

Life Insurance Corporation (Nepal) Limited: [ICRANP-IR] A (assigned)

September 19, 2023

Summary of rating action

Facility/Instrument	Rated Amount	Rating Action
Issuer Rating	NA	[ICRANP-IR] A; assigned

Rating action

ICRA Nepal has assigned an issuer rating of [ICRANP-IR] A (pronounced ICRA NP Issuer Rating A) to Life Insurance Corporation (Nepal) Limited (LICN), indicating adequate degree of safety in the timely servicing of financial obligations. Such issuers carry low credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument.

Rationale

The assigned rating factors in LICN's strong ownership profile (joint venture of Life Insurance Corporation of India and the Vishal Group of Nepal with a 55% stake), its experienced board members and seasoned management team. The rating also positively factors in the company's long track record of operations (since 2001) translating into good market share. LICN remains the second-largest player in terms of industry gross premium written (GPW) in the Nepalese life insurance industry despite recent moderation in market share (~12% GPW in FY2023 against ~18% in FY2019). The rating also takes into consideration the adequate amount and quality of investment, good investment returns, adequate solvency profile (expected to improve further after proposed rights issue, assuming full subscription) and the company's adequate reinsurance arrangements (albeit with relatively higher risk retention and moderate catastrophic coverage over industry peers). Further, the company's controlled business acquisition costs/overall management expenses and good profitability indicators, also remain rating positives. Likewise, the company's endowment insurance dominated business (>99% GPW from endowment policies) and healthy persistency rate (~85% in FY2022 in terms of premium¹) remain positives for revenue sustainability.

However, the rating remains constrained by steady decline in the LICN's first year premium (FYP) in each of last four years ending FY2023, following increased industry competition/fragmentation after licensing of new players in FY2018. This, coupled with uptick in the policy surrender in the last three years, amid difficult economic condition and high interest rate environment, raises concerns regarding the future scalability of LICN's business. Relatively moderate policyholder bonus against other major industry players could also subdue LICN's future business growth. To that end, the future bonus² provisioning norms remain an impediment in the company's ability to declare the returns to policy holders as well as their shareholders. Lag in the actuarial evaluation of adequacy of life fund by the life insurers in general (including LICN) also remains a concern as the latest solvency position (including the impact of recent events/business strategies) can only be ascertained after a time lag of 12-18 months. This also remains a rating limitation.

Insurance sector regulator, vide circular dated December 8, 2022, has lowered the future bonus provisioning requirement. With effect from FY2023, LICs are required to maintain a complete provision against the vested bonuses and 50% provision against future bonuses, against 100% before the circular date³. LICN has maintained adequate

¹ As provided by the management; ~83% in terms of number of policies

² Future policyholder bonus refers to the bonus for immediate year after the actuarial valuation date

³ Valuation directive 2020; Annexure IV- Guidelines on Actuarial Valuation 5 and 10 (e), released by Nepal Insurance Authority in August 2020

provision for vested bonuses and ~36% provision for future bonuses till mid-July 2022⁴. Compliance with the future bonus provisioning norms as well as revised paid-up capital norms (expected to be met through equity-raising programme and capitalisation of internal accruals) will also remain among the key monitorable.

Key rating drivers

Credit Strengths

Strong ownership profile, long track record and experienced management team – LICN is promoted by Life Insurance Corporation (LIC) India that owns ~55% stake and appoints three board members in LICN. The Vishal Group, a unit under one of the major business houses in Nepal, owns a 15% stake. Operating since 2001, LICN has an adequate operational track record in the Nepalese life insurance industry with good pan-Nepal presence through its 81 branches as of mid-July 2023. The senior management team, including the CEO comprise seconded staff from LIC India.

Adequate solvency and good quality of investment – LICN's regulatory solvency ratio of 1.67⁵ as of mid-July 2022 remained adequate against the regulatory minimum of 1.5 times. Although the ratio remains relatively moderate for an established player like LICN, it is expected to improve after the company's proposed capital-raising plans (through rights issue). The company's ability to complete the fund-raising process and ensure the revised minimum regulatory capital requirement of NPR 5 billion, will also remain a monitorable from compliance perspective.

The company had a sizeable investment portfolio of ~NPR 87 billion as of mid-July 2023, which is dominated by FDRs and debentures of class-A banks at ~91%. Additionally, LICN has policy loan portfolio of ~NPR 22 billion with lending yield of 10-11%. LICN reported overall investment (including policy loan) yield of 10.35% for FY2023. Likewise, new investment directive (rolled out by the regulator in December 2022) has widened permissible investment avenues for the LICs. Although LICN's ability to generate returns from those avenues remains to be seen, it nonetheless reflects positively on the company's future investment yield prospects.

Satisfactory reinsurance arrangement – The company has adequate reinsurance arrangement with Himalayan Reinsurance Limited (rated A- by ICRA Nepal) for all regular life policies, micro insurance policies and CAT XL in addition to 10% regulatory direct cession to Nepal Re (Government of Nepal undertaking, Rated at AA- by ICRA Nepal). LICN's risk retention of up to NPR 1.8 million per life for standard life remains relatively higher than rated industry peers but remains supported by better scale of operations and larger capital fund. The company's adequate solvency and liquidity profile also provide comfort in this regard.

Healthy profitability – LICN's return indicators remain supported by its scale of operations, sizeable investment portfolio, decent investment yields and transfer of actuarial surplus. As the company has an endowment dominated business, its future profitability profile will remain dependent on the future actuarial surpluses. Growing scale of operations translates into a gradually declining operating expense ratio (total management expense of ~5% of GPW in FY2023 from ~7% in FY2019) supporting profitability profile. In FY2021, LICN reported a net profit of NPR 745 million on a net premium of ~NPR 17 billion corresponding to a return on net worth, RoNW of ~19% after the actuarial surplus transfer of ~NPR 627 million from the life fund to the shareholder's fund. The reported profitability for FY2022 and FY2023 remained subdued, pending the actuarial evaluation of life fund and finalisation of accounts. Incremental return on equity of LICN is likely to remain pressurised amid sizeable equity-raising plan and recent moderation in premium growth.

⁴ The date of latest actuarial valuation report

⁵ After adjusting for the cost of bonus. Before bonus adjustment solvency ratio was 4.51 times.

Credit Challenges

Fragmented industry and competitive pressure as reflected in declining first-year premium – LICN has reported a steady decline in first year premium (FYP) during FY2019-FY2023, amid the increased competition from multiple new players operational from FY2018. Amid the increased competition from new entrants, LICN's GPW increased at CAGR 7% in the last four years ending mid-July 2023, lower than the industry's CAGR of ~19% over the same period. While the company plans to increase its competitiveness through introduction of new products going forward, it remains to be seen.

High policy surrender – LICN reported notable spike in the surrender claims since FY2021 (surrender claims of ~NPR 3.5 billion in each of the last three years from ~NPR 1.2 billion in FY2020). While the surrender ratio was driven by a particular product, which has been since discontinued; rising policy surrender nonetheless remains a concern to the future scalability, long-term profitability, and solvency. Ability of the company to contain policy surrender, amid the broader economic slowdown and high interest rate environment will also remain a monitorable, going forward.

Regulatory change regarding policy holder bonuses could affect near-term profit and growth prospects – The regulatory provision requires all LICs to maintain a complete provision of the vested bonus and 50% provision on future policyholder bonuses. As of mid-July 2022, the company provided for all the vested bonuses and approximately 36% of the future bonus, which lags the regulatory requirement. Though the requirement for future bonus has been reduced to 50%⁶ from 100%⁷ in the past, future bonus provisioning requirement is likely to moderate the Nepalese LICs' ability to declare the returns to policy holders as well as their shareholders, going forward. This is likely to put pressure on LICN's future policyholder bonus rates, which marginally lags leading industry players.

Analytical approach: For arriving at the rating, ICRA Nepal has applied its issuer rating methodology as indicated below.

Links to applicable criteria

[Issuer Rating Methodology](#)

Company Profile

Life Insurance Corporation (Nepal) Limited (LICN) is a public limited life insurance company (LIC), operating since September 2001. LICN is a joint venture of Life Insurance Corporation of India (LIC India, fully owned by Government of India) and the Vishal Group of Nepal. As of mid-July 2023, LIC India held a 55% stake, Vishal Group 15% and General Public 30%.

LICN's corporate office is in Putalisadak, Kathmandu. As of mid-July 2023, the company had 81 network points (including province offices and corporate office), ~54,000 individual agents (including ~7,600 active agents) and 105 corporate agents spread across the nation for procuring new business and extending after-sales services.

LICN garnered a profit of ~NPR 745 million during FY2021 (the latest audited period) on a total asset base of NPR 87,761 million as of mid-July 2021. Before the transfer of actuarial surplus from life fund, LICN reported a profit after tax of ~NPR 125 million in FY2023 on a total asset base of ~NPR 1,21,217 million as of mid-July 2023 (compared to a net loss of NPR 49 million in FY2022 on a total asset base of NPR 1,05,211 million).

⁶ Circular issued by the regulator to LICs -dated December 8, 2022.

⁷ Valuation directive 2020; Annexure IV- Guidelines on Actuarial Valuation 5 and 10 (e), released by the regulator in August 2020

Key financial indicators:

Amount in NPR million	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Provisional)	FY2023 (Provisional)
Number of months in operation	12	12	12	12
First year premium (FYP)	3,559	3,374	2,969	2,287
Renewal premium (RP)	11,171	13,585	15,109	15,082
Single premium (SP)	222	202	150	99
Total gross premium (TGP)	14,951	17,161	18,228	17,468
Net premium	14,866	17,067	18,140	17,394
Premium on endowment policies	14,897	17,116	18,206	17,452
% share of endowment in total premium	100%	100%	100%	100%
Premium on term policies	55	45	22	16
% share of term in total premium	0%	0%	0%	0%
Total management expenses	1,013	916	945	891
Management expenses as a % of gross premium	7%	5%	5%	5%
Total investment (including policy loans)	68,333	80,742	95,432	108,925
Yield on investment	9.8%	10.5%	9.8%	10.4%
Life fund	67,463	80,790	92,999	107,479
Profit after tax*	720	745	(49)	125
Return on equity	20.4%	18.5%	-1.1%	2.9%
Regulatory solvency margin (after policyholder bonus)		1.07	1.67	NA

*Profit after tax for FY2022 and FY2023 does not include the transfer of actuarial surplus from life fund.

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About ICRA Nepal Limited:

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