May 26, 2022

HDFC Life 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	600.00	600.00	[ICRA]AAA(Stable); reaffirmed
Subordinated Debt Programme	-	350.00	[ICRA]AAA(Stable); assigned
Total	**600.00**	**950.00**	

Instrument details are provided in Annexure-1

Rationale

The rating considers HDFC Life Insurance Company Limited's (HDFC Life) strong promoter profile, given Housing Development Finance Corporation Limited's (HDFC; [ICRA]AAA(Stable)/[ICRA]A1+) majority shareholding in the company. HDFC had a 47.81% stake in HDFC Life followed by abrdn Limited (formerly Standard Life Limited) at 3.72% as on March 31, 2022. HDFC Life's acquisition of Exide Life Insurance Company Limited (Exide Life), resulted in a stake dilution of its existing shareholders by 4.12% to Exide industries Limited in January 2022.

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. ICRA expects that as and when HDFC Life becomes a subsidiary of HDFC Bank, there will be better opportunities for cross-selling and upselling. 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 support to HDFC Life, as and when required.

HDFC Life has a balanced product mix with increasing focus on the high-margin protection and annuity business, a diversified distribution network with a focus on augmenting 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 acquisition of Exide Life is expected to augment HDFC Life's business and market share, provide access to Exide Life's strong presence in South India, support the agency channel and improve the profitability through scale benefits.

HDFC Life witnessed a decline in its net profit in FY2022, resulting in a low return ratio mainly driven by one-time Covid provisions. The higher claims were due to the increase in the scale of business, the rise in the share of the protection business and high net Covid death claims of ~Rs. 818 crore in FY2022 [2.7% of embedded value (EV) as on March 31, 2022] from Rs. 145 crore in FY2021. However, the company witnessed that the claims have largely stabilised in the last couple of quarters and holds a Covid reserve of Rs. 55 crore for FY2023. The cash payment of Rs. 726 crore for the Exide Life acquisition and one-time covid provisions adversely impacted HDFC Life's solvency ratio, which stood at 176% as on March 31, 2022 compared to 201% as on March 31, 2021. HDFC Life's board approved to raise subordinated debt of Rs. 350 crore, which is expected to improve the solvency ratio by 6.3%. ICRA notes that the company's solvency ratio will reduce by 6.5%, post its final dividend payment of Rs. 359.1 crore.

ICRA takes note of the competition in the life insurance segment, especially from entities that enjoy exclusive distribution arrangements with large banks. HDFC Life's ability to improve its operating efficiency while maintaining its growth and profitability and ensuring adequate solvency, post-merger, will remain a key monitorable. Also, the amalgamation (HDFC and HDFC Bank) of the promoter entity and regulatory clarity on its stake in HDFC Life 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 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 with shared brand name – HDFC's stake in HDFC Life stood at 47.81% as on March 31, 2022 compared to 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. The dilution from 49.97% to 47.81% was primarily on account of the equity shares issued to Exide Industries Limited as part-consideration towards the acquisition of Exide Life. 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. 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 HDFC Life becomes a subsidiary of HDFC Bank (subject to regulatory approvals), there will be better alignment in strategy for both companies and more opportunities for cross-selling and upselling. Currently, HDFC Bank is one of the largest distributors for HDFC Life. Post the aforementioned transaction, there will be direct alignment in terms of ownership as well. With a meaningful shareholding in the life insurance business, increased focus on creating value for the stakeholders is expected through various means like deepening the existing distribution setup, exploration of newer avenues for business and closer alignment between the companies. 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.

ICRA notes that when additional capital is raised, HDFC will be limited to 50% ownership by the regulations[2]. Moreover, any additional capital infusion will need the regulator's approval once the merger of HDFC and HDFC Bank is completed. 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. ICRA will continue to monitor the regulator's guidelines and clarity on the amalgamated promoter entity's (HDFC and HDFC Bank) stake in HDFC Life**,** which will impact the company's capital**-**raising headroom from the promoter.

Balanced product mix with increasing focus on high-margin protection business – HDFC Life's growth was above the industry growth rate, resulting in an increase in its market share, in terms of Individual Weighted Received Premium (WRP) to 9.3% in FY2022 from 6.8% in FY2017. This was largely driven by the healthy growth in the protection and group segments. ICRA notes that the company's focus has shifted to protection and retiral products in the last few years from savings products. The share of the protection segment increased to 13.6% in FY2022 from 11.3% in FY2018 in terms of total annualised premium equivalent. Within protection, group credit life witnessed a significant growth of 55.1% YoY in FY2022 due to higher disbursements by financial institutions. Further, the company has been calibrated on the retail protection business underwritten. Also, the gross premium written (GPW) on annuity products witnessed a high compound annual growth rate (CAGR) of 46.2% during FY2018-FY2022 driven by the company's higher focus on retirement products.

The management expects the share of the protection business to improve in the medium term, given the low penetration levels. Going forward, the company plans to continue maintaining a balanced mix of participating (par), non-participating (non-par) and unit linked insurance plans (ULIPs) within the savings business.

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

[2] In May 2020, the RBI had directed HDFC to bring down its stake in HDFC Life to 50% or below from its shareholding of 51.44%, on or before December 16, 2020

Diversified distribution network with increasing focus on proprietary channels – The bancassurance channel remains the largest sourcing channel with the rising share of proprietary channels (agency, direct and online). 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 APE basis, increased gradually to 19% in FY2022 from 14% in FY2018 while the share of the bancassurance channel declined to 60% in FY2022 from 71% in FY2018. Further, the company has been sourcing a large part of its business in the individual category from the direct channel (31-34%) in terms of new business premium in the last few years, which remains high compared to peers.

ICRA notes that the proprietary channels have a higher mix of protection, non-par and annuity products. HDFC Life has a diversified distribution mix with nearly 300 partners including traditional partners such as non-banking financial companies (NBFCs), microfinance institutions (MFIs) and small finance banks (SFBs) along with 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 372 branches across the country. ICRA notes that as and when HDFC Life becomes a subsidiary of HDFC Bank (subject to regulatory approvals), there will be better opportunities for cross-selling and upselling.

Improving VNB margins, though solvency ratio declined – HDFC Life reported a healthy YoY growth of 19.1% in the GPW, supported by a rise in the 13th month persistency ratio[3] to a peak of 87.5% in FY2022. Despite the increase in the top line, the net profit declined to Rs. 1,207.7 crore in FY2022 from Rs. 1,360.1 crore in FY2021 mainly due to the rise in net benefits paid. The higher claims were due to the increase in the scale of business and the high net Covid death claims of ~Rs. 818 crore in FY2022 (2.7% of EV as on March 31, 2022) as compared to Rs. 145 crore in FY2021. However, the company witnessed that the claims have largely stabilised in the last couple of quarters and holds a Covid reserve of Rs. 55 crore for FY2023. The claims experience is expected to normalise in FY2023. The net benefits paid to total premium increased to 70.2% in FY2022 compared to 59.2% in FY2021. The higher claims coupled with the cash payment of Rs. 726 crore for the Exide Life acquisition resulted in a decline in the solvency ratio by 13.1% to 176% as on March 31, 2022. ICRA expects a marginal improvement in the solvency for the next year on the back of higher profitability.

HDFC Life's return ratios have declined consistently with a return on equity of 7.8% in FY2022 compared to 23.4% in FY2018. However, the low return ratio in FY2022 was due to the higher net worth base as equity shares were issued to Exide Industries Limited for the acquisition of Exide Life, and the higher mortality reserve (Rs. 815 crore) created during the year, which was a one-off event. Moreover, the VNB margin is a better profitability indicator for a life insurance company. HDFC Life witnessed a CAGR of 18.5% and 20.2% in the EV and VNB, respectively, during FY2018-FY2022. Further, the VNB margin (calculated as VNB divided by APE) has increased consistently in the last five years to 27.4% in FY2022 from 23.2% in FY2018. This was primarily driven by the healthy growth in the higher-margin protection and annuity products.

Credit challenges

Ability to grow and maintain profitability in protection and non-par business – HDFC Life has witnessed a high growth in the protection and non-par business in the last few years. The share of the protection business increased to 13.6% in FY2022 from 11.3% in FY2018, in terms of total annualised premium equivalent. Within protection, the group credit life GPW witnessed a significant YoY growth of 55.1% in FY2022 due to higher disbursements by financial institutions. Also, the annuity products GPW witnessed a high CAGR of 46.2% in FY2018-FY2022 driven by company's higher focus on the retirement product. Further, the non-par savings segment witnessed a rise in its share to 33.4% in FY2022 from 7.0% in FY2018, based on individual annualised premium equivalent. Nevertheless, the company sources protection products largely through the agency, direct and online channels. ICRA also notes that the company's operating expense ratio remains higher compared to listed peers primarily due to the absence of exclusive tie-ups in the relatively lower-cost bancassurance channel. The company's ability to

[3] *Persistency ratio based on regular premium/limited premium payment under individual category*

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.

Integration challenges related to Exide Life merger – On September 3, 2021, HDFC Life had announced that it has approved the acquisition of 100% of the share capital of Exide Life. HDFC Life received approval from the Insurance Regulatory and Development Authority of India (IRDAI) and Competition Commission of India (CCI), with Exide Life becoming a 100% subsidiary of HDFC Life effective January 1, 2022. The merger process has been initiated with the National Company Law Tribunal (NCLT) and is expected to be completed in H2 FY2023. Integration challenges such as retention of employees, agents and customers would be a key point to monitor. Moreover, there could be a short-term impact on the merged entity's operating expense ratio as Exide Life's operating expense ratio is higher. The company has indicated an intent to remain neutral on margins at an overall level for FY2023.

Liquidity position: Strong

HDFC Life reported liquid assets of Rs. 1,12,497 crore (calculated as liquid investments[4], adjusted for haircuts, and cash & bank balance) as of March 31, 2022. In FY2022, actual benefits/claims paid[5] stood at Rs. 31,864 crore. The nearest debt repayment is the Rs. 40.0-crore coupon payment for the subordinated debt programme, which is due on July 29, 2022.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, 2022, the company had three wholly-owned subsidiaries, which are listed in Annexure 2.

[4] *Excluding linked investments*
[5] *Inclusive of interim and terminal bonus*

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 abrdn (Mauritius Holdings) 2006 Limited (formerly Standard Life (Mauritius Holdings) 2006 Limited). Subsequently, in November 2017, HDFC Life was listed on the stock exchanges. As on March 31, 2022, HDFC had a 47.81% stake in HDFC Life followed by Exide Industries Limited (4.12%), abrdn Limited (3.72%) while the rest is publicly held (including foreign portfolio investors of 26.31%). HDFC is India's leading housing finance institution while abrdn Limited 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 par, non-par, and unit-linked lines of business. Its products are distributed through 372 branches, corporate agents, brokers, online channels and a strong base of financial consultants (individual agents). HDFC Life has nearly 300 partnerships comprising traditional partners such as NBFCs, MFIs and SFBs along with new-ecosystem partners.

HDFC Life reported consolidated assets and a net worth of Rs. 2,30,734 crore and Rs. 15,613 crore, respectively, in FY2022 compared to Rs. 1,79,655 crore and Rs. 8,640 crore, respectively, in FY2021. It reported a consolidated profit after tax of Rs. 1,327 crore in FY2022 compared to Rs. 1,361 crore in FY2021.

Key financial indicators (audited) – Standalone

HDFC Life	FY2019	FY2020	FY2021	FY2022
Gross Direct Premium	29,186	32,707	38,583	45,963
Income from Investment and Fees^	9,632	(2,611)	33,509	20,182
Total Operating Expense*	5,059	6,557	6,134	7,349
PAT	1,277	1,295	1,360	1,208
Total Net Worth	5,656	6,800	8,638	15,486
Total Policyholders' + Shareholders' Investments@	62,174	73,044	99,080	123,549
Operating Expense Ratio$	17.5%	20.3%	16.1%	16.2%
Return on Equity&	22.6%	19.0%	15.7%	7.8%
13th Month Persistency Ratio**	87.2%	90.1%	84.9%	87.5%
61st Month Persistency Ratio	52.3%	55.0%	48.9%	54.0%
Regulatory Solvency Ratio	188.0%	184.0%	201.0%	176.0%

Note: Amount in Rs. crore; All calculations are as per ICRA Research
Source: Company, ICRA Research
^ Includes other income
** Includes provision for diminution in value of investments*
@ Investments exclude linked investments
$ Total operating expenses to net premium written
& Return on equity is calculated based on profit after tax divided by closing equity for that period
*** The 13th and 61st month persistency ratios for FY2021 and FY2022 are based on regular premium/limited premium payment under individual category while the data for FY2019 and FY2020 are based on original premium basis*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of May17, 2022 (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					May 26, 2022	Jun 30, 2021	Jun 16, 2020	
1	Issuer Rating	Long-Term	-	-	**[ICRA]AAA(Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	-
2	Subordinated Debt Programme	Long Term	600.0	600.0	**[ICRA]AAA(Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	-
3	Subordinated Debt Programme	Long Term	350.0	-	**[ICRA]AAA(Stable)**	-	-	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Issuer Rating	NA
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: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Issuer Rating	NA	NA	NA	-	[ICRA]AAA(Stable)
INE795G08019	Subordinated Debt Programme	Aug 29, 2020	6.67%	Jul 29, 2030*	600.0	[ICRA]AAA(Stable)
NA	Subordinated Debt Programme^	NA	NA	NA	350.0	[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*

^ Unutilised

Annexure-2: List of entities considered for consolidated analysis

Company Name	HDFC Life Ownership	Consolidation Approach
HDFC Pension Management Company Limited	100.0%	Full Consolidation
HDFC International Life and Re Company Limited	100.0%	Full Consolidation
Exide Life Insurance Company Limited	100.0%	Full Consolidation

Source: Company

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

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

Neha Parikh
+91 22 6114 3426
neha.parikh@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:

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For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches