Fitch Revises Outlook on HNB Assurance and HNB General Insurance to Positive; Affirms at 'A(lka)'

Fitch Ratings-Colombo/Hong Kong-28 February 2019: Fitch Ratings revised the Outlook on the National Insurer Financial Strength (IFS) Ratings of Sri Lanka-based life insurer HNB Assurance PLC (HNBA) and its fully owned non-life subsidiary, HNB General Insurance Limited (HNBGI), to Positive from Stable and affirmed the ratings at 'A(lka)'.

KEY RATING DRIVERS

The Outlook revision reflects better non-life capitalisation and financial performance while maintaining satisfactory life capitalisation. The rating affirmation takes into account the insurers' favourable business profiles and prudent investment policies.

Fitch expects the insurers' capitalisation, as measured by their risked-based capital (RBC) adequacy ratios, to remain comfortably above the 120% regulatory minimum in the medium term. HNBA's life RBC ratio was strong at 319% at end-2018 (2017: 358%), while the non-life RBC continued to steadily increase to 200% in 2018, from 178% in 2017, supported by an improved non-life underwriting performance.

The insurers' business profile is supported by their substantive business franchise, well-diversified participation in business lines across life and non-life insurance sectors, a risk appetite that is on a par with that of domestic peers and moderate operating scale. Fitch believes the insurers' franchise and competitive position benefit from their association with the group's parent, Hatton National Bank PLC (HNB, AA-(lka)/Stable), with whom they share the 'HNB' brand name.

The insurers' ratings also reflect synergies gained from using the wider branch network of the banking parent. HNBA was Sri Lanka's sixth-largest among 15 life insurers and ninth-largest among 14 non-life insurers at end-September 2018.

The non-life combined ratio continued to improve to 102% in 2018 (2017: 104%; 2016: 108%), helped by better pricing and underwriting practices. Life pre-tax return on assets was 7.6% in 2018, compared with 5.3% in the previous year, owing to a one-off surplus transfer of LKR381 million to shareholders' fund, in line with a direction issued by the regulator coupled with HNBA's improved operating performance.

Fitch expects the insurers to maintain satisfactory financial performance, despite changes introduced through the new Inland Revenue Act that came into effect in April 2018, including a higher effective tax liability for life insurers. However, we expect the impact on HNBA's profitability to be limited due to its ability to utilise some brought-forward tax losses to offset its future taxable income. The Inland Revenue Department of Sri Lanka, through a transitional provision, permits companies to setoff future taxable income using unutilised tax losses for a period of six years from April 2018.

Fitch sees HNBA's investment policy as conservative, with a large allocation to high-quality fixed-income securities and low exposure to equity investments. The investment portfolio was dominated by fixed-income instruments (94% of invested assets), with 35% invested in fixed deposits at leading banks and non-bank financial institutions, 21% in listed debentures and 44% in government securities at end-2018. Allocations to equity were a low 1%.

RATING SENSITIVITIES

Upgrade rating sensitivities:

- Improvement in the market shares of HNBA and HNBGI, while maintaining sound capitalisation levels, with HNBA's RBC ratio staying above 300% and HNBGI's above 200%, on a sustained basis.

Downgrade rating sensitivities:

- Deterioration in the RBC ratio of HNBA and HNBGI to below 250% and 160%, respectively, for a sustained period or a weakening in the perceived strategic importance of HNBA or HNBGI to HNB.

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Applicable Criteria
Insurance Rating Criteria (pub. 11 Jan 2019)
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