

September 07, 2022

HDFC Ergo General Insurance Company Limited: Rating reaffirmed/assigned

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer Rating	-	-	[ICRA]AAA (Stable); reaffirmed
Subordinated debt programme	154.00	154.00	[ICRA]AAA (Stable); reaffirmed
Subordinated debt programme	375.00	375.00	[ICRA]AAA (Stable); reaffirmed
Subordinated debt programme	350.00	-	[ICRA]AAA (Stable); reaffirmed and withdrawn
Subordinated debt programme	-	80.00	[ICRA]AAA (Stable); assigned
Total	879.00	609.00	

*Instrument details are provided in Annexure I

Rationale

The rating considers the parentage of HDFC ERGO General Insurance Company Limited (HEGI) with the largest stake (49.98%) held by HDFC Limited (HDFC; rated [ICRA]AAA (Stable)/[ICRA]A1+) and a stake of 48.99% held by ERGO International AG as on June 30, 2022. HDFC's large shareholding, its representation on HEGI's board of directors and the presence of a shared brand name strengthen ICRA's belief that HEGI will receive capital support from the parent company as and when required.

ICRA notes that the solvency ratio was impacted due to the high claims received in the health segment. As a result, the company reported a lower cushion in the solvency profile (1.68 times as on June 30, 2022) compared to the minimum regulatory requirement of 1.50 times. However, ICRA notes the company's policy and track record of maintaining the solvency buffer above the regulatory minimum and expects capital support from the promoters to maintain the same. The rating also considers HEGI's healthy market share¹ (5.7% in Q1 FY2023) with a strong retail franchise and a diversified product portfolio and distribution network.

In April 2022, HDFC had announced a scheme of amalgamation whereby it would amalgamate with and into HDFC Bank Limited (HDFC Bank) subject to regulatory approvals. The amalgamation (HDFC and HDFC Bank) of the promoter entity and regulatory clarity on its stake in HEGI will remain key monitorables.

HEGI's underwriting performance remains moderate, largely impacted by higher Covid claims, although its net profitability remains supported by healthy investment income. With the severity of Covid-19 infections receding, ICRA expects the company's net loss ratio in the health & personal accident segment to improve in FY2023.

ICRA has reaffirmed and withdrawn the rating outstanding of [ICRA]AAA (Stable) on the Rs. 350-crore subordinated debt programme as the company redeemed the rated bonds by exercising a call option and there is no amount outstanding against the same. The rating has been withdrawn in accordance with ICRA's policy on the withdrawal of credit ratings.

The credit rating also factors in the key features of the rated instrument, in line with the applicable guidelines for subordinated debt:

- » Servicing of interest is contingent on the company maintaining a solvency ratio above the levels stipulated by the regulator
- » In case the interest payouts lead to a net loss or an increase in the net loss, prior approval of the regulator would be required to service the debt

¹Excluding Agriculture Insurance Company of India (AIC) and Export Credit Guarantee Corporation of India (ECGC)

Key rating drivers and their description

Credit strengths

Strong parentage; experienced management team – HDFC is the largest shareholder in HEGI with a 49.98% stake as on June 30, 2022 followed by ERGO International AG (48.99%). The balance (1.03%) is held by the employees of the company. HDFC's stake was diluted from 50.56% as on March 31, 2021 due to the Reserve Bank of India's (RBI) direction to reduce its stake in HEGI to 50% or below. HDFC is a leading housing finance institution operating for more than 40 years in India. With a presence in banking, insurance and asset management, the HDFC Group is an important part of the Indian financial services sector. The shared brand name strengthens ICRA's belief that HEGI will receive capital support from its parent companies as and when required. HEGI's operations are handled by a team of senior managers with considerable experience in the general insurance (GI) industry. In April 2022, HDFC announced a scheme of amalgamation wherein it would amalgamate with and into HDFC Bank subject to regulatory approvals. HDFC Bank is a banking company licensed by the RBI under the provisions of the Banking Regulation Act, 1949. ICRA notes that as and when HEGI becomes a subsidiary of HDFC Bank (subject to regulatory approvals), any further capital infusion will require the regulator's approval.

HEGI's capital-raising ability will be limited to a rights issue, an increase in the stake of other existing investors or the entry of new investors through a preferential allotment or a qualified institutional placement. The additional headroom available for raising subordinated debt was negligible as on June 30, 2022. However, ICRA notes that Insurance Regulatory and Development Authority of India's (IRDAI) draft guidelines on other forms of capital have proposed an increase in the subordinated debt limit to 50% of the paid-up capital and share premium from 25% at present. This will allow HEGI to raise additional subordinated debt of ~Rs. 530 crore or ~25 basis points (bps) of the reported solvency ratio as on June 30, 2022. Moreover, the company has the option to reduce the dividend payout (Rs. 231.7 crore in FY2022 or 11 bps of the reported solvency as on March 31, 2022). ICRA notes that the dividend payout ratio is relatively higher than peers, while the capital buffer is lower compared to peers. ICRA expects the solvency ratio to be above 1.70 times in FY2023.

Diversified product portfolio and distribution network – HEGI is the second largest health insurance company and the third largest private GI company with a market share² of 5.7% in Q1 FY2023. It has a diversified product profile with the health & personal accident segment forming 41.8% of the gross direct premium written (GDPI) in Q1 FY2023, followed by the motor segment (27.2%), fire (19.6%), and others (11.4%). ICRA notes that the company has a considerable presence in the crop segment with a 20-24% share of the GDPI in the last few years.

HEGI has a diversified distribution network, with brokers and direct business contributing 43.1% and 15.4%, respectively, to the total GDPI in Q1 FY2023. The commercial line of business is mainly sourced through the broker channel while the crop business is sourced directly by the company. Following its merger with the health insurance arm, which has a higher retail business, the share of agents in the total GDPI grew to 19.8% in Q1 FY2023 from 11.3% in FY2020. HEGI has one of the largest agency networks in the industry with an agent base of ~1,60,000 as on June 30, 2022. With banks facing a slowdown in credit due to the Covid-19 pandemic in the last couple of years, the company reported lower business (11.2% in Q1 FY2023) from the bancassurance channel. HEGI has tie-ups with various banks and non-banking financial companies (NBFCs), including HDFC Bank, Deutsche Bank, SVC Co-operative Bank, Saraswat Bank, Federal Bank and L&T Finance Ltd.

Credit challenges

Moderate underwriting performance with profitability mainly supported by investment income – Despite the significant rise in the underwriting losses to Rs. 567.8 crore in FY2022 from Rs. 235.0 crore in FY2021, the company reported a net profit, which was largely supported by the rise in net investment income (includes interest, dividend and rent) to Rs. 1,114.2 crore (+8.2% YoY). The underwriting losses were due to the rise in the combined ratio to 107.5% in FY2022 from 103.2% in FY2021. As the share of the health & personal accident business, which witnessed Covid claims, is higher in the company's GDPI mix,

² Excluding Agriculture Insurance Company of India (AIC) and Export Credit Guarantee Corporation of India (ECGC)

its claims ratio remained higher at 75.7% (FY2021) and 84.0% (FY2022) compared to peers. HEGI witnessed high gross Covid claims of Rs. 851 crore in FY2022 and Rs. 615 crore in FY2021.

Further, the company reported a net profit of Rs. 144.2 crore in Q1 FY2023 compared to a net loss of Rs. 35.5 crore in Q1 FY2022 largely due to the improvement in the combined ratio to 107.1% in Q1 FY2023 compared to 124.9% in Q1 FY2022. Also, its net profitability was supported by the rise in the net investment income. The combined ratio improved as the claims ratio declined to 80.1% in Q1 FY2023 from 95.1% in Q1 FY2022. The improvement in the claims ratio was mainly due to the reduced severity of Covid as the company reported gross Covid claims incurred of Rs. 30 crore in Q1 FY2023. The moderation in the profitability and the increase in the reserving requirement because of higher Covid claims in the last couple of years led to a deterioration in the solvency to 1.68 times as on June 30, 2022. Going forward, HEGI's ability to improve its underwriting performance while maintaining the growth momentum and healthy cushion on the solvency profile would remain a key rating monitorable.

High share of crop insurance, making the business vulnerable to the vagaries of the weather – HEGI continues to underwrite a significant proportion of the crop business, which accounted for 20.1% of the total GDPI in FY2022. The company has a decade of experience in this business and a significant portion of the crop business (76-78%) is reinsured. Consequently, HEGI's overall retention ratio has been low in the range of 50.0-54.0%, with the same remaining lower compared to peers. The net claims ratio in the crop segment was 76.2% in FY2022 (77.6% in FY2021). ICRA notes that the claims in this segment remain contingent on climatic conditions, which are unpredictable, thus posing a risk.

Liquidity position: Strong

HEGI had estimated liquid assets of Rs. 14,546 crore (sum of total investments less haircuts estimated by ICRA, plus cash and bank balances plus net due from insurance companies) as of June 30, 2022, against which it had a total liability of Rs. 12,309 crore (total technical reserve plus debt due in the next one year). The total net claims paid stood at Rs. 4,903 crore (48.2% of liquid assets) in FY2022 and Rs. 637 crore (17.5% annualised) in Q1 FY2023. The nearest debt repayment is the principal of the subordinated debt programme of Rs. 80 crore, wherein the company is likely to exercise the call option due on September 19, 2022. Simultaneously, the company intends to issue fresh subordinated debt amounting to Rs. 80 crore. Moreover, the business generated in FY2023 would provide liquidity cushion. ICRA does not foresee any liquidity risk for the company in the near to medium term.

Rating sensitivities

Positive factors – Not applicable

Negative factors – The rating or outlook could be revised if there is a downward revision in the ratings of the promoter company (HDFC) or a decline in the strategic importance of HEGI to its promoter companies or a decline in the expectation of support from the promoters. In addition, a decline in the company's solvency ratio to less than 1.70 times on a sustained basis could lead to a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Issuer Rating Methodology for General Insurance Companies Methodology for Rating Hybrid Debt Instruments Issued by Insurance Companies Impact of Parent or Group Support on an Issuer's Credit Rating Policy on Withdrawal of Credit Ratings
Parent/Group support	Parent/Investor: HDFC Limited ICRA factors in the implied support of the parent entity, HDFC Limited, and takes comfort from the experience of the management team in the insurance business. The capital ownership structure and shared branding provide comfort.
Consolidation/Standalone	Standalone

About the company

HDFC ERGO General Insurance Company Limited (HEGI) is a joint venture between HDFC Limited, India's premier housing finance institution (49.98% stake as on June 30, 2022) and ERGO International AG (48.99% stake), while the balance is held by the employees of HEGI. The company offers a complete range of general insurance products including crop, motor, health, travel, home and personal accident insurance in the retail space and customised products like property, marine and liability insurance in the corporate space. HEGI has a presence across the country with 203 branch offices as on June 30, 2022.

Key financial indicators (audited)

HDFC Ergo General Insurance Company Limited	FY2020	FY2021	FY2022	Q1 FY2022	Q1 FY2023
Gross direct premium	9,630	12,295	13,498	2,386	3,073
Total underwriting surplus / (shortfall)	(343)	(235)	(568)	(324)	(115)
Total investment + Trading income	881	1,152	1,297	301	328
PAT	327	592	500	(36)	144
Total net worth*	2,768	3,254	3,577	3,268	3,634
Total technical reserves	8,983	10,430	11,536	11,000	12,229
Total investment portfolio	13,577	16,643	18,397	17,162	19,122
Total assets	17,060	19,319	21,290	19,229	21,358
Return on equity	11.8%	18.2%	14.0%	(4.3%)	15.9%
Gearing (times)	0.18	0.15	0.15	0.15	0.15
Combined ratio	105.3%	103.2%	107.5%	124.9%	107.1%
Regulatory solvency ratio (times)	1.78	1.90	1.64	1.69	1.68

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore

* Total net worth includes share capital, reserve & surplus and fair value change account

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current Rating (FY2023)		Chronology of Rating History for the Past 3 Years			
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2023 Sep 07, 2022	Date & Rating in FY2022 Oct 22, 2021	Date & Rating in FY2021 Feb 02, 2021	Date & Rating in FY2020 Jan 30, 2020
1 Issuer Rating	Long Term	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-
2 Subordinated debt programme	Long Term	350.00	-	[ICRA]AAA (Stable); reaffirmed and withdrawn	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
3 Subordinated debt programme	Long Term	154.00	154.00	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-
4 Subordinated debt programme	Long Term	375.00	375.00	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
5 Subordinated debt programme	Long Term	80.00	0.0	[ICRA]AAA (Stable)	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Subordinated Debt Programme	Moderately Complex
Issuer Rating	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE092V08010	Subordinated debt programme	Sep 18, 2017	8.40%	Sep 17, 2027	80.00	[ICRA]AAA (Stable)
INE092V08028	Subordinated debt programme	Sep 18, 2018	10.25%	Sep 18, 2028	74.00	[ICRA]AAA (Stable)
INE225R08014	Subordinated debt programme	Nov 09, 2021	7.10%	Nov 09, 2031	375.00	[ICRA]AAA (Stable)
INE392I08011	Subordinated debt programme	Nov 09, 2016	7.60%	Nov 09, 2026	350.00	[ICRA]AAA (Stable); reaffirmed and withdrawn
Not yet placed	Subordinated debt programme	NA	NA	NA	80.00	[ICRA]AAA (Stable)
NA	Issuer Rating	NA	NA	NA	NA	[ICRA]AAA (Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not applicable

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Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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Branches



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