Rating Rationale for Reliance Life Insurance Company Ltd's EWRM and Financial Strength Rating

EWRM and Financial Strength Rating: BWR AAA^{efs}

Brickwork Ratings (BWR) has assigned **BWR AAA^{efs} (Pronounced BWR triple A EWRM and Financial Strength rating)** for Reliance Life Insurance Company Limited (RLIC) Enterprise wide Risk Management (EWRM) and Financial Strength Rating. Brickwork Ratings' 'BWR AAA^{efs}' stands for the Best EWRM capabilities and financial strength to meet ongoing policyholder obligations.

The rating has, inter alia, factored demonstrated ability of RLIC's promoters to infuse capital at regular intervals to fund growth, potential strategic partnership with Japan's Nippon Life Insurance Company, improving market position in terms of new premium written, diverse customer profile, technological expertise, reported profit for Q3FY11 and over all Life insurance industry's growth supported by changing demographics.

RLIC also faces certain challenges with regard to improving persistency ratio in future, dependence on unit linked products, maturity of claims analytics and quantitative risk management techniques. In the past, the RLIC growth was primarily driven by ULIP and Universal Life products, and now with changed regulations, the Company will have to demonstrate its ability to sell traditional products on sustained basis.

The ability of the company to meet its shared business plan, improve persistency, diversify its revenue mix across products and ensure timely implementation of its EWRM initiatives are key rating sensitivities.

Background: Reliance Capital Limited holds 100% economic interest in Reliance Life Insurance Company Limited. In September 2005, Reliance Capital bought Chennai based life insurance company AMP Sanmar Life Insurance Company Limited to make a direct entry into life insurance with the existing customer base. Reliance Capital had acquired the entire equity capital of AMP of Australia and Chennai-based Sanmar Group in AMP Sanmar Life Insurance.

The AMP Sanmar Life Insurance had over 90 offices across the country, over 9,000 agents and 900 employees at the time of acquisition.

The Company's market share, in terms of new business weighted receipt premium, has increased over last four years from 1.1% in 2005-06 to 10.50% in 2009 -10. As of Dec 2010 the company is amongst top five private life insurers in India. As per FY10 data, RLIC has 1248 branches 1,95,565 Advisors and over 17,169 employees. As on Dec 2010, the Company has approximately seven million policies issued. The Company is well diversified, geographically, 37% offices are in rural locations, 46% in semi urban, 10% in Urban and 7% in metro locations. All offices are connected online and well integrated with the core systems. The policy generation is completely automated across all offices.

Nippon Life Insurance Company, Japan's largest private insurer signed agreements to acquire 26% stake in RLIC, subject to necessary regulatory approvals. Nippon Life Insurance Company Limited, Japan, is Asia's largest private insurer and the sixth largest insurer in the world. Apart from capital RLIC would benefit from vast experience, expertise and global best practices that Nippon Life Insurance company would bring in the areas of product development, underwriting, investment management, customer relationship management and enhanced risk management practices.

Board of Directors:

Director	Designation	Profile
Mr. Satya Pal Talwar	**Independent Director**	He holds an experience of more than 35 years in operations and policy formulation. Satya Pal has served as the 'Chairman and Managing Director' of renowned organisations such as Bank of Baroda, Union Bank of India and Oriental Bank of Commerce. He also held advisory and board level positions in Indian and as well Global organisations such as SEBI, IDBI and MasterCard International. He has also held the coveted position of Deputy Governor of RBI from 1994 to 2001
Mr. Rajendra Chitale	**Independent Director**	Rajendra is the Managing Partner of M/s. M.P. Chitale & Associates. Rajendra serves as independent director on the boards of the National Securities Clearing Corporation Limited, Asset Reconstruction Company (India) Limited, Reliance Capital Limited, Ambuja Cements Limited, Hinduja Global Solutions Limited, Hinduja Ventures Limited, Ishaan Real Estate Plc, Reliance General Insurance Company Ltd. He is a member of the Insurance Advisory Committee of the IRDA and the Advisory Committee on Regulations, Competition Commission of India. He has served on the board of LIC, UTI, NSE, SIDBI, and has served as a member of Takeover Panel of SEBI, the Company Law Advisory Committee, Government of India, the Investor Education and Protection Fund, Government of India, and the Maharashtra Board for Restructuring of State Enterprises. Rajendra is an eminent

		Chartered Accountant and law graduate.
Mr Soumen Ghosh	**Non Executive Director**	Soumen is currently the Group President of Reliance Capital Limited and Non – Executive Director of Reliance Life Insurance Company Limited. Soumen has an experience of around 22 years in the areas of General Insurance and Life Insurance in India and abroad. Soumen was previously responsible for the overall Allianz operations in India and Middle East. Soumen worked as the Chief Executive Officer of Bajaj Allianz Life Insurance Company and Country Manager, Bajaj Allianz, India. Soumen is a member of the Institute of Chartered Accountant in England & Wales and Institute of Chartered Accountant of Australia
Mr. Malay Ghosh	**Executive Director & President**	Malay is the Executive Director and President of Reliance Life Insurance Company. He has over 24 years of work experience in the insurance industry. He has worked for 17 years with LIC across various functions and for 7 years with Bajaj Allianz Life Insurance where he was last designated Head of Sales. Malay holds a Masters degree in statistics from Indian Statistical Insititute, Kolkata.
Mr Amit Bapna	**Non-Executive Director**	Amit is currently the Chief Financial Officer at Reliance Capital Limited and Non Executive Director of Reliance Life Insurance Company Limited. Amit has been with the Reliance Group since 1999. He has over thirteen years of experience in varied business environments e.g. manufacturing and financial services. He has earlier worked in the capacity of Chief Financial Officer of Reliance Capital Asset Management Limited and Reliance Consumer Finance. Earlier still, he had worked in the Corporate Treasury of Reliance Industries Limited. Amit is a Chartered Accountant.

RLIC has overall 5 directors on its board of which 2 are Independent Directors. We believe RLIC Board has adequate competencies in place with highly experienced professionals from Insurance, legal, Accounting & Regulatory fields.

Capital Adequacy:

Reliance Life's Solvency ratio in Dec 2010 was at 1.59x compared to 1.86x in March 2010.. Though the ratio has always been above the regulatory limit of 1.5x, since FY09 the ratio is observed to be on a downward trend and currently it is one of the lowest among its peer group. However, as disclosed to us during the discussions with the Management, the Company has the advantage of ease of access to capital on requirement through strong promoter support and hence does not keep excess capital. This is evidenced by the Company's capital infusion pattern in the past by the promoters of Reliance Life. In past 5 years Reliance Group has infused over Rs 27.57 bn in Reliance Life, of which Rs 8.5 bn was in FY08 and Rs 12.29 bn in FY09. Equity capital for Reliance life has increased at 36.96% CAGR since FY06 which is in line with Life Insurance Industry's CAGR of 37.43%. Further the IRDA's requirement of 150% solvency for Life insurers is higher than the general global norm of 100% solvency.

By next year Reliance Capital expects to receive investment of about Rs 3060 Cr from Nippon life, part of which is expected to be kept with Reliance Life for solvency purposes. Taking this into account, RLIC's solvency ratio could reach to a more comfortable level to support its future business growth driven by traditional products which command high capital requirements.

Enterprise Wide Risk Management

Reliance Life has taken many initiatives towards implementation of Enterprise Risk Management. The Company monitors market risk, credit risk, information technology risk, insurance risk and operational risk at organization level through dashboards and risk reports. The Company is developing its experience which would enable them to transition to next level of maturity where the company would be able to quantify risk in the form of economic capital. Both Risk and Actuarial teams are involved in this strategic initiative.

The Company has clearly defined its risk management framework based on COSO ERM framework. The company has automated key processes across compliance, Audit & risk for integrated assessment and effective monitoring. Going forward, the company intends to automate other processes in areas of ALM also..

The management's commitment for effective ERM initiative is clearly visible from the independent organization structure set up by the company for the purpose.. The company has formed a Committee that includes heads of business functions like actuary, human resource, finance, risk management etc along with chief executive officer that meet on monthly basis to monitor and review the risk management processes, and identify and resolve any issues at the initial stage. Similarly Risk management practices are also reviewed quarterly at a Board Level committee comprising of two independent directors and two non-executive Directors.

The risk management initiatives have strategic focus and support at the Board and promoter Group Level. However the current assessment is based on qualitative measures given the short period in business for the company. The ability of the Company to transition to quantitative measures and implement the plans shared with BWR in a timely manner will be vital for the Company's performance.

Business Growth

Reliance Life entered into life insurance business by acquisition of AMP Sanmar in FY 2005-06. The company has grown exponentially at CAGR of more than 80% from FY 2006-07 to FY 2009-10. Prior to the acquisition by RLIC, single premium formed more than 60% of the new business premium for the company. However the trend reversed after acquisition and single premium formed approximately 7% of new business premium for FY 2009-10. Since the company grew mostly after FY 2006-07, the share of the renewal premium of the total premium for the company has been lower in initial years. For the FY 2009-10 the share of the renewal premium increased to approximately 41% of the total premium for the year.

The growth of an Insurance company depends on its ability to write new business and on its ability to sustain business acquired. Reliance Life clearly has demonstrated excellent ability to generate business which is evident from their higher growth in new business premium versus the industry growth. However the company's persistency ratio (13th month by number) has not been satisfactory. 9M-FY2010-11 persistency ratio for the 13th month based on policies issued was 54% for the company which is lower than other industry participants as per IRDA public disclosure. The company has taken cognizance of lower persistency ratio and has taken steps to improve the same. Persistency is now key performance metric for all sales and operation people. The Company has taken additional steps to educate the customer about the policy, provide on demand MIS, give reminders and offered wide range of premium payment options to prevent lapse of policy. The company has shown some improvement in its 25th month persistency ratio. The ability of the company to improve its persistency is important for the long term sustainability of the business and is the major challenge for the company.

Product Portfolio

Reliance Life offers wide range of product like ULIP-Life, ULIP-Health, Traditional Endowment, Term and Group plans. The company achieved high growth during year 2007-08, 2008-09 by focusing on the sale of ULIP products. In fact ULIP formed 99% of the new business premium written during the year 2008-09. Subsequently the company increased its efforts on sale of traditional products to avoid excessive dependence on ULIPs. The share of traditional products consequently increased to 9% of new business premium written for the FY 2009-10 and to approximately 48% of the new business premium written for the FY 2010-11. However universal life product formed the large share of the traditional product sold during the first half of the FY 2010-11.Universal Life products were later banned by IRDA and subsequently the company was able to quickly adapt to new regulatory norms and sold other permitted traditional products.

The Company's product strategy has transitioned from sale of ULIP to Universal Life to traditional products in their brief period of business. However for the future, the company has clearly identified its customer segment and products. After the regulatory changes, the company has been able to successfully demonstrate the implementation of its revised strategy for last three months. The success of the company to sustain this diversified revenue mix between ULIP and traditional products is crucial to its performance..

Distribution Analysis:

As per FY10 data, RLIC has 1247 branches 1,95,585 Advisors and over 16,000 employees. Geographically, 37% of company offices are in rural locations, 46% in semi urban, 10% in Urban and 7% in metro locations. In FY06 as per new business premium, agents contributed 93.5%, Employee benefits contributed 4.5%, third party distribution (TPD) was 1.7%, and Channel development associates (CDA) were 0.3%. However, as per FY10 data the distribution is more diversified with Agency contributing 55.1%, TPD were 23.6%, Employee benefits contributed 10.4%, CDA was 9.7% and Affinity contributed 1.2%.

As per FY09 data, of 1, 49,613 agents approximately 70% were active, however this number fell in FY10 where of 1,95,585 agents, approximately 54% were active. Of various distribution channels, the higher contribution is from variable cost channels like agency, CDA, and TPD this may positively help the overall cost structure of firm in long run.

Company's strategy is to increase licensed advisor count, double the CDA contribution, and increase the new third party relationships with focus on large distributors and brokers.

Claims Analysis:

With growing customer base and increasing vintage of portfolio, the company has identified "claims monitoring" as key focus area. The Company has taken various initiatives for claims management like automation of workflow, investigation of early claims, monthly analysis to identify triggers and concentration of bad claim experience. Currently the Company conducts thorough claims investigation for all early claims irrespective of the Sum Assured. Looking at the number of policies issued in FY10, the Company reported claims ratio (claims paid as % of policies issued) of 0.3% which is lower compared to peers like HDFC Life (0.6%), Bajaj Allianz (0.9%), SBI Life (2.4%), and ICICI Prudential (0.84%). Effectively, the Company has paid 1.17 claims per 1000 lives. Its claims settlement ratio stood at average of 94% for past four years.

In FY10, Benefits Paid (net) Rs. 693.42 crores as on FY 10 and Rs. 155.53 crores as on FY09. For 9MFY11 the benefits paid drastically increased to Rs.1240.32 crores as against the net premium of Rs.4236.95 crores in the same period. Total benefits paid as percentage of net premium for period is 29.39% for Dec 2010 vs 10.52% for March 2010.For all three quarters of FY11 the total benefits paid continued to increase majorly due to policy surrenders. The policy surrenders started heavily in Q4FY10 and are continuing to be major part of (more than 80%) total benefits paid. This is due to the fact that since inception in FY06, company sold majorly ULIP products and their lock in period comes to an end in three years. Due to the financial crises in year 2008 these products performed generally badly and the industry is experiencing high surrender on completion of lock in period.

Profitability:

Reliance life has come to profit zone for Dec 2010 quarter. The Company reported a profit of Rs23.8 Cr for Q3FY11, as against a loss of Rs 41.6 Cr for Q2FY11 and Rs 121.8 Cr for Q1FY11. The Company has consistently reduced losses since past three quarters by controlling various expenses. If company performs consistently as that of Dec 2010 quarter, it expects to break even in next one year on annual basis. Accumulated loss as on Dec 2010 stands at Rs 2813 Cr.

Currently in life insurance industry only 5 players (out of 22) are profit making for FY10 viz. LIC, SBI Life, ICICI Prudential, Kotak Life Insurance and Bajaj Allianz. Before Oct 2010 surrender charges of insurance companies were substantially high. Thus high surrenders used to actually support profits for insurance companies. However, as per new regulations the surrender charges have been substantially reduced thus insurance profit will have to be driven by reducing the cost of operations and generating economies of scale.

RLIC has effectively reduced its operational expenses in last 3 quarters the overall expense ratio (i.e operating expenditure to total premium) for March 2010 was 24.84%. It however, increased to 37.93% in Q1FY11.After that the Company has tried to effectively manage the cost and reduced expense ratio to 28.30% in Q2FY11 and 21.50% in Q3FY11. It initiated several initiatives like branch cost rationalization, vendor renegotiation; process reengineering, and rightsizing to improve cost efficiency. It follows a strict delegation matrix where payout process is automated and approval authority is inbuilt into the system.

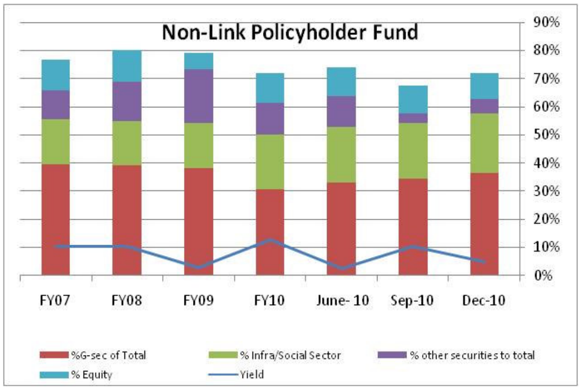
Investment Analysis

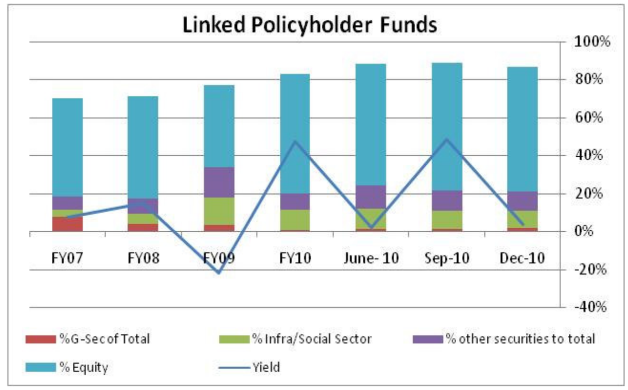
The quality and yield of the investment made by the life insurers is important to understand their ability to meet policyholder's obligation. The investment risk in case of linked business is transferred to the policyholders whereas for the non-linked business the risk is retained by the insurance company.

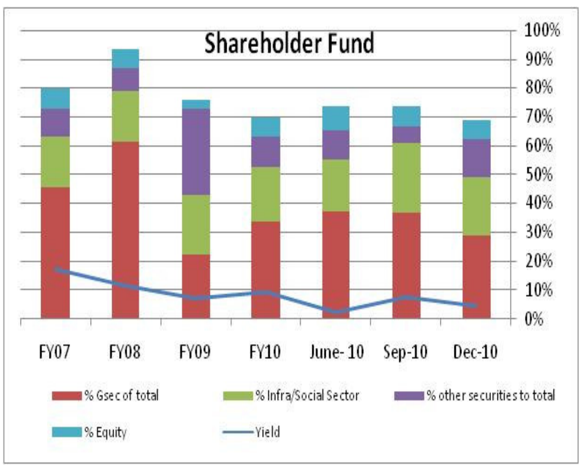
RLIC has defined detailed investment guidelines in line with the IRDA guidelines that are approved by the Board. The defined investment guidelines are quite conservative and adherence to the same ensures high quality assets. The policy clearly articulates the policy on derivatives and limits for such transaction on the conservative side. Adherence to the policy is audited by an independent agency as required by IRDA.

RLIC had primarily grown through the sale of linked products so the asset under management is skewed towards linked fund. As on December 2010, the total AUM for linked funds formed 93% of total AUM for the company. The key investments include equities that formed 66% of the linked funds, infrastructure & social sector investment that formed 9% of the linked funds and other securities that formed 10% of the linked fund. In case of the non-linked policyholder funds the majority investments include government securities which formed 37%, infrastructure & social sector investment which formed 21% and equity which formed 9%. In case of shareholder's fund the investments in government securities formed 29%, infrastructure & social sector investment formed 20% and equity formed 7%.

The yield on investment for linked funds has been volatile in the past few years. This is in line with other peers in the industry and can be attributed to higher volatility in the underlying capital market. The volatility of yield for non linked policyholder funds & shareholder fund is relatively less due to higher investment in G-Sec. The charts below provide the details of the yield and asset allocation for each of the funds.







Asset Liability Management:

In linked insurance business all the investment risk is borne by policyholder and thus duration is close to zero. This does not require monitoring on ALM front. However, in case of traditional (non – linked) business the investment risk is completely or partly borne by the insurance company. Hence, the Asset Liability Management is an important concern for traditional insurance business. However currently this segment forms a small part of the RLIC business. However as per company's future plans this segment is expected to grow for RLIC. For this segment of business (i.e non linked segment), RLIC has already established a well defined asset liability management framework.

RLIC's ALM Policy demonstrates significance of liquidity and funds management for effective supervision of its balance sheet, related earnings and cash-flows. The policy also seeks to address structural mismatches in the assets and the liability maturity ladder, typical to the insurance industry in India. The objective of asset/liability management process at RLIC includes providing acceptable earnings and return on capital with acceptable and controllable levels of Market Risk, Credit Risk, Insurance risk and Catastrophic Risk.

The Asset Liability Management policy of RLIC falls under the authority of the Executive Control Committee (approved by the Board of Directors), which in turn assigns authority for its formulation, administration and revision to the Asset Liability Management Committee (ALCO). Responsibilities and duties of Executive ALCO range from developing ALM framework to overseeing and maintenance of management information systems. The committee meets at least quarterly and reviews the liquidity position (maturity analysis of liability, investments and shares), interest rate risk analysis, market analysis and other risk analysis, and other reports as deemed appropriate.

Industry Outlook

The long term outlook for the life insurance industry is positive backed by the favorable demographic profile and continued economic growth witnessed by the country. The industry saw an overhaul in regulation in FY 2010-11 for the Unit Linked products which formed more than 80% of the business mix for the private insurers. This has forced companies to revisit their business strategy and they are aligning to the new regulation which may impact the performance of the companies in short term. The product focus for the industry seems to be now shifting to insurance protection as opposed to savings earlier. Competition in the industry has also increased considerably with 23 players doing business in 2009-10 against 15 in 2005-06. IRDA has also issued strict guidelines with regards to the persistency requirement for the agents in order to address the issue of mis-selling. The companies are cutting their operating cost, revisiting their business strategy, strengthening their distribution channel to be competitive in the industry. Despite the short term challenges faced by the companies due to changing regulation, long term prospects are robust with the penetration of life insurance in the country still much lower as compared to developed countries.

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Brickwork Ratings (BWR) has adopted SEBI's standardized Rating Symbols and their definition advised vide SEBI circular CIR/MIRSD/4/2011 dated June 15,2011, with effect from June 21, 2011. While there is no change in the Rating symbol as a consequence to the above, for the amended definition of the Rating, please refer to http://www.brickworkratings.com/scale.html. It is clarified that the said change in the definition should not be construed as a change in the Rating.

Annexure I – Revenue Account (Policyholder's Account)

(Rupees in Millions)

Statement Of Revenue Account (as restated)	FY08	FY09	FY10
First year premium	18,440	30,721	36,302
Renewal premium	4,744	14,186	26,841
Single premium	9,071	4,418	2,906
Total premium	32,255	49,325	66,049
Reinsurance ceded	-122	-172	-166
Premium earned - net	32,133	49,153	65,883
Income from investments	-686	-9,734	34,542
Other income	202	24	87
Total income	31,649	39,443	100,512
Contribution from Shareholder's funds	7,828	11,062	3,053
Total	**39,477**	**50,505**	**103,565**
Expenditure			
Commission	2,757	5,969	6,279
Operating expenses	10,308	19,230	16,367
Provision for tax – Fringe Benefit tax	91	79	-
Benefits paid	1,624	1,555	6,934
Interim Bonuses paid	0	1	1
Change in valuation of liability in respect of life policies	24,697	23,512	73,116
Total Expenditure	39,477	50,346	102,697
Surplus / Deficit	**-**	**159**	**868**

Note: Financials based on Indian statutory reporting. Financials are provided in a format different from the prescribed IRDA format.
Source: Reliance Life

Annexure II – Revenue Account (Shareholder's Account)

(Rupees in Millions)

Statement Of Profit and Loss Account (as	FY08	FY09	FY10
Income from investments	155.00	215.00	257.00
Other income	-	-	-
Operating expenses	8.00	2.00	42.00
Transfer to Policyholders' account	7828.00	11062.00	3053.00
Profit/(Loss) before tax	(7681.00)	(10849.00)	(2838.00)
Provision for taxation	-	-	-
Profit/(Loss) after tax	(7681.00)	(10849.00)	(2838.00)

Note: Financials based on Indian statutory reporting. Financials are provided in a format different from the prescribed IRDA format
Source: Reliance Life

Annexure III – Balance Sheet

(Rupees in Millions)

Statement of Assets and Liabilities (as restated)	FY08	FY09	FY10
Shareholders' funds			
Share capital	11,477	11,623	11,646
Reserves and surplus	3,663	15,810	18,097
Credit/(Debit) Fair value change account	-20	-73	21
Shareholders' funds - sub total (a)	15,120	27,360	29,764
Borrowings (b)	-	-	-
Policy holders' fund	-	-	-
Credit/(Debit) Fair value change account	-20	-94	68
Policy liabilities	2,243	3,247	4,876
Insurance reserves	-	-	-
Provision for linked liabilities	33,015	55,524	127,012
Policyholders' funds - sub total (c)	35,238	58,677	131,956
Funds for future appropriation (d)	-	159	1,026
Total liabilities = (a) + (b) + (c) + (d)	**50,358**	**86,196**	**162,746**
Investments	-	-	-
Shareholders' funds	2,222	3,947	3,693
Policy holders	2,529	3,426	5,264
Asset held to cover linked liabilities	33,016	55,524	127,651
Loans	14	299	302
Fixed assets	704	442	140
Current assets	5,814	5,532	6,333
Current liabilities	-6,993	-6,875	-7,376
Net current assets	**-1,179**	**-1,343**	**-1,043**
Debit balance in Profit & Loss Account (Shareholders' account)	13,052	23,901	26,739
Total assets	**50,358**	**86,196**	**162,746**

Note: Financials based on Indian statutory reporting. Financials are provided in a format different from the prescribed IRDA format
Source: Reliance Life