**– As per the regulatory changes rolled out by the Nepal Insurance Authority (insurance sector regulator) in May 2022, Nepalese insurance companies are required to directly cede 10% of their premium (and risk) and ensure a minimum of 15% share in the reinsurance treaty each to the two domestic reinsurers. While this has curtailed NRIC's share of direct cession (from 20% in the past to 10% going forward), the provision of mandatory treaty shares and NRIC's decreasing reliance on direct cession over the year (given its growth along other segments) is likely to cushion the blow on NRIC to some extent. Furthermore, the regulatory provision has given the preferential right of reinsurance to domestic reinsurers for all major businesses (treaty/facultative) originating in Nepal. Although the incremental business prospect of both the reinsurers operating in Nepal (including Nepal Re) remains similar under the regulation; NRIC is likely to remain a major beneficiary given its past track record, economies of scale and sovereign ownership.

**Adequate reinsurance cover through retrocession arrangement** – The company has adequate reinsurance arrangement for all the business lines. The company has agreements with Hannover Ruck SE - Hannover Re (Financial Strength Rating (FSR) of A+ (Superior) and long term Issuer Credit Ratings (ICR) of "aa" (superior) by AM Best) for Whole Account CAT XL and riots, strikes, malicious damage, sabotage terrorism (RSMDST) facility, with similar arrangement with other reputed counterparties for other business lines. The company's net retention per risk insured remains on the lower side (around up to NPR 100 million per risk) with excess risk passed on to other reinsurance companies through the retrocession agreement. Similarly, NRIC also maintains adequate catastrophic reinsurance cover, which remains a comfort against the company's claims paying ability during a major catastrophe such as the April 2015 earthquake (catastrophic cover of up to NPR 25 billion in net retained account).

**Adequate solvency and liquidity** – On the solvency front, NRIC's solvency margin ratio as of mid-July 2022 stood at 3.26 times (2.82 times as of mid-July 2021). NRIC has been maintaining the mandatory technical reserves and restricted reserves<sup>2</sup> as prescribed by the regulator. Similarly, the company maintains adequate liquidity as evidenced by cash and

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<sup>2</sup> Technical reserve includes reserve towards unpaid claims & unexpired risk; restricted reserves include Insurance reserve and Insurance fund appropriated from annual profits

liquid assets to the technical reserve ratio of 1.85 times as of mid-July 2022. Similarly, the adequacy of reserves being maintained by NRIC is also reflected in net claims paid to technical reserve of 57% in FY2022 (54% in FY2021).

**Healthy profitability supported by investment earnings** – NRIC’s underwriting performance has improved in FY2022 after a moderation in FY2021 amid high claims. Claims ratio spiked in FY2021 on account of higher claim settlement during the year as the company discharged all past claims including Covid-19 claims of ~NPR 1.2 billion (22% of total claims for the year) which impacted the company’s underwriting performance for the year. Claim ratio improved thereafter in FY2022 to ~55% from ~72% in FY2021 supporting the improvement in underwriting surplus to ~NPR 934 million in FY2022 from loss of ~NPR 559 million in FY2021. Nonetheless, a steady investment income (yield on average investment of ~8% in FY2022; average of ~8.2% in past three years) continued to support the company’s overall profitability and cashflows during the period of weak underwriting surplus. High interest rate environment in the Nepalese banking sector is expected to support the company’s incremental investment yield. NRIC’s investment portfolio, as of mid-July 2022, was compliant with the regulatory guidelines with ~82% of the portfolio in FDRs and debentures of BFIs, ensuring adequate liquidity for the company.

The overall profitability indicators of the company remained modest in FY2021 (amid weak underwriting surplus) which subsequently improved in FY2022. The company’s return on net worth (RoNW) improved to ~9% in FY2022 from ~2.6% in FY2021 likewise return on assets (ROA) to 5.2% from 1.6% in the respective period. NRIC’s profit after tax (PAT) grew by around 270% y-o-y to NPR 1,484 million in FY2022.

## Credit Challenges

**Limited track record of operations** – NRIC’s track record as a full-fledged reinsurance company is less than 10 years (operating since November 2014). Its track record of operations on a higher scale remains even shorter (after the introduction of the mandatory cession norms by the GoN from FY2019). Although the company’s business growth in the last few years has remained healthy, its ability to meet the claims on a sustained basis over a longer timeframe and during various situations (events/catastrophe) remains untested. This, along with the evolving technical/human capability in the Nepalese reinsurance industry in Nepal remain a concern.

**High geographical concentration** – Though the company’s business comes from several foreign countries, the domestic business dominates the company’s gross premium written (GPW). The share of domestic premium in the GPW has further increased to ~94% in FY2022 from ~82% in FY2021, as the company adopted a cautious approach on foreign business due to the higher loss experience. Moreover, the fire (property insurance) portfolio constitutes sizeable share in its GPW (~21% in FY2022), which could result in chunky claims in the event of a natural disaster. The retention ratio across portfolios has also increased (~89% in FY2022 from ~86% in FY2020), which could lead to higher loss ratios in the event of elevated claims. However, an adequate reinsurance arrangement (including catastrophic coverage) provides some comfort.

**Increased competition in the domestic market and regulatory risk** – The addition of second Nepalese reinsurance company. The increased competition in the domestic market for business is also likely to result in increased commission expense to the insurance companies to secure more business, which could affect the profitability of the domestic reinsurers. NRIC’s incremental business, profitability and overall financial profile will remain vulnerable to any further regulatory changes that could lead to loss of business stream (such as any change in the reinsurance norms related to RSMDS<sup>3</sup> business, etc).

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<sup>3</sup> Riot, Strike, Malicious Damage, Sabotage and Terrorism; Nepal Re is the sole beneficiary of premium ceded under this category by domestic reinsurers. Nepal Re has been doing this business since its days as “Reinsurance Pool” during the Insurgency period of Nepal.

**Link to the previous rating rationale:**

[Rationale-Nepal Reinsurance Company Limited, October 2021](#)

**Analytical approach:** For arriving at the rating, ICRA Nepal has applied its issuer rating methodology as indicated below.

**Links to applicable criteria**

[Issuer Rating Methodology](#)

## Company Profile

Nepal Re-Insurance Company Ltd. (NRIC) is the successor of the Insurance Pool that was set up in 2003 with the aim to cover the losses arising from riot-sabotage-terrorism and malicious damage (RSTMD) during the Maoist insurgency in Nepal. NRIC was incorporated on 7th November 2014, under the Companies Act, 2006 as per the decision of Council of Ministers to convert the pool to the re-insurance company. The company came into operation in December 2014. This is the first Nepalese re-insurance company.

The paid-up capital and the net worth of NRIC as of mid-July 2022 stood at ~NPR 11,650 million and ~NPR 16,775 million, respectively. At present, the equity shares of the company are distributed between the promoter and public in 84:16 ratio. The shareholding is divided among the Government of Nepal (GoN) (~44%), multiple non-life insurance companies (~27%), several life insurance companies (~6%), seven public limited companies (~7%), and the general public (16%).

During FY2021, NRIC reported a profit after tax of ~NPR 401 million over an asset base of NPR 27,987 million as of mid-July 2021. The company has reported<sup>4</sup> a profit after tax of ~NPR 1,484 million during FY2022 over an asset base of NPR 30,288 million.

### Key financial indicators:

Amount in NPR million	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Provisional)
<b>Number of months in operation</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>
Gross premium earned (GPE)	5,739	7,532	9,101	10,969
Net premium earned (NPE)	4,779	6,488	7,955	9,732
Premium retention (NPE/GPE)	83%	86%	87%	89%
Claims ratio (Net claims incurred/NPE)- A	41%	53%	72%	55%
Management expense ratio (Management expense/NPE)-B	4%	5%	3%	4%
Commission expense ratio (Commission expense/NPE)-C	39%	33%	32%	31%
Combined ratio (A+B+C)	83%	91%	107%	90%
Underwriting surplus	791	555	(559)	934
Investment earnings	1,085	1,247	1,311	1,521
Average yield on investments	10.1%	8.9%	7.6%	8.0%
Profit after tax (PAT)	917	1,134	401	1,484

<sup>4</sup> Provisional numbers for FY2022

Amount in NPR million	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Provisional)
<b>Number of months in operation</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>
Return on equity	7.5%	7.6%	2.6%	8.8%
Return on assets	6.1%	5.5%	1.6%	5.2%
Solvency margin ratio	2.01	2.47	2.82	3.26

Source: Company data; financial indicators as per NFRS

For further details please contact:

### Analyst Contacts:

**Mr. Sailesh Subedi**, (Tel No. +977-1-4419910/20)

[sailesh@icranepal.com](mailto:sailesh@icranepal.com)

**Ms. Kushum Bhattarai** (Tel No. +977-1-4419910/20)

[kushum@icranepal.com](mailto:kushum@icranepal.com)

### Relationship Contacts:

**Ms. Barsha Shrestha**, (Tel. No. +977-1-4419910/20)

[barsha@icranepal.com](mailto:barsha@icranepal.com)

### About ICRA Nepal Limited:

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ICRA Nepal Limited,

Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.

Phone: +977 1 4419910/20

Email: [info@icranepal.com](mailto:info@icranepal.com)

Web: [www.icranepal.com](http://www.icranepal.com)

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