June 16, 2020

HDFC Life Insurance Company Limited: Rating assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Issuer Rating	-	[ICRA]AAA(Stable); Assigned
Subordinated Debt Programme	600.00	[ICRA]AAA(Stable); Assigned
Total	**600.00**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned rating reflects HDFC Life Insurance Company Limited's (HDFC Life) strong promoter profile, given the majority shareholding of Housing Development Finance Corporation Limited (HDFC; [ICRA]AAA(Stable)/[ICRA]A1+) in the company. As on March 31, 2020, HDFC had a 51.44% stake in HDFC Life followed by Standard Life (Mauritius Holdings) 2006 Limited (a unit of Standard Life Aberdeen Plc) at 12.25% while the rest was publicly held (including foreign portfolio investment (FPI) stake of 21.07%). HDFC's majority stake, its representation on HDFC Life's board of directors and the presence of a shared brand name strengthen ICRA's belief that HDFC will provide capital support to HDFC Life, as and when required. HDFC Life has a balanced product mix with a rising share of high-margin protection products, a diversified distribution network with a focus on increasing the share of proprietary channels, and improving individual persistency levels resulting in the consistent expansion of the value of new business (VNB) margins. The company has a comfortable capitalisation profile with its solvency ratio (184% as on March 31, 2020 compared to the regulatory requirement of 150%) supported by internal accruals and consequently has not required any capital infusion in the last eight years. Further, the subordinated debt issuance of Rs. 600 crore is expected to improve the solvency position by 15% and cushion against the equity market volatility. This will also support the shift in the company's product strategy to protection products in the last few years, which consume higher capital compared to savings products.

ICRA does take note of the competition in the life insurance segment, especially with entities that enjoy exclusive distribution arrangements with large banks. ICRA also notes the impact of the Covid-19 pandemic on the business growth during the lockdown period. In addition, the company is likely to experience higher claims due to the pandemic. ICRA notes that the company has moderate (in participating and shareholder portfolios) to high (unit linked portfolio) allocation to equity assets which exposes it to equity market volatility. HDFC Life's ability to improve its operating efficiency while maintaining its growth, profitability and adequate solvency will remain a key monitorable. The proposed subordinated debt programme of Rs. 600 crore is subject to the receipt of approval from the Insurance Regulatory and Development Authority of India ("IRDAI") pursuant to the provisions of IRDAI (Other Forms of Capital) Regulations, 2015. HDFC Life has applied to IRDAI for the same and is awaiting approval.

The rating also factors in the key features of the subordinated debt instrument:

- Servicing of interest is contingent on the company maintaining a solvency ratio above the levels stipulated by the regulator[1]
- In case the interest payouts were to lead to a net loss or an increase in the net loss, prior approval of the regulator would be required to service the debt

Key rating drivers and their description

Credit strengths

Strong promoter profile – HDFC's stake in HDFC Life stood at 51.44% as on March 31, 2020. HDFC is a leading housing finance institution operating for more than 40 years in India. The Reserve Bank of India (RBI) directed HDFC to reduce its stake in HDFC Life to 50% by December 16, 2020. In June 2020, HDFC sold a 1.29% stake and reduced its shareholding to 50.15%. With a presence in banking, insurance and asset management, the HDFC group is an important part of the Indian financial services sector. The presence of a shared brand name strengthens ICRA's belief that HDFC Life will receive capital support from its majority shareholder (HDFC) as and when required.

Standard Life Aberdeen Plc was formed through the merger of Standard Life Plc and Aberdeen Asset Management Plc on August 14, 2017. ICRA notes that Standard Life shareholding in HDFC Life declined to 12.25% as on March 31, 2020 from 29.31% as on March 31, 2018. In June 2020, Standard Life sold a 1.98% stake in HDFC Life and reduced its shareholding to 10.27%. ICRA notes that when additional capital is raised, HDFC will be limited to 50% ownership by the regulations. The capital-raising plan will be limited to HDFC Life's ability to raise money through a rights issue, other existing investors increasing their stake or by bringing in new investors through preferential allotment or a qualified institutions placement.

Balanced product mix with rising share of high-margin protection business – HDFC Life reported a 15.1% YoY growth in new business premium in FY2020, which was higher than the private sector growth of 11.6% YoY. The company's strategy to grow at a higher rate than the private sector resulted in an increase in its market share in new business premium (individual and group) to 21.5% in FY2020 from 17.2% in FY2017. The improvement in new business premium was mainly driven by the healthy growth in the high-margin protection, non-participating business and new products introduced. ICRA notes that the company's focus has shifted to protection products in the last few years compared to savings products earlier. As a result, the share of the protection business (including annuity) improved to 43% of the total new business premium in FY2020 from 26% in FY2017 while the share of the savings business declined to 57% (FY2020) from 74% (FY2017). All the product segments witnessed a growth in the gross premium written in FY2020 except for the ULIP segment, which reported a degrowth of 1.1% YoY in FY2020. The decline in the ULIP segment was on account of low customer demand due to high market volatility. Further,

[1] *As per IRDAI regulations, insurers are required to maintain a minimum solvency ratio of 150%*

the company plans to maintain a balanced mix of participating, non-participating and ULIPs within the savings business.

Diversified distribution network with rising share of proprietary channels – The bancassurance channel remains the largest sourcing channel with the rising share of proprietary channels. The company expects the agency and direct (including online) channels to deliver higher growth on a relatively smaller base over the medium to long term and provide higher flexibility and control over its product mix compared to non-proprietary channels. Consequently, the share of direct channels (including online), on an individual Annualised Premium Equivalent (APE) basis, increased gradually to 22% in FY2020 from 11% in FY2017 while the share of the bancassurance channel declined to 55% in FY2020 from 72% in FY2017.

ICRA notes that the share of non-participating products increased significantly across all channels. Proprietary channels (online and agency) have a higher mix of protection products. The company has a diversified distribution mix with more than 270 partners including traditional partners such as non-banking financial companies (NBFCs), microfinance institutions (MFIs) and small finance banks (SFBs) as well as 40 plus new-ecosystem partners. The new ecosystem partners or alternative distribution channels include health, e-commerce, auto, telecom, mutual funds and fintech companies. HDFC Life operates through 421 branches across the country.

Improving persistency ratio – The diversified distribution network with a balanced product mix, distributed as per the needs of a target customer segment, resulted in higher persistency levels. HDFC Life reported an improvement in the individual 13th month and 61st month persistency ratios to 88% and 54%, respectively, in FY2020 from 84% and 51%, respectively, in FY2019. However, the individual persistency in protection is lower in the 13th month and 61st month cohorts compared to traditional savings products. This is because protection products do not include the return of the premium, which leads to the tendency of customers to switch to new products. The persistency for ULIP products is lower compared to other traditional savings products for individual business. Even though bancassurance is a low-cost channel, its persistency is lower compared to other channels. HDFC Life focuses on and plans the distribution channels to be used for each product category to improve the persistency ratio.

Comfortable capitalisation profile supported by internal accruals – HDFC Life reported a comfortable solvency position at 184% as on March 31, 2020 compared to the regulatory requirement of 150%. There has been no capital infusion in the company during the last eight years (except through employee stock ownership plan - ESOPs) and the solvency was supported by internal accruals. However, the company's solvency ratio declined to 184% as on March 31, 2020 from 194% as on February 29, 2020. While a 10% fall in the solvency was mainly due to a decline in the equity markets in March 2020, a 2% decline was due to the provision on the AT-I bonds of Yes Bank. However, the solvency level was supported by 2% due to lower new business premium and renewal premium in the month of March 2020 due to Covid-19 pandemic resulting in lockdown.

The planned raising of Rs. 600 crore of subordinated debt is expected to support the solvency ratio by 15%. As per IRDAI's direction, insurance companies have not paid dividends in FY2020 to conserve capital. HDFC Life's solvency ratio was impacted by 8-10% in FY2019 due to the dividend payment. The purpose of raising the subordinated debt is to improve its solvency position to cushion against the current equity market volatility and support the change in the product mix to protection products, which consume higher capital than savings products. Further, the demand for protection products (which consumes higher capital) is expected to increase faster than for savings products as a result of the pandemic.

Healthy profitability metrics with rising VNB margins – Despite a negative investment income of Rs. 2,610.6 crore in FY2020 compared to the positive investment income of Rs. 9,632.0 crore in FY2019, HDFC Life was able to report a net profit of Rs. 1,295.3 crore with a return on equity (RoE) of 19.0% in FY2020 compared with a net profit of Rs. 1,276.8 crore in FY2019 with RoE of 22.6%. A large part of negative investment income pertains to unit-linked segment and is directly passed on to the policyholders. The profitability was supported by a muted rise in the net premium written, a rise in individual persistency levels and lower tax outflow in FY2020. The investment income turned negative in FY2020, largely in Q4 FY2020, due to a change in the market value of the investment book mainly because of the weak equity market in March 2020. The profitability was negatively impacted due to a rise in the total operating expenses but was partially offset by the lower additional reserve requirement due to lower ULIP assets under management (AUM). As a result, the total operating expenses to net premiums written (NPW) increased to 20.3% in FY2020 from 17.5% in FY2019. The net profit was after taking impairments in asset value into account as per the Board approved investment policy. The operating expenses also increased due to the provision related to the investment exposure to the IL&FS Group and Yes Bank (AT-I bonds). Further, the company provided an additional death claim provision of Rs. 41 crore in Q4 FY2020 related to the pandemic. HDFC Life expects the operating expenses ratio to improve in the next couple of years due to scale, change in distribution strategy, change in the product mix and operating efficiency.

HDFC Life witnessed a CAGR of 26.9% in the VNB during FY2016-FY2020. Further, the VNB margin (calculated as VNB divided by APE) has consistently increased in the last five years to 25.9% in FY2020 from 19.9% in FY2016. The VNB margin is a better profitability indicator for a life insurance company. The expansion in the VNB margin was primarily driven by healthy growth in higher margin protection products, non-participating business and scale benefits.

Credit challenges

Ability to grow and maintain profitability in protection business – HDFC Life witnessed a high growth in the protection business in the last few years due to a change in its product mix. As a result, the share of the protection business in individual APE increased to 12% in FY2020 from 5% in FY2017. ICRA notes that protection products have low adoption compared to savings products in the country due to low awareness and as customers generally target products with a return of premium. However, the pandemic is expected to increase the demand for the protection business and rising customer awareness is likely to support the demand. Therefore, the company’s ability to scale up the protection portfolio to a sizeable proportion in an under-penetrated market, while maintaining the product pricing, persistency and death claims settlement ratio, will be a key monitorable.

Exposure to equity market investments exposes the company to volatility risk – HDFC Life witnessed a significant decline in its investment income in FY2020 because of high equity market volatility, which also impacted its solvency profile. The company’s investment exposure to equity was relatively high at 37% as on December 31, 2019 although it improved from 41% as on March 31, 2017. However, ICRA notes that the high equity exposure is also dependent on customers opting for a high share of equity mix in their portfolios. ULIP continues to dominate the product mix accounting for 34.2% of the gross premium written in FY2020 though its share declined from 52.8% in FY2016. Although the ULIP business has a lower capital requirement, its low-margin nature necessitates an improvement in the persistency levels and cost control. Going forward, the company's rising focus on the protection business and maintaining a balance between participating, non-participating and unit linked savings products is expected to lower the impact of volatile market conditions. HDFC Life's ability to withstand weak equity market conditions will be an important point to monitor.

Liquidity position: Strong

The company reported liquid assets of Rs. 64,984 crore (calculated as liquid investments[2], adjusted for haircuts and stressed investments and includes cash & bank balance) as of December 31, 2019. The total non-linked liabilities were Rs. 61,958 crore as on December 31, 2019. In FY2019, actual benefits/claims paid stood at Rs. 13,989 crore, amounting to 14.1% of the policy and linked liabilities as on March 31, 2018. The linked and non-linked liabilities were Rs. 1,17,012 crore as of March 31, 2019. HDFC Life has no outstanding subordinated debt. ICRA does not foresee any liquidity risk in the near term.

Rating sensitivities

Positive triggers – NA

Negative triggers – The outlook or the rating could be revised in case of a revision in the rating of the parent company (HDFC), a significant change in the company's majority shareholding or in its linkages with the parent. Pressure could also arise if the company's solvency ratio deteriorates to less than 170% on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for rating hybrid debt instruments issued by insurance companies Issuer Rating Methodology for Life Insurance Companies Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	Parent/Group Company: HDFC The rating takes into account HDFC's shared brand name and past capital support from the promoter, indicating implicit support from the parent. The rating also factors in management support, given HDFC's board representation, and its ability to leverage HDFC Bank's wide branch network for the distribution of its insurance policies.
Consolidation	For arriving at the rating, ICRA has used the consolidated financials of HDFC Life. As on March 31, 2020, the company had two wholly-owned subsidiaries, which are listed in Annexure 2.

About the company

HDFC Life Insurance Company Limited (erstwhile HDFC Standard Life Insurance Company Limited) started its operations in 2000 and was a joint venture between HDFC Limited and Standard Life (Mauritius Holdings) 2006 Limited, a unit of Standard Life Aberdeen Plc. Subsequently, in November 2017, HDFC Life was listed on the stock

[2] *Excluding linked investments*

exchanges. As on March 31, 2020, HDFC had a 51.44% stake in HDFC Life followed by Standard Life at 12.25% while the rest is publicly held (including FPIs' stake at 21.07%). In June 2020, HDFC sold a 1.29% stake and reduced its shareholding to 50.15%. HDFC is India's leading housing finance institution while Standard Life is a global investment company headquartered in Scotland.

HDFC Life provides life insurance, pension, savings, investment, annuity and health insurance products to individuals and groups. The company's products are offered under the participating, non-participating, and unit-linked lines of business. Its products are distributed through 421 branches along with individual agents, corporate agents, banks, brokers and online.

HDFC Life reported consolidated assets and equity of Rs. 1,27,234 crore and Rs. 6,807 crore, respectively, in FY2020 compared to Rs. 1,24,897 crore and Rs. 5,643 crore, respectively, in FY2019. The company reported a consolidated profit after tax of Rs. 1,297 crore in FY2020 compared to Rs. 1,278 crore in FY2019.

Key financial indicators (audited) – Standalone

	FY2018	FY2019	FY2020
Gross Direct Premium	23,564	29,186	32,707
Income from Investment and Fees^	9,000	9,632	(2,611)
Total Operating Expense*	4,245	5,059	6,557
PAT	1,109	1,277	1,295
Total Net Worth	4,749	5,656	6,800
Total Policyholders' + Shareholders' Investments@	49,417	62,174	73,044
Operating Expense Ratio	18.2%	17.5%	20.3%
Return on Equity&	23.4%	22.6%	19.0%
13th Month Persistency Ratio	87.1%	87.2%	90.1%
61st Month Persistency Ratio	51.0%	52.3%	55.0%
Regulatory Solvency Ratio	192.0%	188.0%	184.0%

Amount in Rs. crore

Source: Company & ICRA research

^ Income from Investment and Fees includes other income

** Total operating expense include provision for diminution in value of investments*

@ Investments exclude linked investments

& Return on Equity is calculated based on profit after tax divided by closing equity for that period

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019	FY2018
					16-Jun-2020	-	-	-
1	Issuer Rating	Long Term	-	-	[ICRA]AAA(Stable); Assigned	-	-	-
2	Subordinated Debt Programme	Long Term	600.00	-	[ICRA]AAA(Stable); Assigned	-	-	-

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Issuer Rating	NA	NA	NA	NA	[ICRA]AAA(Stable)
NA	Subordinated Debt Programme	NA	NA	NA	600.00	[ICRA]AAA(Stable)

Source: HDFC Life Insurance Company Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
HDFC Pension Management Company Limited	100.00%	Full Consolidation
HDFC International Life and Re Company Limited	100.00%	Full Consolidation

Analyst Contacts

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Sahil Udani
+91 22 6114 3429
sahil.udani@icraindia.com

Niraj Jalan
+91 33 7150 1146
niraj.jalan@icraindia.com

Sudam S Shingade
+91 22 6114 3425
sudam.shingade@icraindia.com

Relationship Contact

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999