HDFC Life Insurance Company Limited

9M FY25 Earnings Conference Call

January 15, 2025

Vibha Padalkar: Good evening, everyone. Welcome to the earnings conference call for nine months ended December 31st, 2024. The results, which include the investor presentation, press release and regulatory disclosures, have already been made available on both our website and the stock exchanges. I have with me Niraj Shah, Executive Director and CFO; Vineet Arora, Chief Business Officer - Distribution, Data and Technology; Eshwari Murugan, our Appointed Actuary; and Kunal Jain, Senior Vice President, Investor Relations and Business Planning. Turning to the key highlights of 9MFY25.

<u>Starting with our operating performance:</u>

We have registered a healthy growth of 22%, based on individual WRP for 9MFY25, outpacing private industry and overall sector growth of 19% and 14% respectively. Our market share in the overall sector, expanded by 70 bps to 10.8% and our market share in the private sector stands at 15.3%. We have witnessed both ticket size and volume expansion during this period. The number of policies sold has grown by 15%, outperforming the private sector's growth of 9%. The average ticket size has also grown by 8% during 9MFY25. Over 70% of the customers acquired during this period are new to HDFC Life, demonstrating progress towards our objective to expand our customer base. Retail sum assured has grown by 22% YoY for this period. We continue to clock secular growth across tier 1, 2 and 3 cities with number of lives insured crossing 36 million during 9M FY25.

<u>Moving to product mix:</u>

Individual APE in 9M was composed of ULIPs: 37%, non-par savings: 35%, participating policies: 18%, term: 6%, and annuities: 5%. ULIPs continue to remain range-bound for us so far this year. Non-par savings products sustained their strong growth, growing by 55% YoY. Retail protection continues to grow well, with APE for nine months clocking a growth of 28%. Credit protect growth has been tepid due to slower disbursements amongst specific partners and the MFI sector, in particular. However, we firmly hold our position as market leader in this segment. Momentum was sustained in rider attachments, both on individual as well as group policies. Annuity and protection together contributed 44% to our overall new business premium. We are happy to introduce our latest offering in the participating category, Click 2 Achieve Par Advantage, which provides flexibility to the customer to customize and combine plan options, policy and premium paying term, along with policy continuance benefits for single and joint life. On the surrender regulations, we have largely closed our discussions with all our distributors and rolled out a combination of measures, including deferred commission payout, claw-back of commission and reduction of commission. We are happy to share that we have been able to equitably share the impact between us and our partners.

<u>Moving onto key financial and operating metrics:</u>

Value of new business for the 9M period was Rs. 2,586 crores, reflecting a 14% YoY growth. New business margin for the 9-month period was 25.1%, with the compression mainly attributable to changes in product mix in line with macro trends. Our embedded value grew by

18% and stood at Rs. 53,246 crores as on 31st December, delivering an operating return on embedded value of 16.0%. We ended the quarter with a comfortable solvency ratio of 188%. Profit after tax grew 15% YoY to Rs. 1,326 crores, driven by an 18% increase in profit emergence from our back book. Renewal collections grew by 12% YoY. 13th and 61st month persistency stood at 87% and 61%, an increase of 110 and 780 bps respectively.

Next on distribution:

All channels registered healthy double-digit growth. Our counter share at HDFC Bank has remained stable at close to 65% in 9M FY25. We are focused on building a profitable, high-quality Agency franchise and are happy to report that protection business sourced by this channel grew more than 2x when compared to our overall growth in protection of 28%.

On subsidiaries:

HDFC Pension continues to be one of the fastest growing pension fund management company in the industry, enjoying a market share of 43.2% and an AUM of Rs 1.06 lakh crore. We are pleased to inform you that HDFC International has maintained an Insurer Financial Strength Rating of "BBB" from S&P Global Ratings and has received a "B++" rating from AM Best Ratings.

On other updates:

We are excited to announce the partial deployment of the first phase of Project Inspire, which includes the group business module. We expect our partners and members covered to avail of benefits such as automated member onboarding, issuance of Certificates of Insurance, straight through claims processing, payouts and real-time communication. We were recognised as India's Top 50 Best Workplaces for Women by Great Place to Work. We also featured in Business Today's BT500 list of India's Most Valuable Companies, demonstrating our commitment to creating value for all our stakeholders.

In closing, we remain focused on achieving our full year outlook on APE and VNB growth. We are committed to adapting to the evolving market and regulatory landscape with agility and resilience. This includes continued investment in distribution, tech and customer-centric product innovations to deliver long-term value for our stakeholders. For a detailed overview of our results, please refer to our investor presentation. We are now open to any questions from the participants.

Moderator: Thank you very much. We will now begin the question-and-answer session. Our first question comes from Avinash Singh from Emkay Global.

Avinash Singh: Great set of numbers particularly, the margins holding up amidst surrender regulations are pretty much comforting. The first question is that if I see the margin walk and if I compare with how it was at H1 versus 9M, the YoY impact from the business mix change on the margin seems to be turning favorable in this quarter despite the fact that sequentially, par has gone up slightly, protection is holding up and non-par sequentially has come down marginally.

So, is it to do with that? Or you have adjusted your guaranteed rates to reflect the new realities and that has helped you recoup whatever margin you had lost some bit in last quarter on the non-par products. So, if you can just help with that?

Second bit is, if I see your New Business Strain, that seems to be growing again at 18%-20% rate YoY over 9M. So just to understand, which are the segments that are of driving this New Business Strain? I mean, is it just because the non-par is increasing as compared to last year?

And related to that, if I go to your accounting surplus disclosure, and if I look at nine months, the non-par individual and Group Life or surplus in the nine months is turning a significant negative number vis-a-vis last year. So, I mean, what are the sort of factors that's underplaying here? So, these are my three questions.

Niraj Shah: Yes, on your question on margins, we just start with basically what's happened on a nine-month basis from last year to this year. We started that last year was about 26.5%, currently, we're reporting 25.1%. The significant change is on account of product mix. That's primarily visible in terms of what you see on the unit linked front from 32% last year to 37% this year. That's largely what is driving this change.

The other factor is the implementation of the surrender value regulations. We're basically talking about on a nine-month basis, a 10-basis points impact, and on a quarter basis, about 30 basis points impact of the surrender value regulation implementation. So, these are really the two big changes on a YoY basis.

If I were to just quickly talk through what's happened sequentially, that will also completely make it clear in terms of what we had spoken about last time as well. So, the number for Q2 last year appeared as about 24.3%. We had basically called out a lag in repricing and that is to the effect of about 100-110 bps. So, the starting point really is about 25.3%-25.4%. And as such, the margins are expanded by about 60 bps if we were to look at it from that perspective.

And that is largely on account of inherent product margins being a lot better now, especially on the Unit Linked segment because of two reasons; one is our persistency has improved significantly and second is our level of protection that we are able to attach on Unit Linked products is a lot higher than what it was in the prior period.

This is obviously offset by the surrender value impact of 30 bps that I spoke about. So, on a net basis, we are talking about 24.3% going up to 26%, or if you were to actually just normalize last period's number to 25.3%, then it's about 60-70 bps delta.

Moderator: The next question comes from Madhukar Ladha from Nuvama Wealth Management Limited.

Madhukar Ladha: Good evening. Congratulations on a good set of numbers. Just a couple of questions. We see growth in this quarter, particularly in individual APE has slowed down. For non-par savings, I think that's a product line where growth is not there and even protection I think is a little bit flattish. So, can you give us some color as to what is happening to broader growth?

Second question would be, what has been the share of HDFC bank, what is our counter share in HDFC Bank? And there's been a lot of noise around primary bank's contribution. Some color or some sense around that as to, what would your sort of comments be on this current environment and this current talk that we seem to get in the media. I think the entire investor community and analysts are slightly worried about this. So, some sort of sense there would be helpful.

Vibha Padalkar: Hi, Madhukar. Vineet will answer your first couple of questions on growth and HDFC Bank counter-share. I'll take the last question in terms of the noise.

Vineet Arora: Hi, Madhukar. I think the growth the way we see it is, it's largely in line with how the private industry has moved and slightly better than the overall industry. We don't really see a very big concern about the growth slowdown and no particular channel has shown this kind of a slowdown. It's more holistic, some base impact has come in from last year and it's in line with the industry movement.

Coming specifically to HDFC Bank, our counter share is steady. We have been in this range of close to 65%. We don't see an impact on the counter share in HDFC Bank because of any of the noise that you were referring to, it remains the same. So, I think that should answer your first two set of questions. Over to Vibha for the last part.

Vibha Padalkar: On this bancassurance related commentary. We've only heard it from media sources. We haven't heard anything at all from our regulator. At the same time, if misselling is the purpose then misselling complaints is something that we anyway work on. And overall for the sector, bancassurance misselling is actually lower than perhaps some of the other channels, but there's always scope for improvement.

Now our focus has been on growing proprietary channels, which includes the agency and direct as well as tie-ups with other banks and we have been fairly successful in doing that. Now from a bancassurance perspective, I think agency and broking is where our focus will continue.

And also, in terms of some numbers, our bancassurance, if I were to look at from an overall business perspective at a company level, new business premium, it is only 35% and HDFC Bank is about $1/4^{th}$. This, of course, I'm including Credit Life and all our businesses, if the intent is to bring down in terms of concentration risk, these are the numbers.

And last point is that while we are talking about some artificial construct on percentages, I think also the question to ponder about is, does the customer need choice in terms of open architecture? That also is something that really would give scope to give customer choice and hence, open up and widen the market, widen the reach and so on. So, there are different aspects to bancassurance but we'll see how and if it evolves.

Madhukar Ladha: So, my last question, in the EV walk, economic variance has reduced from the last quarter's numbers. I presume, obviously, this will be mainly a result of the equity markets coming down. Can you give me a split of the equity and the fixed income breakdown of this?

Eshwari Murugan: Yes, for the nine months ending December, the economic variance is mainly coming from the fall in the interest rate. Because for the equity markets on 9-month basis, the performance is around 8%, which is in line with the expectation. So, there is no positive variance from equities in the nine months. But yes, in the six months, we had a positive equity performance, which was reflected in the higher investment variance that you saw in the EV walk for September.

Moderator: Thank you. We'll take the next question from Avinash Singh from Emkay Global.

Avinash Singh: There were a couple of questions. First, what is driving this New Business Strain for the nine months? Is it change in product mix more towards non-par this year ? And the second one, if I look at the GAAP accounting surplus, the surplus in individual and group non-par life category for the nine months, is a reasonably negative big number vis-a-vis last year when it was reasonably positive. So, what is sort of underlying mechanics here?

Eshwari Murugan: So, if you look at the growth in the New Business Strain, it's only 13% for the nine months, which is in line with the new business growth. And the EB surplus has grown by 18%, which is in the range that we have always explained. So, I don't think the New Business Strain has grown higher than expected. And obviously, it will always be influenced by product mix but nothing very different in terms of reserving approach or anything that has happened.

And the product mix being very similar, slightly higher UL but the strain is not anything different from what we have seen in the previous quarters or in the previous financial year. Strain as a percentage of the premium, that's what I'm referring to.

Avinash Singh: Okay. And while the surplus generated for a non-par life is negative for the nine months?

Eshwari Murugan: The New Business Strain on the non-par is what you're referring to?

Avinash Singh: No, I'm referring to the surplus that is a part of your P&L filing.

Eshwari Murugan: The surplus is lower because the non-par segment has grown at a higher percentage compared to total top line growth. So non-par savings, for example, has grown by around 55% compared to the individual APE growth of 24%.

Avinash Singh: So I was referring to the same, in the segment level surplus generation for 9 months, your individual and group non-par life. That surplus last year was a positive number. If I see for the 9 months, that surplus was Rs 39 odd crores, now it's Rs 54 crores loss. So, is this referring to non-par savings? What has changed this year, why surplus is negative big time?

Eshwari Murugan: Okay. Because the non-par savings has grown higher compared to the surplus generation from the back book, there is a net strain overall in the non-par savings book, which is why you see a negative number in the LODR surplus, is what you're referring to?

Avinash Singh: Yes.

Eshwari Murugan: So last year, the growth was lower. The EB surplus was more than sufficient to offset the strain. This year, it is slightly reverse because of the higher growth.

Moderator: The next question comes from Suresh Ganapathy from Macquarie Capital.

Suresh Ganapathy: Sorry Vibha, on this bancassurance just to understand, as per the data disclosure, 60% of the overall APE comes from bancassurance, right? You're saying 35%, didn't get that.

Vibha Padalkar: Yes, this is APE. Anything that is done with the regulator and in our regulatory filings, APE is nowhere in the picture. APE is a common industry metric in terms of weightage of single premium and so on. Even in the way Life Council's numbers come out, the only thing being looked at is received premium, which is cash received. And hence, these are the numbers if I were to look at on a received premium basis.

Suresh Ganapathy: Then what should we look at for like-to-like disclosure for everybody in the system? For APE, on basis of that, you are at 60%, somebody as is 50%-55%, right? But you're saying the regulator will not look on APE basis. Is that the way you are arguing?

Vibha Padalkar: No. So, what I'm saying is, first of all, we don't know whether regulator is looking at anything because the only news flow is from a channel. We have not heard anything from the regulator. I'm saying that as a percentage of anything, whether it is expense of management, there's no place in expense of management for an APE number, right? So, I'm saying that if a calculation had to be done, it has to be done based on how we report it in the financials as well as in the public disclosure.

Niraj Shah: Suresh, in fact, if you just look at any of the data that comes out of Life Council, firstly there is overall premium. That includes all businesses, including group. And then you have individual business, and within that, there are segments, but everything is about first year and renewals. There is nothing about anything which is equated. That's just a convention used to basically explain some of the businesses that we do. But as such, the segments that get reported even at a granular level are only about new business and received premium. So that is something that can be used as a fairly straightforward measure to assess any of these things, if at all, it's getting assessed.

Suresh Ganapathy: So what I was arguing here is that, is there a thought process of the Board as well as the management to say, it's always better to reduce the concentration risk of any channel structurally. And within that also, a dependence on HDFC Bank or whatever partner you're talking about. Ideally speaking, you want to distribute and diversify the channel. So, longer term, you will be focusing perhaps much more in some of the other channels. Is that the thought process that you guys are considering?

Vibha Padalkar: So, that has been the case even without this news flow. If you look at our investor presentation, one of our core stated strategies has been this diversification, and we've also talked about growing agency channel very specifically. It's more in recent times that the number has gone up to some extent.

It's not just that bancassurance has gone up. But for various reasons, including tax changes being one of the single biggest reasons for our agency channel over the last couple of years being a tad weaker than normal.

So, nothing really in terms of that this is causing a change in strategy. If you were to look at Slide 10 of our investor presentation, at least for the last 7-8 years to my memory, you will find the same slide, which is when you see point number two, it is diversified distribution mix. So, it will just be sharpening, accelerating that and so on, which we will do in the normal course.

Suresh Ganapathy: Okay. Just one last question on the liberalization of the agency model itself, do you think we are a bit too early to talk about that? And the challenge there is that we follow tied agency model. What happens when you try to free that up because that's what perhaps is also mentioned in the amendment to the Insurance Act, and the news reports are also talking about liberalizing. What's your view on that?

Vineet Arora: So, I think it's a little too early. But just from a point of view on how this channel does operate, clearly, if agents today need multiple products, do have methods of having themselves their colleagues, etcetera to take multiple licenses and they would operate with that.

I don't see one agent taking too many companies just because it gets opened up, but they would want to continue to restrict themselves to the few companies that provide product differentiation, service differentiation, etcetera. But as of now until the time this really gets passed and the entire notification happens with proper guidelines being drafted, I think it's going to take some time for this to really get the ground.

Moderator: Next question comes from Nischint Chawathe from Kotak Institutional Equities.

Nischint Chawathe: Hi, thanks for taking my question. This is actually on growth. You mentioned somewhere that on your growth during the quarter, you're broadly in line with the market. What we have seen is that quite a few of the larger peers have slowed down in the last couple of months. So, do you see this as an immediate term impact of the change in surrender value guidelines where probably some part of the strain has been picked up by distributors? And in that sense, after fairly strong activity in first half, do you really see next couple of months being softer by the distribution channels.

Vineet Arora: I think the surrender guidelines change was practically an industry event. The distributors and the companies were able to really have a logical discussion and do an equitable participation on the entire impact of it. So, I don't really think that caused any kind of slowdown. It's largely a base impact that at the industry level and our level has led to this. This is across channels also, like I said earlier, all channels have contributed equally. And the growth is also broad-based.

Nischint Chawathe: But do you see sort of similar run rate continuing or do you expect things to sort of pick up as we go towards the end of the year?

Vineet Arora: So, towards the end of the year, we always see seasonality coming in, and that seasonality does help in picking up the run rate. We do expect that to happen in JFM also, to be able to pick up what we have been guiding as our annual numbers. I think we do expect that to happen.

Nischint Chawathe: Sure. And I think from a slightly more medium-term point of view, do you see the overall ULIP shares coming down, maybe not like in next 1 quarter, but maybe over the next 4 quarters, do you see the ULIP share coming down? And in that sense, getting a little bit of a lift in terms of margins?

Vibha Padalkar: See, there is a close correlation between ULIP and the markets. And I've seen over the past 1.5 decades that it’s with a 9- to 12-month lag. If markets continue to remain volatile, then ULIP starts coming off and maybe that's how it will pan out again. And that's why, regardless of what's happening in the market, this is our other stated core strategy that balanced product mix is important.

So that a distribution line doesn't get used to just selling one kind of product that is relatively easy to sell because of the market, but it has to be balanced. So, we are not overthinking as to where ULIP might be or might not be. Because regardless some peers selling over 50% ULIPs, we have remained range bound. And in the past also, when we launched Sanchay Plus, again, we reigned it in, and that's what we will do to some extent, regardless of whatever else is happening. So on margins, yes, with ULIPs coming down and ceteris paribus, then yes, that will aid margins.

Moderator: The next question comes from Dipanjan Ghosh from Citi.

Dipanjan Ghosh: Few questions from my side. One, if I look at the HDFC Bank channel, while you mentioned that your counter share has kind of stabilized around 65%, just wanted to get some sense of whether you also look at the VNB counter share in that channel? Or in other words, in terms of product mix that you're getting from the channel and whether there is kind of levers available to improve that, now that the counter share has stabilized. And if so, what steps are you really taking in that direction?

And the second is the data keeping question, for the quarter or the 9 months, if you can just spell out, what would be the growth at HDFC Bank and other banks separately?

Vibha Padalkar: On the first question, Dipanjan, yes, we are working to make it a win-win on the right product mix. Without sharing too much, looking at product mix at a broad level, we do put out data in terms of bancassurance and how much is the mix in bancassurance.

At slide 16 of our investor presentation, if you look at banca, you will see that term is only 4% of what banca sells while if I were to pick agency, term is close to 10%, so 2.5x where they are. So even baby steps on 50% of our business can make a very material impact.

So that is one. Second is in terms of what is the optimum manpower, and do we really need more and more people at their branches.

I think we have a fair bit of commonality now in our thought process as to what is optimal manpower level because the bank is also there for banking business. So just flooding branches with people probably is not the best approach to take. And there are a couple of other levers on how are we using more and more of digital solutions. So yes, we are working very closely on many small and big initiatives to get that margin to inch up.

Vineet Arora: And I think your question around HDFC Bank growth, for the year, we have seen HDFC Bank growing at 20%. And for the quarter, it's around 10%, where we have seen the base impact of last year also coming in.

Moderator: The next question comes from Nidhesh Jain from Investec.

Nidhesh Jain: First question is on bancassurance. What are the next steps that you are expecting from regulator on bancassurance? Do you expect a draft or discussion with the regulator, because that is becoming a bit of overhang for the entire sector? So, as you mentioned that there is no communication from the regulators, but what are the expectations that you have now?

Vibha Padalkar: So, expecting nothing Nidhesh. Because we have our work cut out. We know that we as a sector, are responsible in how we're looking at multiple factors, more de-risking, complaints, giving customer a choice and so on.

Like I mentioned, if there's any concern, it is already being talked about because maybe I just need to remind that we did have a draft paper that was issued by the regulator. There were discussions. We did go back in terms of some of the tightening of the processes and so on. And I'm sure us and many of our peers have already rolled that out in terms of tightening the sales and servicing process. So that's where it is at this point in time.

A couple of points here, which I'm sure everyone knows that bancassurance does play a very important role. One data point to chew on is that the number of touch points of banks is comfortably 10x of the touch points of all life insurance companies. So, do we want to miss out on those touch points? Second is that if you see insurance penetration, life insurance penetration in the recently issued annual report of our regulator that also shows a downward trend. So, given that, is it a time to really reduce the touch points.

So that's where it is at this point in time. Like we mentioned to the earlier caller, we are focused on more broad-basing distribution. This is not new, we will continue to work on it. And there are many other things also up our sleeve in terms of not only organic but also inorganic solutions.

It's difficult to give an answer because you don't know what the question is. And we will, of course, continue to ensure that what the regulator has in mind in terms of best product, most transparent, best service, ease of on boarding, transparency is provided to our customers.

Nidhesh Jain: Sure. Secondly, on the VNB margin. Sequential improvement in VNB margin is driven by ULIP VNB margin improving. Is that right understanding?

Niraj Shah: No, it's not just Unit Linked margin improving. Its inherent margins across the board improving. Unit Linked definitely plays a part there because we're able to attach higher levels of protection and over the period of time persistency is improving. So largely that really is contributing to that. And, of course, the gap looks larger than what it actually is because of the repricing lag that we had in the previous quarter.

Once you normalize for that, then the gap is just about 60-70 bps in our view and that can be explained by some adverse product mix because of Unit Linked being higher and the inherent pricing more than compensating for that along with the surrender value regulations gap of about 30 bps for the quarter.

Nidhesh Jain: So just to clarify there's no one-off thing on the margins. Because last quarter, there was a one-off of lagging pricing. This quarter we have seen interest rates have gone up through the quarter. So, because of that we have not got any benefit in our margins in this quarter?

Vibha Padalkar: I can clarify that there are no one-offs in this quarter. These are inherent margin improvements.

Moderator: The next question comes from Supratim Datta from Ambit.

Supratim Datta: Thanks for the opportunity. My first question is on agency. Now you have been making investments in that channel. However, if I look at the growth rates on a quarterly basis it has been fluctuating. So just wanted to understand when should we start seeing these investments that you're making start delivering fruit? And what have been the challenges. You have been making investments in this channel for nearly 2 years. So, what have been the challenges that you have faced and how you are trying to address that? So, could you give some color on that, that would be helpful.

Now moving to Credit Life. Now it contributes around 6%-7% of your APE. And recent comments from the FM suggests that banks could look at reducing the cost of borrowing, particularly with respect to insurance. So, are you hearing from your channel partners any rationalization on the products that they are attaching with loans or what could you do to improve the product proposition there better? And then the corollary to that is how would that result in the margins moving in that product, given it's a fairly high-margin product.

And lastly coming to the recent data breach, could you give us an update on what happened, what have you done to address that? You have been investing in technology to improve the processes. So why did it happen? What has been done to address that?

Vibha Padalkar: Yes, I'll take the data breach. So, nothing further than what we had reported to the exchanges. But in the meantime, we have obviously strengthened and closed wherever the leak was from. It was identified very swiftly and we have closed that. Fortunately, no material impact on the company's operations as well as from a customer servicing point of view.

Since then, a lot of tightening has been done and we have looked at robust security across our IT environment. We also have been working closely with a couple of external partners who are doing an independent audit and a review of our entire system.

We have also obtained an injunction from Mumbai High Court. This is to prevent the circulation of leaked customer data. This is just a pre-emptive measure that we again obtained very swiftly, so that was fairly reassuring for us while we put in a lot of controls to stem anything further. So, we are in that stage now. And we're kicking off each and every aspect of our IT networks, cloud, our APIs so that we ourselves and the Board are fairly reassured that it's fairly water tight.

Vineet Arora: Yes. Coming to your question on agency, the agency growth this year has been 19%, which is quite in line with what we have grown as an organization. Last year we had seen a lower growth and that largely came in from the impact that we have on greater than Rs 5 lakh regulation which changed there the tax benefit was changed. So that saw some impact and lastly, channel took some time to recalibrate, retrain all the agents, et cetera to pick up products with the new story and everything else.

Within that also, we have now been able to clearly establish a very strong product mix in the agency channel. Term contribution for agency is one of the highest in the organization. So that brings in a good profitable mix for the agency channel as well. UL is lower than the entire company level at agency channel.

And also, this entire initiative of attaching more sum assured to UL is also working well in that channel. I think the investment in agency then continues. The growth has come back this year. And we are also confident that this investment will result in good margin as well as higher growth going forward.

We also added a lot of agents in this year. We've also expanded by adding nearly 65* branches this year, that expansion of branches will also continue. Our mix from not just Tier 1, but Tier 2 and Tier 3 is also high, thanks to this channel.

**65 new branches have been added during the period 9MFY25, erroneously mentioned as 35 by the speaker*

Supratim Datta: Got it. And of Credit Life?

Vineet Arora: Yes. So, on the Credit Life, the entire suppression of this is coming from the MFI segment and the MFI segment has been suppressed because of the NPAs and all the action happening around the banking space and the lending space. So, every other line of business in Credit Life has been stable. We have seen MFI getting impacted.

Now the question about the noise around cost of insurance over loan, the MFIN guidelines also which came out I think two months back, also very clearly stated that insurance is a critical factor especially in the segment of MFI because it hence covers the loan in an eventuality.

So, RBI also recognizes that and MFIN also very well-articulated that in the entire circular. So, it's very much part of the proposition, good for banks, good for customers, it's a clear win-win strategy. And these products today also fit in that bracket of the cost that RBI allows these NBFCs and the banks to charge the MFI customers. We don't really see an impact. It's an impact more because the total disbursements have come down. Once that cycle starts to come back the business should also come back.

Moderator: The next question comes from Sanketh Godha from Avendus Spark.

Sanketh Godha: Thank you for the opportunity. Niraj you said that in the third quarter the margin impact is 30 basis points. So, our previous guidance was if we don't change anything then it will be 100 basis points. So, naturally that 30 bps impact is much lower compared to what you told initially in the front-end rules at 100 bps.

So, is it because of clawback in commissions or IRR change or attachment of more riders? What has played a role for the impact to be lower compared to what initially we anticipated it to be 100 bps? So that's my first question.

Niraj Shah: Sanketh, if you recollect what we had said at the time when the regulations came out in our exchange notice was that on a gross basis we expect an impact of 100 bps if we do not make any changes. And our intent was to try and see what we need to do in terms of sharing whatever pain there is with the distribution and trying and keeping the customer proposition intact.

And given that our reliance on the earlier regulation in terms of our profitability was very low as we had shown in one of the slides of our investor presentation. We did not really need to touch the customer proposition at all. In fact, because of our disciplined pricing approach, whatever pricing was warranted by changes in the interest rate, we were anyway doing. So, we do not need to do anything in addition to that after the surrender value regulations.

In fact, that data is all available in the public domain in terms of how pricing has changed after October 1 for various players, you can look us up on that also. As far as the impact of 30 bps for the three months is concerned, it's more a function of having put some of these new arrangements in place in terms of claw-backs, deferments and reduction in commission to some extent.

Those on an annualized basis, we expect the impact to be closer to what we reported for nine months. It's 10 bps because it's only been three months since the regulation has come in. But our endeavor will be to try and keep it as close to 20-30 bps on an annualized basis going forward as well because that's basically more in terms of sharing this burden with our distributors and leaving our customer proposition intact.

Sanketh Godha: So, to summarize it is largely because of the pay-out structure change to the distributors played the role in containing the impact of the margin?

Niraj Shah: Yes. So basically, we're trying to isolate the impact of these regulations and that's the reason why we've completely kept it as if nothing has changed and only if the surrender value with regulations change, this would be the impact, just to make it easier for everyone to appreciate.

Sanketh Godha: Got it. Perfect. And this clawback thing you implemented for the entire quarter fully or it was partial and therefore the benefit might be more in fourth quarter relatively? Just wanted to understand that part, when we had the second result call, you still mentioned that you were in discussion phase. So, I'm assuming it was partial for the current quarter. I mean if it is for the full quarter, the benefit would have been a little higher?

Niraj Shah: That is correct. So, some of the arrangements are in place. Some of the arrangements come into effect as we go forward in quarter 4 as well.

Vineet Arora: Yes. So, some arrangements would be there, but a lot of our arrangements are under discussion to have an impact from first of October only. So, I don't see there would be more benefit coming in the next quarter. So, this would be the benefit. And whatever is left right now is a very small percentage of our business. I would not have the exact number, but maybe 90%- 95% of business is already discussed and closed.

Sanketh Godha: Got it. Perfect. And the second question was that your unwind rate in the nine months looks to be lower at 7.3% compared to almost 8% in first half. So, anything to read there why unwind rate has come down?

And the other question which I had is that your deeper bucket persistency has improved meaningfully. The 61 month is at 780 bps better. And if I look at the presentation it seems to be largely coming from traditional products. So, if you can give a bit of color what led to this improvement in the persistency, is behavior better than expected and that also helped in kicking the margins up. Just wanted to understand that point.

Eshwari Murugan: So, on the unwind rate it has remained same as in H1. It's 8.1%. And as we have explained earlier as well, the unwind rate is based on the economic environment at the start of the year. It's based on the investment return on the debt or the assets that the policyholder funds are invested in as well as shareholder funds. And that has been fixed at 8.1%, and that is what has been consistently reported in all the 3 quarters. So, I don't see a decline in the unwind rate which you're referring to.

Sanketh Godha: Okay. Maybe I will do the calculation again. Sorry, on that part. And on persistency, if you can give a bit of more color - any benefit on margin?

Eshwari Murugan: Yes, the increase in the 61st month persistency, it is relating to the cohort of policies we sold 5 years back. That was a year where the non-par guaranteed IRR products were introduced and these products have had a much better persistency right from the 13th month. And that is now getting reflected in the 61st month. And sometimes the experience may be different from what is assumed.

And that will get reflected, but it's not very different because if you see the operating variance in our EV walk, that's always been a small positive. So, it's not going to be a big material difference from the assumptions that we have. But whenever we see this experience, we keep truing up the assumptions.

Moderator: Next question comes from Swarnabha Mukherjee from B&K Securities.

Swarnabha Mukherjee: Congrats on a good set of numbers. So, I just wanted to understand on the surrender charges that 10 bps or the 30 bps number you alluded to. What I understood was, this would largely factor in the impact of the higher payout. So just wanted to understand that whether you have factored in any kind of change in the lapsation behavior, maybe not immediately, but, say, third or fourth year down the line of the policy, so whether that is there? And also like over the next 2-3 or 4 quarters, would we expect that this number to broadly be remaining in this range going forward?

And also, in terms of the persistency that you are discussing, I think, on a nine-month basis, if the number looks fairly strong. It has been stuck even in the longer duration cohort. If I look at second quarter versus third quarter, that number has come off across cohorts. So just wanted to understand whether there is anything more to read into this apart from the fact that maybe last year same quarter, the new mix have started to go up. So, these were the 2 questions.

Niraj Shah: Yes. On the surrender values, when the regulations were announced, we had actually added a disclosure in our investor presentation last time, which basically said that all the impact of the surrender value regulation change for us is in the second year and there is no impact thereafter. And the reason for that is basically pretty much the entire book stays on the books either as premium paying or as paid-up policies.

So, we have not changed any assumptions on whether more or lesser number of customers will continue with the policy or they'll surrender or they'll lapse or they do any of that. So, there's no change in any of our assumptions. This entire change is flowing as a consequence of the enhanced value that needs to be paid to customers if the second premium does not come in.

And that is what we had articulated as 100 basis points on a gross basis. And what we just reported now was 30 basis points for the quarter on a net basis after making whatever changes that we had to from a distribution perspective and our own operations without changing anything from a customer perspective.

So also, what we had mentioned is that given that the surrender value will now build up in a different way compared to what it was building up earlier, whether a customer decides to surrender earlier or stay paid up does not really affect us economically. We of course, would want the customer to stay in the policy, continue paying premiums. If not that, then be paid up and stay in the policy. But if they still choose to surrender, we will not be any worse off economically given the way the benefits are structured from a regulatory perspective.

Eshwari Murugan: Just to add, we have not assumed any improving persistency in our margin calculation. If there's an improvement in the persistency because of the way that distribution payout has been now structured to align with the persistency, there will be an upside in the margins. But that has not been currently factored in because we have to see the experience, how that emerges.

Swarnabha Mukherjee: Understood. And would it be safe to assume that before you update any kind of assumptions going forward, maybe after a year or so, this is likely going to be the benefit over the next 3 quarters also. Could that be a fair assumption?

Eshwari Murugan: Yes, that's right. Yes.

Swarnabha Mukherjee: Okay. And if you could respond to the persistency question on a quarterly basis how to look at it?

Eshwari Murugan: So, at a generic level, I would like to say that the 3 months ratios are generally influenced by a lot of factors, there will be a collection trend. Generally, we see that, for some reason, the Q3 is a little low in collection, maybe due to festivals and that the collection pattern actually picks up in the subsequent quarter, which is the JFM. That is why looking at the quarterly trends may not give the right picture.

It also depends on other things like product mix, etcetera, and that's why from 25 to 49 months, the drop that you see is mainly because of the difference in the collection pattern that we have. Otherwise, on a 12-month rolling basis, the persistency is improving.

On 13 months, typically, the higher UL mix that we had in the last year, that is resulting in a slightly lower persistency. But here also, we believe that given the improvement on a 12-month basis in quarter 4, this should pick up.

Swarnabha Mukherjee: Understood. Just a quick one. So, I think as an alternative to customer surrendering, this product - loan against insurance, is also what you have been doing. So that is, I think, one of the methods that have been kind of discussed that will be used to circumvent the challenges of surrendering of customers.

So just wanted to understand how this segment is playing out for you guys? What are your thoughts on that? And as it picks up, how should we think about how the revenue will get booked and what would be the arrangement, whether you will do it yourself or you tying up with a lender? If you can give some color on that.

In case of like once there is a surrender requirement, loan against the insurance is offered, against whatever is the surrender value of the insurance product. Sometimes loan is given out rather than doing a surrender of the policy. So, wanted to understand that part.

Niraj Shah: Yes. Okay. So, the loan value is obviously linked to surrender value. You are right. And higher surrender value higher the loan eligibility, definitely. So, we definitely believe that a loan against policy is a very efficient way for the customer to utilize their own resources. And for us, it works like a fully secured loan in that sense.

So as such, it works for everybody. Whether this will change customer behavior remains to be seen. But everything else remaining the same, our customer will be able to I guess, avail of a higher loan compared to what they were earlier on their policy because the surrender value will improve.

Moderator: The next question comes from Aditi Joshi from JPMorgan.

Aditi Joshi: On the commission structure, is it possible for you to share which all channels have resorted to the changed commission structure, either claw back or reduction in commission across the bank agency and the brokers.

Vineet Arora: So, I think like you articulated, we have a combination of these three things, which means the claw-back, deferment and reduction. And depending on partner and depending on business models, etcetera, various combination of these three factors would have been taken in. So, there is no one standard approach to say that this channel has been approached with a particular method.

All these three, and as a combination or as individual are the methods that have been used to close the negotiations.

Aditi Joshi: Okay. And can I ask that all these negotiations are going on across all the channels, no matter in which form its going on, but is it across the channels or 1-2 channels, any channels that you would like to highlight as somewhat lagging.

Vineet Arora: So, like I said, this is more or less a done deal from our side. And about 90%-95% of our business are already closed. Certain partners, not specific to any channels, have their internal approval process, etcetera, which might be taking slightly longer, but that should also get closed in the next few weeks or maybe a month.

Moderator: The next question comes from Neeraj Toshniwal from UBS Securities.

Neeraj Toshniwal: Most of my questions have been answered. Just on the competitive intensity, how do we see things changing post surrender norms getting implemented. Should we see IRR getting actualized and the protection going up but wanted more sense how you are thinking about it?

Niraj Shah: So, as we mentioned, we have not made any changes to our pricing, whether it's on protection or non-par savings or annuities, but we definitely have seen some downward revision in pricing from some of our peers. And I guess, the only thing that we could correlate it to, apart from changing interest rate environment, which applies equally for everybody was the differential impact of the surrender value guidelines.

I guess that's the only thing which we could impute from some of the reactions that we've seen across the sector. So that's just the way we've seen it. We have seen non-par pricing, non-par IRRs come down. We've seen annuity prices being revised downwards. We've also seen term prices increase. So, we've seen a combination of all these measures across the sector.

Neeraj Toshniwal: Got it. And does it really help big players like you and others, I mean the private players to gain market share out of this given the environmental factors have improved? Are we able to leverage and gain disproportionately out of this?

Niraj Shah: It's difficult to say. It's just been 3 months. So, we'll have to wait and see how some of these things pan out. But yes, if you were to look at market share, has it expanded for us in this quarter? It has. Has it expanded in nine months? It has. This could be one of the reasons, but obviously, a large part of it would be our own operations and this expanding distribution as well as all our channels. That's the way we look at it.

Over a period of time, we do expect some of these regulations, which we believe, be beneficial for companies who are relatively more, let's say, balanced in their approach, whether it's in terms of listing requirement or in terms of implementation of risk-based capital or IFRS. So, all of these things would definitely, we believe, help companies who are taking a more balanced view of the business.

Moderator: The next question comes from Rishi Jhunjhunwala from IIFL Institutional Equities.

Rishi Jhunjhunwala: So, in this quarter, the impact of surrender on a net basis has been 30 basis points in the margins and you still have some of the benefit from a full quarter impact of clawback of commissions to play out. So, is it fair to say that keeping everything in place, the overall impact of surrender regulations on our business will eventually end up being lower than 30 basis points?

Niraj Shah: Like we had mentioned, there is no further benefit in quarter 4 from implementation of these distribution arrangements. But I mean, if you were to just annualize the numbers, will it land somewhere between 10-30 bps, mathematically, it looks like it will.

Moderator: The next question comes from Prayesh Jain from Motilal Oswal.

Prayesh Jain: Just one question on the protection business, and that's mainly on retail & pure term business. How are you thinking about this business and some granularity if you can share as to how the behavior is? As you enter the lower tier cities more, what is the kind of ticket sizes?

And just 1 more thing on the Tier 2, Tier 3 strategy. Vibha, we spoke about this a couple of quarters back and you mentioned that the persistency and all things will evolve and eventually, you cannot have a differentiated pricing between geographies, but then you will have to figure out in some way the impact that could be there from a lower persistency or a higher mortality, and some capital charge or some kind of charge would have to be levied and that could impact margins. Are there any thoughts around it, has that evolved and can come into the picture now? So yes, those are 2 questions.

Vibha Padalkar: Yes. So happy to share that our growth in retail protection has been very secular. Just to recap, overall, our growth was 28%. Tier 1 was in the early '20s and Tier 2 and Tier 3 put together were in the early 30s and thereby giving an average of 28%. So, happy with that, and that was the intention as well.

Now there are different preferences. While products might be the same, but there are different preferences in terms of whether it is return of the premium or regular pay and so on. So, those nuances, we will continue to calibrate. We will also look at affordability, what kind of alternative underwriting tools that we have, what kind of modes of payment work, what kind of claims experience, persistency and so on. So, it's an ongoing learning for us, but we continue to do fairly well in all 3 Tiers in our country.

And also, what is noteworthy is that the ticket sizes don't drop significantly between the tiers. So, we've also articulated that our focus or baby steps will be on the upper quartile or the top quartile of Tier 2 and top quartile of Tier 3.

Moderator: The next question comes from Himanshu Taluja from Aditya Birla Sunlife AMC Limited.

Himanshu Taluja: Given now the most of the surrender norms impact is largely over and you have delivered the VNB margin of 26.1% for the quarter, can we say that the margins have broadly bottomed out? Assuming not a very significant change in the product mix that will happen over the next 6-9 months. How do you expect this VNB margin trajectory to behave over the near to medium term?

And the second part of the question is, what led to the slowdown in the agency channel? And how do you expect it to behave over the next 6 months?

And lastly, if in the insurance amendment bill, if this open architecture in agency comes and passes-through, how do you expect this to behave, particularly for the industry?

Niraj Shah: Yes. On the VNB margins, we'll basically just reiterate our outlook that we were gunning for after the first quarter, we basically said that we will try and get to 18%-20% APE growth and try and deliver a VNB growth of upwards of 15%. We believe that is something we are on course to deliver. We've not changed any of our aspirations on that front.

And to your question in terms of on a quarterly basis for this year, have the margins bottomed out? We are still in the quarter, so we don't know, but a couple of things we can maybe look at. One is that we definitely expect the scale of business to be a lot higher in quarter 4 compared to any other quarter in the year.

We don't expect any significant deterioration in product mix. So, putting those two together, we can expect margins to be in a similar zone or maybe slightly better. But honestly, that's not something that we are really solving for. What we are solving for is trying to deliver a VNB growth.

So, we will try and see what growth opportunity is there in front of us, and then we will take a view in terms of what product mix really solves for that and try and get to the VNB growth answer.

Vineet Arora: And answering your agency question, I think I will repeat my comment there. This year, the growth on agency, we have seen it to be 19%, which is pretty much in line with what we have seen at the organization level, maybe just a tad bit lower. The lower growth from Agency, we had seen last year, and that was primarily due to the tax changes which happened on the greater than Rs 5 lakh policies. And because the distribution was aligned to that particular product category a lot more, it took some time for them to realign themselves.

Himanshu Taluja: Yes. And anything on if this open architecture in the agency channel also comes, how do you expect to behave for the industry? And because we have a lot of unlisted peers as well, where the profit could be operated in a different profit pool band as well. Overall, how do you expect the benefits to play out if this gets passed through?

Vineet Arora: So, like I said, most of the agents, which are top agent for any company and do a reasonable amount of business, they do have within their friends and families multiple company products available for themselves. So, I don't think at that segment, it will make much of a difference.

For the other agents also. I mean, depending on the size of business that they do, if they need multiple products from different companies, I think that will open an opportunity for them to pick up the best suitable product that they might need for their customers. Will it impact us? I don't, at this point, anticipate much impact because of this. If any, it would have positives also available to us.

So, I think once the guideline comes out and the entire operational details also get notified, we might be in a better position to anticipate and analyse the impact. But as of now, I don't see any impact from this.

Himanshu Taluja: Sure, thanks.

Moderator: The next question comes from Raghvesh from JM Financial.

Raghvesh: Congrats on a strong set of numbers. So broadly on ULIP, we have been selling higher sum assured variants since the last year. So, what has changed in this quarter? Are we attaching higher sum assured as compared to what we were doing earlier? Or has the proportion of people choosing the higher sum assured variant increased? And if that has been specific to any channel?

Niraj Shah: So, what has happened is that our journey of enhancing the level of protection in all our products, including Unit Linked products started sometime last year at scale. Of course, the efforts were being made earlier as well, but we started picking up a lot of scale once the Unit Linked volumes also started increasing.

But of course, they've gone to the next level in this period that has resulted in some of the improvements that we spoke about, both in terms of a higher proportion of business being sold at higher levels of some sum assured and rider attachment as well. And within riders as well, I think now we are getting to a stage where people are looking at riders differently compared to when it started out with a very low level of coverage, that was being sought out earlier.

Now things are changing. People are getting more and more nuanced about it. Customers realize that this is a very efficient way of buying more coverage while buying a savings product. So, some of these behavioral changes are definitely healthy. And also, of course, persistency is improving. So, some of these aspects add up as far as the behavior is concerned.

Vineet Arora: So, I'll just add maybe one more point there is that our experience of the last maybe a year plus has also helped us identify those sweet spots where we get good persistency and a good coverage and the focus on those cohorts have increased, it has helped us increase this number.

Raghvesh: Okay. So, in the old policies before the new surrender norms, essentially no people were surrendering after the second year, they were just keeping policies paid up. So, you were not making surrender profits. Now even if they surrender, there will be no loss to you, at the same time, there will be no profit, as you said, right?

Niraj Shah: Exactly. That was the whole objective of giving you that data point last time that for us, the impact is largely related to whether people pay the second premium on no, nothing after that.

Moderator: The next question comes from Prithvish Uppal from Elara Securities.

Prithvish Uppal: I just wanted a sort of clarification on the first year commission number that seems to be north of 50% for this particular quarter. So, with the implementation on commission deferment and clawback, just wanted to get some sense on where the reconciliation is with this number because it seems higher sequentially.

Niraj Shah: Actually, if you were to look at it, we've had changes in regulations that happened over the last year. Looking at our total expense ratio, that has changed from 19.5% to 20.2% in this period. So that basically encompasses all expenses, including what is our cost of acquisition, what is our direct cost and overheads.

So as such, that basically gets subsumed in our accounting profit as well as in the value of new business. The change is not anywhere as dramatic as some of the line elements might be indicating.

Vibha Padalkar: And just to add. So overall, if you were to look at the commission plus expenses, the growth has been about 15% in the quarter. Which is largely in line with overall growth.

Prithvish Uppal: Okay. Because even in the commission norms that have been placed last quarter, the rise in first year commission would offset the lower opex. So, there's nothing much to read into it. That's what you're basically indicating?

Vibha Padalkar: Yes, you just have to look at overall new business cost.

Moderator: Thank you. Ladies and gentlemen, as there are no further questions, I now hand the conference over to Ms. Vibha Padalkar for closing comments.

Vibha Padalkar: Thank you, everyone, for joining today's call. Please feel free to reach out to our IR team in case of any queries. Have a great evening.