May 15, 2019

# The Oriental Insurance Company Ltd.: Update on 9M FY2019 results

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Claims Paying Ability | - | - | iAAA; outstanding |
| Subordinated Debt Programme | 750.00 | 750.00 | [ICRA]AAA (negative); outstanding |
| **Total** | **750.00** | **750.00** | |

**Instrument details are provided in Annexure-1*

## Update

The Oriental Insurance Company Ltd.'s (OICL)[1] reported Q3 FY2019 and 9M FY2019 results. The company continue to report underwriting losses at Rs. 3,034.7 during 9M FY2019 which negatively impacted the solvency ratio to 1.21 times as on December 31, 2018. OICL's solvency ratio was below the minimum regulatory requirement of 1.50 times. ICRA notes the issuance of Rs. 750 crore of subordinated debt which would help to increase the solvency margin.

ICRA has rating outstanding of [ICRA]AAA (pronounced ICRA triple A) for the Rs. 750-crore subordinated debt programme and iAAA (pronounced I triple A) on the claims paying ability rating of OICL. The outlook on the long-term rating is Negative.

## Rationale

The rating remains unchanged as it takes into account OICL's sovereign ownership, given that it is entirely owned by the Government of India (GoI), and the expectation of continued GoI support in future. The rating takes cognisance of the specific regulatory forbearance allowed to the company by the Insurance Regulatory and Development Authority of India (IRDAI) for the entire tenure of the instrument, which allows it to service the debt instrument even if the solvency ratio is below the minimum regulatory requirement. The rating continues to factor in OICL's leading market position, as the fifth-largest player in the domestic general insurance industry, its healthy investment buffer in the form of a fair value change account (FVCA - unrealised gains) in its equity holdings, and its comfortable liquidity buffer.

However, the ratings are constrained by the company's persistent underwriting losses driven by a high combined ratio. The high combined ratio was mainly due to the high claims ratio in the motor and health segments. This resulted in pressure on profitability and a moderate solvency ratio, which was below the minimum regulatory requirement. However, the rating derives comfort from the Rs. 750 crore subordinated debt issue in March 2019 and further scope to increase the proportion of FVCA for solvency calculation, which is 25% at present. This is expected to cushion the solvency indicators.

[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

## Outlook: Negative

The outlook may be revised to Stable if there is a consistent improvement in the underwriting performance and capital infusion by the GoI, resulting in an improvement in the solvency indicator. However, there could be a rating action if the company's solvency ratio continues to fall below the minimum regulatory requirement or there is a substantial change in the FVCA dispensation for the calculation of the solvency ratio.

## Key rating drivers

## Credit strengths

**Sovereign ownership; entirely owned by GoI** – OICL is fully owned by the GoI. ICRA expects the company to continue to receive strong support from the GoI, given its systemic importance to the domestic general insurance industry coupled with its extensive distribution network. Considering the extremely low insurance penetration in India, the role of Government-owned insurers, such as OICL, becomes more imperative. Further, in the February 2018 Union Budget, the GoI announced its plan to merge three public sector general insurance companies (National Insurance Company Ltd., The Oriental Insurance Company Ltd. and United India Insurance Company) to improve the financial position of these companies and reduce the intense competition in the industry. The GoI plans to list the merged entity to raise capital and support the credit profile. However, ICRA does not foresee the completion of the merger in CY2019.

**Established player with long operating history** – OICL has a long operating history with a recognised brand value in North India. It is the fifth-largest player in the general insurance industry with a market share[2] of 8.2% in 9M FY2019 compared to 8.1% in FY2018. The market share was driven by the healthy YoY growth of 13.7% in the gross direct premium written in India (GDPI) in 9M FY2019. However, the four public-sector general insurance entities combinedly reported a GDPI degrowth of 85 bps on YoY basis during 9M FY2019. While the company has a presence in all major segments, the motor and health segments continue to account for a major share of the GDPI at 35% and 33%, respectively, in 9M FY2019 compared to 37% and 34%, respectively, in 9M FY2018.

Management plans to diversify and reduce its portfolio, mainly in the loss-making group personal accident (GPA) and group medical coverage (GMC) segments and grow selectively in the motor portfolio. Further, OICL began underwriting the crop insurance business in FY2017, under the Pradhan Mantri Fasal Bima Yojana (PMFBY) scheme, which gradually increased to 13.4% of the GDPI in 9M FY2019 from 7.2% of the GDPI in FY2018. Around 39% of OICL's business is sourced through the direct channel due to its large branch network and reach, while individual agents and brokers sourced around 39% and 21%, respectively, in 9M FY2019. The rise in the share of the direct business to 39% of the total GDPI in 9M FY2019 compared to 28% in FY2018 was mainly due to the traction in crop insurance (direct business) through state governments.

## Credit challenges

**Solvency ratio declined below mandatory regulatory requirement although comfort derived from relatively large unrealised gains in equity holdings and recent sub-debt issue** – OICL reported a solvency ratio of 1.21 times as on December 31, 2018 compared to 1.54 times as on September 30, 2018 and was below the mandated regulatory requirement of 1.50 times. The decline in the solvency ratio was due to precautionary provisioning related to motor (third party) claims (in relation to a Supreme court judgement on liabilities relating to Motor - third party claims), motor

[2] *The market share calculation excludes ECGC Ltd. and Agriculture Insurance Company of India Limited*

(third party) indexation for outstanding claims and provision related to Kerala floods. OICL has considered 25% of FVCA (Rs. 1,961.4 crore) for solvency calculation as on December 31, 2018 compared to 30% of FVCA in FY2018. Further, the company raised Rs. 750 crore of subordinated debt in March 2019 which is expected to support its solvency ratio by ~20 – 25 bps. Nevertheless, ICRA derives comfort from OICL's high FVCA of Rs. 7,910 crore, as on December 31, 2018, which is not completely accounted for in the solvency calculation but will provide support in times of a liquidity crunch. Further, ICRA estimates that the solvency ratio is likely to remain above the regulatory minimum in FY2019 driven by subordinated debt issue and its scope to increase the inclusion of FVCA in the solvency calculation.

**Weak underwriting performance** – OICL reported an underwriting loss of Rs. 3,034.7 crore in 9M FY2019 compared to an underwriting loss of Rs. 1,918.9 crore in 9M FY2018 mainly due to high combined ratio. The company's combined ratio deteriorated to 139.5% in 9M FY2019 from 126.4% in 9M FY2018 mainly driven by an increase in net incurred claim ratio to 112.7% (9M FY2019) from 92.3% (9M FY2018). Consequently, the net loss ratio increased to 113% in 9M FY2019 from 92% in 9M FY2018, driven by an increase in the net loss ratio across segments. OICL is witnessing steep pricing pressure in the motor (own damage) segment from private sector general insurance companies. However, the company is trying to achieve the early closure of cases in the motor (third party) segment to avoid a long tail risk by conciliation. ICRA will monitor OICL's ability to improve its underwriting performance while maintaining premium growth to meet minimum regulatory solvency levels.

**Profitability remains muted; largely supported by investment portfolio** – OICL's profitability remains subdued as it reported net loss of Rs. 633.9 crore in 9M FY2019 compared to net profit of Rs. 799 crore in 9M FY2018. The net loss was mainly driven by high underwriting loss which was partially offset by healthy growth in GDPI by 13.7% YoY in 9M FY2019 to Rs. 9,779 crore. However, the company's net loss was partially offset by healthy performance of its investment portfolio with net investment income of Rs. 993.7 crore (-2.2% YoY) and profit on the sale of investments of Rs. 1,355.0 crore (+2.3% YoY) in 9M FY2019. Moreover, ICRA derives comfort from the company's large investment portfolio though it remains vulnerable to interest rate movements in the economy. As a result, OICL reported a negative return on asset and return on reported net worth of -3.4% and -8.1%, respectively, in 9M FY2019 compared positive return on asset and return on reported net worth of 5.0% and 8.5%, respectively, in 9M FY2018. Moreover, OICL has an exposure of Rs. 358.4 crore or 3.4% of the net worth, as on December 31, 2018, to IL&FS Group companies. The company classified this exposure as a sub-standard asset on its books as on December 31, 2018 and a 10% provision was charged in Q3 FY2019. ICRA expects the profitability to remain muted in the near future, given the low expected GDPI growth and likely high claims ratio.

## Liquidity position

OICL had a liquidity buffer of Rs. 4,747 crore (calculated as 50% of the sum of total investments and cash & bank balance less technical reserve and net dues to other insurance companies) as of December 31, 2018. The nearest debt repayment is the coupon payment of the subordinated debt programme, amounting to Rs. 66.0 crore, falling due on March 18, 2020. The subordinated debt repayment of Rs. 750 crore is due on March 18, 2024 in case the company exercises call option. The maturity date of the Rs. 750 crore subordinated debt is March 18, 2029. Therefore, ICRA does not foresee any liquidity risk in the near term and the company will be able to pay its obligation in the near term.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| Applicable Rating Methodologies | [Methodology for claims paying ability rating for General Insurance companies]<br>[ICRA's Credit Rating Methodology for rating hybrid debt instruments issued by insurance companies] |
| Parent/Group Support | Parent/Group Company: Government of India (GoI)<br>ICRA factors in the implied support from the GoI (fully owned by the sovereign) and takes comfort from OICL's vast experience in operating an insurance business |
| Consolidation/Standalone | The rating is based on the standalone financial statements of the issuer |

## About the company

The Oriental Insurance Company Ltd. (OICL), incorporated on September 12, 1947, is a general insurance company fully owned by the Government of India. It offers general insurance services across a variety of segments. New Delhi-based OICL has 31 regional offices and 1,943 operating offices with 14,000+ employees. In 9M FY2019, OICL's gross direct premium written was Rs. 9,779 crore and underwriting loss was Rs. 3,034.7 crore while net loss was Rs. 633.9 crore.

## Key financial indicators (audited)

| | FY2017 | FY2018 | 9M FY2018 | 9M FY2019 |
|---|---|---|---|---|
| Gross Direct Premium | 11,117 | 11,737 | 8,598 | 9,779 |
| Total Underwriting Surplus/(Shortfall) | (4,336) | (1,923) | (1,919) | (3,035) |
| Total Investment + Trading Income# | 2,341 | 3,323 | 2,340 | 2,349 |
| PAT | (1,691) | 1,510 | 799 | (634) |
| Total Net Worth[3] | 11,664 | 11,814 | 12,549 | 10,433 |
| Total Technical Reserves | 14,627 | 15,374 | 15,947 | 18,057 |
| Total Investment Portfolio | 22,802 | 22,804 | 24,285 | 24,236 |
| Total Assets | 29,362 | 29,984 | 31,693 | 32,808 |
| Return on Net Worth | -14.5% | 12.8% | 8.5% | -8.1% |
| Gearing | - | - | - | - |
| Combined Ratio* | 148.1% | 118.6% | 126.4% | 139.5% |
| Regulatory Solvency Ratio | 1.11 | 1.67 | 1.43 | 1.21 |

*Amount in Rs. crore*
*Source: Company & ICRA research*
*# Includes investment and other income (including capital gains)*
** Combined ratio – (net claims incurred/net premium earned) + (mgmt expenses + net commission expenses)/net premium written*

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

[3] *Including FVCA*

## Rating history for last three years

| Sl. No. | Instrument | Current Rating (FY2020) Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs. crore) | Date & Rating May 2019 | Chronology of Rating History for the Past 3 Years: Date & Rating in FY2019 March 2019 | May 2018 | Date & Rating in FY2018 April 2017 | Date & Rating in FY2017 April 2016 |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Claims Paying Ability | Long Term | - | - | iAAA; outstanding | iAAA; Reaffirmed | iAAA; Reaffirmed | iAAA; Reaffirmed | iAAA; Reaffirmed |
| 2 | Subordinated Debt Programme | Long Term | 750.00 | - | [ICRA]AAA (Negative); outstanding | [ICRA]AAA (Negative); Assigned | - | - | - |

## 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 No. | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Claims Paying Ability | NA | NA | NA | NA | iAAA |
| INE06GZ08015 | Subordinated Debt | 18-Mar-2019 | 8.80% p.a. | 18-Mar-2029* | 750.00 | [ICRA]AAA (negative) |

**The company has a call option, which is exercisable five years from the date of allotment*

*Source: The Oriental Insurance Company Ltd.*

## Annexure-2: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|---|---|---|
| NA | NA | NA |

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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.

For more information, visit www.icra.in

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