June 30, 2021

HDFC Life Insurance Company Limited: Rating reaffirmed

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	600.00	600.00	[ICRA]AAA(Stable); Reaffirmed
Total	**600.00**	**600.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation considers 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, 2021, HDFC had a 49.97% stake in HDFC Life followed by Standard Life (Mauritius Holdings) 2006 Limited (a unit of Standard Life Aberdeen Plc) at 8.89% while the rest was publicly held (including foreign portfolio investment (FPI) stake of 25.67%). 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 increasing focus towards the high-margin retail protection business, a diversified distribution network with a focus on increasing the share of profitable 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 (201% as on March 31, 2021 compared to the regulatory requirement of 150%) supported by internal accruals. Consequently, it has not required any capital infusion in the last nine years. ICRA does not foresee any capital requirement for organic growth in the near term as the new business growth is funded through backbook surplus. The company witnessed 2,324 Covid-19-related death claims of Rs. 145 crore in FY2021. HDFC Life holds a Covid reserve of Rs. 165 crore for FY2022 and it will reassess the adequacy of its reserves at regular intervals. ICRA estimates that even if the Covid claims increase by 3x of the FY2021 claims in FY2022 and post adjusting the same against the Covid reserves, the impact on the solvency ratio will be marginal at 5.8% and will hence remain manageable.

ICRA does take note of the competition in the life insurance segment, especially from entities that enjoy exclusive distribution arrangements with large banks. ICRA also notes that HDFC Life is likely to experience higher claims due to the Covid-19 pandemic and business growth might get impacted. ICRA notes that the company has moderate (in participating and shareholder portfolios) to high (unit linked portfolio) allocation towards equity assets, which exposes it to equity market volatility. However, the risk in unit linked portfolio is borne by the policyholders and not the company. HDFC Life's ability to improve its operating efficiency while maintaining its growth and profitability and ensuring adequate solvency will remain a key monitorable.

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

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

Key rating drivers and their description

Credit strengths

Strong promoter profile with shared brand name ensures timely capital support as and when required – HDFC's stake in HDFC Life stood at 49.97% as on March 31, 2021. The same was reduced from 51.44% as on March 31, 2020, in line with the Reserve Bank of India's (RBI) direction to bring down its stake in HDFC Life to 50% or less by December 16, 2020. 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 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's shareholding in HDFC Life declined to 8.89% as on March 31, 2021 from 29.31% as on March 31, 2018 as Standard Life became an asset management company post the merger and insurance subsequently became a non-core business for the company. Standard Life plans to strengthen its capital position by monetising its remaining stake in HDFC Life over the next two years. 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 institutional placement.

Balanced product mix with increasing focus on high-margin retail protection business – HDFC Life'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 FY2021 from 19.1% in FY2018. This was mainly driven by the healthy growth in the non-participating and annuity businesses and the introduction of new products.

ICRA notes that the company's focus has shifted to protection products in the last few years from savings products. The share of the protection segment increased to 27.6% in FY2020 from 21.8% in FY2017, though it declined to 19.6% in FY2021 in terms of total new business premium. Within the protection segment, the share of high-margin retail term protection increased to 32.4% in FY2021 from 23.3% in FY2017 in terms of gross premium written, driven by the company's focus in this segment and rising awareness due to the pandemic. However, the share of gross premium written for the group credit life and group term business declined, with the slowdown in disbursements by financial institutions in FY2021 due to the pandemic. Going forward, the company plans to maintain a balanced mix of participating, non-participating and unit linked insurance plans (ULIPs) within the savings business.

Diversified distribution network with increasing focus on 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 19% in FY2021 from 11% in FY2017 while the share of the bancassurance channel declined to 61% in FY2021 from 72% in FY2017. However, the share of the bancassurance channel increased to 61% in FY2021 from 55% in FY2020 as banking services were operating during the lockdown, given the status as an essential service provider.

ICRA notes that the proprietary channels (online and agency) have a higher mix of protection products. HDFC Life has a diversified distribution mix with more than 300 partners including traditional partners such as non-banking financial companies (NBFCs), microfinance institutions (MFIs) and small finance banks (SFBs) including 50 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 390 branches across the country. In FY2021, the company entered partnerships with Yes Bank, SBI Capital Markets, State Bank of Mauritius, Doha Bank and Edelweiss, among others.

Comfortable capitalisation profile supported by internal accruals – HDFC Life reported a comfortable solvency position at 201% as on March 31, 2021 compared to the regulatory requirement of 150%. There has been no capital infusion in the company during the last nine years (except through employee stock ownership plan - ESOPs) and the solvency was supported by internal accruals. Further, the company announced a dividend of Rs. 2.02 per share, translating into Rs. 408 crore for FY2021. Post the dividend payment, HDFC Life's solvency ratio would decline to ~192% compared to the reported solvency ratio of 201% as on March 31, 2021. The company's backbook surplus (surplus accumulated from historical business written) exceeds the new business strain. As a result, it does not require any capital infusion for organic growth in the next couple of years. HDFC Life raised Rs. 600 crore of subordinated debt in FY2021 to support its solvency position.

Healthy profitability metrics with rising VNB margins supported by operating efficiency and improving persistency ratio – HDFC Life witnessed a net profit of Rs. 1,360.1 crore in FY2021 compared to Rs. 1,295.3 crore in FY2020, supported by operating efficiency and an improving persistency ratio, which was partially offset by a rise in death claims. HDFC Life's operating expense ratio improved to 15.9% in FY2021 (20.0% in FY2020) due to the increasing scale and operating efficiency. The improvement in operating expenses was largely driven by scale benefits and the containment of employee expenses to Rs. 1,675.6 crore in FY2021 compared to Rs. 1,677.0 crore in FY2020. Further, the top line was positively impacted by the rise in the 13th month persistency ratio to a peak of 91.7% in FY2021. However, the company's profitability was negatively impacted by the rise in death claims to Rs. 3,052.6 crore in FY2021 from Rs. 2,303.2 crore in FY2020 due to the scale of business and the increase in the protection business, which typically has a high average sum assured. HDFC Life paid Covid-related net death claims of Rs. 145 crore (gross Covid claims of Rs. 231 crore) in FY2021 and holds a Covid reserve of Rs. 165 crore for FY2022. ICRA estimates that even if the Covid claims rise by 3x of the FY2021 claims in FY2022 and after adjusting the same against the Covid reserves, the impact on the solvency ratio will be lower at 5.8%.

HDFC Life's return ratios have consistently declined with a return on equity of 15.7% in FY2021 compared to 23.2% in FY2017. However, the VNB margin is a better profitability indicator for a life insurance company. HDFC Life witnessed a compound annual growth rate (CAGR) of 20.8% and 24.1% in the embedded value (EV) and VNB, respectively, during FY2017-FY2021. As a result, the VNB margin (calculated as VNB divided by APE) has consistently increased in the last five years to 26.1% in FY2021 from 22.0% in FY2017. The expansion in the VNB margin was primarily driven by the healthy growth in the 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 with its share rising to 27.6% in FY2020 from 21.8% in FY2017, in terms of new business premium. However, its share declined to 19.6% in FY2021 as the business underwritten for group credit life and group term was impacted by the slowdown in disbursements by financial institutions in FY2021 due to the pandemic. Nevertheless, the company witnessed a rise in the share of retail term protection largely through the agency and online channels. ICRA also notes that the company's operating expense ratio is higher compared to listed peers primarily due to the absence of exclusive tie-ups in the relatively lower expense bancassurance channel. HDFC Life's operating efficiency improved in FY2021 although the operating expense ratio remained higher compared to peers as a relatively higher share of business is sourced through the direct channel (52.5% in FY2021) compared to the bancassurance channel (29.9% in FY2021). 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's investment exposure to equity was relatively high at 36% as on March 31, 2021 although it improved from 41% as on March 31, 2017. A higher equity share exposes the company to volatility in equity markets, which also impacts its solvency profile. 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 constitutes a higher share in the product mix accounting for 29.1% of the gross premium written in FY2021 though its share declined from 46.7% in FY2017. Although the ULIP business has a lower capital requirement, its low-margin nature necessitates an improvement in the persistency levels in the near-term cohorts and cost control. Going forward, the company's rising focus on the protection business and its ability to maintain a balance between participating, non-participating and unit linked savings products are 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

HDFC Life reported liquid assets of Rs. 90,469 crore (calculated as liquid investments[2], adjusted for haircuts, and cash & bank balance) as of March 31, 2021. In FY2021, actual benefits/claims paid stood at Rs. 22,575 crore. The nearest debt repayment is the Rs. 40.0-crore coupon payment for the subordinated debt programme, which is due on July 29, 2021. The principal of the subordinated debt programme of Rs. 600 crore is due on July 29, 2030. However, the company has a call option, which is exercisable five years from the date of allotment on July 29, 2025 and at the end of every year thereafter before the redemption date. ICRA does not foresee any liquidity risk in the near term.

Rating sensitivities

Positive factors – NA

Negative factors – 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	Issuer Rating Methodology for Life Insurance Companies Methodology for Rating Hybrid Debt Instruments Issued by 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/Standalone	For arriving at the rating, ICRA has used the consolidated financials of HDFC Life. As on March 31, 2021, 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 exchanges. As on March 31, 2021, HDFC had a 49.97% stake in HDFC Life followed by Standard Life at 8.89% while the rest is publicly held (including FPIs' stake of 25.67%). 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 390 branches along with corporate agents, brokers, online channels and strong base of

[2] *Excluding linked investments*

financial consultants (individual agents). The company has more than 300 partnerships comprising traditional partners such as NBFCs, MFIs and SFBs, and includes more than 50 new-ecosystem partners.

HDFC Life reported consolidated assets and equity of Rs. 1,73,121 crore and Rs. 8,640 crore, respectively, in FY2021 compared to Rs. 1,27,234 crore and Rs. 6,807 crore, respectively, in FY2020. It reported a consolidated profit after tax of Rs. 1,361 crore in FY2021 compared to Rs. 1,297 crore in FY2020.

Key financial indicators (audited) – Standalone

HDFC Life	FY2019	FY2020	FY2021
Gross Direct Premium	29,186	32,707	38,583
Income from Investment and Fees^	9,632	(2,611)	33,509
Total Operating Expense*	5,059	6,557	6,134
PAT	1,277	1,295	1,360
Total Net Worth	5,656	6,800	8,638
Total Policyholders' + Shareholders' Investments[@]	62,174	73,044	99,080
Operating Expense Ratio	17.3%	20.0%	15.9%
Return on Equity[&]	22.6%	19.0%	15.7%
13th Month Persistency Ratio	87.2%	90.1%	91.7%
61st Month Persistency Ratio	52.3%	55.0%	54.4%
Regulatory Solvency Ratio	188.0%	184.0%	201.0%

Note: *Amount in Rs. crore; All calculations are as per ICRA research*
Source: *Company, ICRA research*
^ Income from investment and fees includes other income
** Total operating expense includes 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 (FY2022)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Jun 30, 2021 (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2020	Date & Rating in FY2020	Date & Rating in FY2019
					Jun 30, 2021	Jun 16, 2020	-	-
1	Issuer Rating	Long Term	-	-	[ICRA]AAA(Stable)	[ICRA]AAA(Stable)	-	-
2	Subordinated Debt Programme	Long Term	600.0	600.0	[ICRA]AAA(Stable)	[ICRA]AAA(Stable)	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Issuer Rating	Very Simple
Subordinated Debt Programme	Moderately Complex

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: Click Here

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)
INE795G08019	Subordinated Debt Programme	Aug 29, 2020	6.67%	Jul 29, 2030*	600.0	[ICRA]AAA(Stable)

Source: *Company*

**The company has a call option exercisable five years from the date of allotment on July 29, 2025 and at the end of every year thereafter before the redemption date*

Annexure-2: List of entities considered for consolidated analysis

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

Source: *Company*

Note: *ICRA has taken a consolidated view of HDFC Life and its subsidiaries while assigning the rating*

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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.

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