ICRA Lanka reaffirms the [SL]A- claims paying ability rating of Softlogic Life Insurance PLC

February 20, 2018

Instrument	Rated Amount (LKR Mn)	Rating Action
Claims paying ability rating	N/A	[SL]A- (Stable); reaffirmed

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the claims paying ability rating of [SL]A- (pronounced SL A minus) with a stable outlook for Softlogic Life Insurance PLC (SLI or the company).

Rationale

The rating factors in the company's position as the fifth largest life insurance company, a steady increase in its market share (8.9% in December 2016 to 10.2% in September 2017) and its healthy business performance indicators. The rating also factors in the expected operational, managerial and financial support from the Softlogic group (Softlogic Capital PLC, a subsidiary holding company of Softlogic Holdings PLC [SHP] has a 59.19% shareholding in SLI as on September 30, 2017; SHP rated at [SL]BBB with a stable outlook). ICRA Lanka however takes note of the high acquisition cost and, rising claims ratio, which has impacted SLI's underwriting and profitability indicators. SLI' capital adequacy ratio (CAR) of 179% as in September 2017 is above the regulatory requirement (120%), however the same is moderate compared to similar-sized peers. The CAR moderated from 226% in December 2015 to 179% in September 2017 (195% in December 2016) as the premium growth was quite robust at about 38% and 25% (annualized) in FY2016 and in 9MFY2017 respectively. The rating takes cognizance of the changes made to the taxation regime of Life Insurance companies, which is expected to have an impact on the profitability of the players, including SLI, going forward. The company also has contingent tax liabilities of about LKR 1,246 Mn (57% of the networth as in September 2017), while ICRA Lanka notes the accumulated tax losses of about 7,508 Mn (3.4x of networth as on September 2017) available with SLI; any unfavorable regulatory changes in the taxation policy could adversely impact the financial risk of the company.

ICRA Lanka continues to factor in the large capital expenditure and high leverage of the Softlogic group which limits SHP in extending any significant financial support to SLI in the near term. SLI however is expected to leverage on the operational synergies with the Softlogic group and, is envisaged to receive adequate financial support, if required, in the medium to long term.

Outlook: Stable

ICRA Lanka believes that SLI's current solvency and healthy business indicators support near to medium term growth. The outlook may be revised to 'Positive' in case of steady improvement in the capitalization and earnings of the company. The outlook may be revised to 'Negative' in case of a deterioration in the Soflogic group's credit risk profile and significant weakening in solvency or profitability of SLI.

Key rating drivers

Credit strengths

Low life insurance penetration in Sri Lanka to support business growth- Life insurance industry in Sri Lanka is largely underpenetrated compared to regional peers. In 2016, penetration ratio of the life insurance business was recorded at 0.54% (2015: 0.49%). Positive growth outlook is expected over the medium-long term as the Sri Lankan life insurance industry would benefit from favourable macro factors such as increasing disposable income and increasing demand for private sector healthcare.

Steady increase in SLI's market share: SLI's gross written premium (GWP) grew at 27% YoY for the nine months ended September 2017 to LKR 5,283 Mn vis-à-vis a growth of 38% during CY[1]2016. Overall market share stood at 10.2% in September 2017, an increase of 130 bps from December 2016 (1.2% increase in market share during CY2016). SLI's growth has been above the industry average (18% in CY2016) and the same is because of the company's business model which focuses on niche customer segments along with differentiated endowment/protection products, within the growing life insurance sector.

Healthy business performance indicators: SLI's first year persistency rate was 83% as in September 2017 and CY2016, which is higher than peers; this is on account of its focused target marketing and product positioning, resulting in lower rate of lapses. The company caters mainly to the premium segment of customers and, hence is characterized by above average ticket sizes; average premium per policy was LKR 99,573 in FY 2016 (Industry average is between LKR 35,000- 50,000). ICRA Lanka expects the company's targeted customer selection approach to support its medium term growth plan of 30% YoY GWP growth. However, the ability to grow in view of an expected increase in competitive pressures and the consequent impact on performance indicators would be a key monitorable

Operational, managerial and financial support from Softlogic group: As part of the Softlogic group, the parent company provides support from the group entities; and the ability to leverage synergies between different business units, including the healthcare segment comprising of the Asiri Hospital Chain. Large capital expenditure and high leverage of the Softlogic group limits SHP in extending any significant financial support to SLI in the near term. However, ICRA Lanka envisages SHP to adequately support, if required, in the medium to long term.

Credit challenges

Solvency indicators moderate compared with similar-sized peers: Risk Based Capital adequacy ratio of the company is comfortably above the regulatory minimum of 120%, although lower than peers; Risk Based CAR as on September 30, 2017 was 179% vis-à-vis 195% as on December 31, 2016 (226% as on December 31, 2015). The steady moderation is on account of the sharp growth in GWP during CY2016 and 9MCY2017. ICRA Lanka expects the solvency to remain adequate in the near to medium term to support business growth.

Impact of any unfavorable changes in the taxation regime and, contingent liabilities: Life insurance industry currently enjoys a tax advantage on its taxable profit calculation; which has resulted in negligible taxation on profits for most players including SLI. However, the policy would change with the new Inland Revenue Act coming into effect on April 1, 2018 wherein the total income of life insurance businesses will be liable to income tax going forward. SLI has an accumulated tax loss of LKR 7.5 Bn as of December 31,

[1] CY-Calendar Year

2016, which could be used to set-off against future income tax payable, for a period of six years. ICRA Lanka further notes that the company also has contingent liabilities (approximately LKR 1.2 Bn) as of December 31, 2016, due to tax assessments relating to the previous years; any potential liabilities arising may presently be set-off against the carried forward tax loss. However, any unfavorable regulatory changes in the taxation policy pertaining to set-off against accumulated tax losses, could adversely impact the financial risk of the company.

Expected increase in the claims ratio: SLI's claims ratio (as percentage of NPE) spiked to 21.4% as of CY2016 vis-à-vis 11.5% in CY2015. The claims ratio for the nine months ended September 2017 was 20.3%. A maturing product portfolio as well as a higher number of claims on SLI's investment products has been the reason for the increase in claims in CY2016 and 9MCY2017; ICRA Lanka expects the claims ratio to remain at elevated levels than in the past as the product portfolio seasons further.

Above average acquisition cost: SLI's cost structure is characterized by relatively high acquisition costs (acquisition cost/NPE of 32% in FY 2016 vis-à-vis 28% in FY2015), as the company has an expansive business model, along with comparatively high commission structures. In terms of business sourcing, sales are primarily generated by SLI's internal sales team currently contributing to 86% of total GWP in CY 2016, while the contribution from brokers is quite modest. Ability to improve its operating efficiencies, in view of the expected increase in claims going forward, would be crucial for incremental profitability.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria: ICRA Lanka's Credit Rating Methodology for Insurance Companies

About the company:

Softlogic Life Insurance PLC, formally known as Asian Alliance Insurance PLC commenced operations in December 1999 and had evolved into a composite insurance solutions provider with a sizeable market share in the life insurance segment. The company catered to a clientele that consists of corporates and individuals both in Life and non-life businesses through an extensive network of regional distribution offices located throughout Sri Lanka. The company was acquired by the diversified conglomerate, the Softlogic Group in 2011. In 2012, two foreign institutional investors, DEG of Germany and FMO of Netherlands, invested in a significant minority (about 19% each) in the company. Owing to a change in the regulations in 2014, the general insurance and the life insurance businesses were segregated with the former becoming a step-down subsidiary of the latter. In October 2016, company divested its entire stake in the general insurance business and the life insurance company was renamed as Softlogic Life Insurance PLC.

During the year ended December 31, 2016, SLI (standalone/ life insurance) reported a net profit of LKR 967 Mn on a Gross Written Premium of LKR 5.6 Bn compared to net profit of LKR 993 Mn on a Gross Written Premium of LKR 4.1 Bn for the corresponding period of the previous fiscal year.

On a consolidated (composite) basis SLI reported a Net profit of LKR 1,036 Mn on a Gross Written Premium of LKR 5.6 Bn during the year ended December 31, 2016 compared to a Net profit of LKR 924 Mn on a Gross Written Premium of LKR 4.1 Bn for corresponding period of the previous fiscal year.

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