April 21, 2023

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	950.00	950.00	[ICRA]AAA (Stable); reaffirmed
Total	**950.00**	**950.00**	

**Instrument details are provided in Annexure I*

Rationale

The rating considers HDFC Life Insurance Company Limited's (HDFC Life) strong promoter profile with Housing Development Finance Corporation Limited (HDFC; [ICRA]AAA (Stable)/[ICRA]A1+) holding a 48.66% stake as on December 31, 2022. 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.

In April 2022, HDFC had announced a scheme of amalgamation, whereby it would amalgamate with and into HDFC Bank Limited {HDFC Bank; [ICRA]AAA (Stable)} subject to regulatory approvals. ICRA notes that HDFC Life will become a subsidiary of HDFC Bank, post the merger. HDFC Bank has requested the Reserve Bank of India (RBI) to increase its stake in HDFC Life to 50%. The amalgamation of the promoter entity (HDFC and HDFC Bank) and regulatory clarity on its stake in HDFC Life will remain key monitorables.

The rating considers HDFC Life's established market position, balanced product mix, diversified distribution network, and strong persistency, which has supported its profitability. Further, the company's solvency profile improved to 2.09 times on a merged basis as on December 31, 2022, mainly driven by a capital infusion of Rs. 2,000 crore by HDFC in Q2 FY2023. ICRA notes that the merger of Exide Life with HDFC Life was completed with effect from October 14, 2022. The merger has provided HDFC Life access to Exide Life's strong presence in South India and its agency channel.

ICRA notes that HDFC Life does not have an exclusive distribution partnership with HDFC Bank compared to peers enjoying exclusive arrangements with their large parent banks. Hence, its operating expenses remain relatively high compared to peers. Also, the group fund business (10.9% of new business premium (NBP) in 9M FY2023) could be lumpy and is volatile in nature. The profitability and solvency may remain susceptible to changes in the actuarial assumptions, driving long-term changes in the reserving requirements.

The Stable outlook reflects HDFC Life's strong brand recall, diversified distribution network and balanced product mix, which will help it maintain its market position. It also reflects the expectation that the company will receive support from the promoter, if required, and will maintain its solvency level above the negative rating trigger.

Key rating drivers and their description

Credit strengths

Strong promoter profile – HDFC held 48.66% in HDFC Life as on December 31, 2022. HDFC is a leading housing finance company 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. HDFC Life benefits from HDFC's strong brand recognition. 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.

In April 2022, HDFC announced a scheme of amalgamation, whereby it would amalgamate with and into HDFC Bank subject to regulatory approvals. HDFC Bank is the largest private sector bank in India. ICRA notes that as and when HDFC Life becomes a subsidiary of HDFC Bank (subject to regulatory approvals), any further capital infusion will require the RBI's approval. Given the existing directions from the RBI, HDFC's ownership is limited to 50%[1]. Hence, the company's capital-raising ability is currently 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. 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 could impact its headroom for capital-raising from the promoter. However, the current solvency position is comfortably above 2.0 times and there is no requirement to raise capital in the near term.

Established market position – HDFC Life is the second largest private life insurer with a market share of 10.3% (including Exide Life) in 9M FY2023 (9.3% in FY2022) in terms of individual annualised premium equivalent (APE). The APE and NBP grew by 12% and 3%, respectively, to Rs. 8,174 crore and Rs. 18,311[2] crore, respectively, in 9M FY2023 over the previous corresponding period. HDFC Life's product mix is largely diversified with non-participating (non-par) accounting for 32.6% of the APE in 9M FY2023 followed by participating (par) and unit linked insurance plans (ULIPs) at 24.8% and 17.8%, respectively. ICRA notes that the company's focus has increased in the protection and retiral segments. As a result, the share of the protection segment increased to 14.8% in 9M FY2023 from 13.6% in FY2022 in terms of total APE. Within protection, group credit life witnessed a significant YoY growth of 52% in 9M FY2023 due to higher retail loan disbursements by financial institutions. ICRA notes that around one-third of this business is sourced from HDFC Group (including HDFC Bank). Further, the APE of annuity products increased by 68% YoY to Rs. 617 crore in 9M FY2023, driven by new product innovation and the company's higher focus on retirement business.

Diversified distribution network – The company's growth is supported by a diversified distribution network with bancassurance accounting for 59% of the individual APE in 9M FY2023, agency (18%), direct channel (15%) and brokers and others (9%). While the bancassurance channel remains the largest sourcing channel, its share has been declining (59% in 9M FY2023 from 71% in FY2018). HDFC Life expects the proprietary channels to deliver higher growth over the medium to long term and provide more flexibility and control over its product mix compared to third party distribution channels. Further, the company has been sourcing a large part of its business in the individual category from the direct channel (29-34%) in terms of NBP in the last few years, which remains high compared to peers.

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 500+ branches across the country and will have better cross-selling and upselling opportunities once it becomes a subsidiary of HDFC Bank (subject to regulatory approvals).

Healthy profitability metrics supported by strong persistency ratio – HDFC Life's profitability has historically been healthy with the company reporting a return on equity (RoE) of more than 15%. However, the profitability was impacted in FY2022 with adjusted RoE (excluding shares issued to Exide Life) of 12.7% mainly due to the higher net Covid death claims of ~Rs. 818 crore. The annualised RoE, on a merged basis, moderated to 10.5% in 9M FY2023 because of the equity infusion of Rs. 2,000 crore.

Moreover, the value of new business (VNB) margin (calculated as VNB divided by APE) has been improving and increased to 26.5% in 9M FY2023 on a merged basis from 24.6% in FY2019. The company's profitability is supported by the strong persistency. HDFC Life's 13th month persistency ratio[3] improved to 87.2% in 9M FY2023 on a merged basis from 86.6% in 9M

[1] In May 2020, the RBI had directed HDFC to reduce its stake in HDFC Life to 50% or below on or before December 16, 2020 (from 51.44%)

[2] The 9M FY2023 figures are published on standalone basis from April to September 2022 and merged basis from October to December 2022 as per public disclosures

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

FY2022. This was due to the product mix change, the quality of business, increasing customer awareness and the focus of the management team. The higher persistency supports the renewal premium, which aids in profitability as well as liquidity.

Comfortable solvency profile – The company's solvency profile was mainly supported by healthy internal accruals and there was no equity capital infusion in the last 11 years (except through employee stock ownership plans – ESOPs) till FY2022. As its backbook surplus (surplus accumulated from historical business written) has exceeded the new business strain, HDFC Life does not require capital for organic growth in the near future. The profitability and solvency may remain susceptible to changes in the actuarial assumptions, driving long-term changes in the reserving requirements.

The company's solvency profile (1.76 times as on March 31, 2022) was adversely impacted by a cash payment of Rs. 726 crore related to the Exide Life acquisition and high Covid claims in FY2022. Consequently, HDFC infused Rs. 2,000 crore of capital in Q2 FY2023 to fund the acquisition and build a cushion. The company's solvency ratio improved to 2.09 times on a merged basis as on December 31, 2022. Further, the company has additional headroom to raise subordinated debt of Rs. 1,982 crore or 29 bps to the reported solvency as on December 31, 2022. ICRA notes that once HDFC Bank becomes the promoter of HDFC Life, any capital infusion will be subject to RBI approval.

Credit challenges

High share of group fund business leads to volatility in premium income – The group fund business accounted for 23-29% of the total business in terms of NBP during FY2019-FY2022 and declined to 10.9% in 9M FY2023 as a part of conscious strategy by the company. Group funds business largely comprise of gratuity, superannuation and leave encashment corpus accruing from corporates. It is a very thin margin business and its contribution to the VNB is negligible. ICRA notes that the group fund business is a chunky business and typically witnesses a high churn rate as corporates remain sensitive to the rates being offered, leading to volatility in premium income.

Operating expenses remained relatively higher than peers – HDFC Life's operating expense ratio to gross premium written remained relatively higher at 12-14% in the last few years compared to listed peers. The operating expense ratio increased further to 14.6% in 9M FY2023, as Exide Life's operating expense ratio was higher. Historically, HDFC Life's high operating expense ratio was mainly due to the lack of exclusive tie-ups unlike its peers in the relatively low-cost bancassurance channel, thereby leading to higher competition.

Environmental and social risks

Life insurance companies like HDFC Life typically invest in long-term debt securities and equity, have broadly diversified portfolios that include exposure to sectors affected by environmental risks. However, active portfolio management mitigates this risk. While pollution and other environmental damage could somewhat affect mortality rates in the long run, the overall trends toward increased environmental regulation mitigate this risk. Life insurers that underwrite policies only in a limited region could be more affected by natural and man-made disasters, but HDFC Life by virtue of its large scale and diversified business, does not face such risks.

As for social risks, even as life spans in general have increased, changing lifestyle, increased obesity levels and pandemic/ other disease-induced mortalities could have adverse impact on long-term mortality/ morbidity rates and accordingly the future claims could be higher than currently estimated. Increase in mortality rates could adversely impact the financial performance as the company would be required to increase the reserving against possible future claims on the business it has written in the past. Other social risks faced by HDFC Life stem from potential mishandling of sensitive customer data and privacy breaches whose impact on the credit profile could be transmitted from the channel of regulatory penalties or reputation damage. Human capital risks are also reasonably high for life insurance companies like HDFC Life with challenges that concern recruiting and retaining key employees.

Liquidity position: Superior

The company's net premium (excluding ULIP) stood at Rs. 33,382 crore in FY2022 in relation to the maximum net claims and benefits (excluding ULIP) paid of Rs. 16,728 crore in the last few years. For 9M FY2023, the net premium (excluding ULIP) stood at Rs. 27,729 crore against net claims paid (excluding ULIP) of Rs. 16,026 crore. In addition, investments in Central and state government securities stood at Rs. 99,076 crore, accounting for 65% of the total investments (excluding ULIP) as on December 31, 2022, further supporting the liquidity to meet the claims of policyholders. The shareholders' investment of Rs. 12,933 crore also remains superior in relation to the sub-debt outstanding of Rs. 950 crore as on December 31, 2022.

Rating sensitivities

Positive factors – Not applicable

Negative factors – The rating or the outlook could be revised if there is a deterioration in the credit profile of HDFC or a decline in the strategic importance of HDFC Life to HDFC or in the expectation of support from the promoter. In addition, a decline in the company's solvency ratio below 1.70 times on a sustained basis could lead to a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology – Life Insurance Rating Approach – Consolidation Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group support	Parent/Group Company: HDFC Limited (HDFC) The rating considers the financial and management support received by HDFC Life from its parent and its representation on HDFC Life's board. The rating also factors in the strong ability to leverage HDFC Bank's wide branch network for the distribution of the insurance policies.
Consolidation/Standalone	For arriving at the rating, ICRA has used the standalone financials of HDFC Life. However, in line with its limited consolidation approach, ICRA has factored in the capital requirement of HDFC Life's subsidiaries. ICRA notes that all the subsidiaries have a limited scale of operations. As on December 31, 2022, the company had two wholly-owned subsidiaries, which are listed in Annexure II.

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) is a wholly-owned subsidiary of abrdn plc (formerly Standard Life Aberdeen plc), which held a 1.66% stake as on December 31, 2022. Subsequently, in November 2017, HDFC Life was listed on the stock exchanges. In January 2022, HDFC Life announced the acquisition of Exide Life Insurance Company Limited and completed the merger in October 2022. HDFC Ltd. is India's leading housing finance institution while Abrdn (Mauritius Holdings) 2006 Limited is a global investment company headquartered in Scotland.

HDFC Life provides life insurance, pension, savings, investment, annuity and health insurance to individuals and groups. Its products are offered under the participating, non-participating, and unit linked lines of business. HDFC Life's products are distributed through its 500+ branches along with individual agents, corporate agents, banks, brokers and online channels.

Key financial indicators (audited)

HDFC Life	FY2021	FY2022	9M FY2022^^	9M FY2023
Gross direct premium	38,583	45,963	31,542	36,298
Income from investment and fees^	32,678	19,216	17,819	10,756
Total operating expense	6,296	7,553	5,123	6,799
PAT	1,360	1,208	850	997
Total net worth@@	8,638	15,486	9,190	12,700
Total policyholders' + Shareholders' investments@	99,080	123,549	112,806	151,761
Operating expense ratio$	12.1%	12.4%	12.3%	14.6%
Return on equity&	15.7%	7.8%	12.3%	10.5%
13th month persistency ratio	84.9%	87.5%	86.6%	87.2%
61st month persistency ratio	48.9%	54.0%	53.2%	52.2%
Regulatory solvency ratio	2.01	1.76	1.90	2.09

Source: Company, ICRA Research; Note: Amount in Rs. crore; All calculations are as per ICRA Research
^^ Unaudited figures; ^ Includes other income
@@ Net worth includes fair value change account; @ Investments exclude linked investments
$ Total operating expenses to gross premium written; & 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 (FY2024)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of April 20, 2023 (Rs. crore)	Date & Rating In FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					April 21, 2023	May 26, 2022	Jun 30, 2021	Jun 16, 2020
1	Issuer Rating	Long Term	-	-	[ICRA]AAA (Stable)	[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)	[ICRA]AAA (Stable)
3	Subordinated Debt Programme	Long Term	350.0	350.0	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Issuer Rating	Not Applicable
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 I: 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	NA	[ICRA]AAA (Stable)
INE795G08019	**Subordinated Debt Programme**	Jul-29-2020	6.67%	Jul-29-2030*	600.0	[ICRA]AAA (Stable)
INE795G08027	**Subordinated Debt Programme**	Jun-22-2022	8.20%	Jun-22-2032*	350.0	[ICRA]AAA (Stable)

Source: Company

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

Key features of rated debt instrument

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

- Servicing of interest is contingent on the company maintaining a solvency ratio above the level stipulated by the regulator[4]
- If the interest payouts lead to a net loss or an increase in the net loss, the prior approval of the regulator would be required to service the debt

Annexure II: List of entities considered for consolidated analysis

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

Source: Company

[4] *As per IRDAI, insurers are required to maintain a minimum solvency ratio of 1.50 times*

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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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