Fitch Affirms HNB Assurance, HNB General Insurance at IFS 'A(lka)'; Outlook Positive

Fitch Ratings - Colombo - 20 February 2020:

Fitch Ratings has affirmed 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) at 'A(lka)'. The Outlook on the ratings is Positive.

KEY RATING DRIVERS

The rating and Outlook continue to reflect HNBA's favourable business profile, improving financial performance and capitalisation of its non-life business, which is backed by an already strong life capital position, as well as its conservative investment policy.

The insurers' business profile is buoyed by their substantive business franchise, which benefits 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' franchise is also strengthened by the synergies gained from using the wider branch network of HNB. Fitch's business profile assessment also factors in the insurers' diversified participation in business lines across the life and non-life insurance sectors, a risk appetite that is on a par with that of domestic peers and their moderate operating scale. HNBA is the sixth-largest among Sri Lanka's 15 life insurers and HNBGI is the ninth-largest among 14 non-life insurers.

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 309% in 2019 (2018: 319%), while the non-life RBC ratio improved to 223% from 200% in 2018 as its non-life underwriting performance improved. We also believe that the impact from the adoption of the new accounting standard for lease contracts, SLFRS 16 (the local equivalent of IFRS 16) on the insurer's regulatory capital position will be manageable given the comfortable capital buffers in its life operation.

The new lease accounting standard removes the distinction between operating and finance leases. Most contracts classified as operating leases, which were previously off-balance-sheet, are now recognised on the balance sheet as right-of-use (RoU) assets, along with a corresponding lease liability. The local RBC regime regards RoU assets as inadmissible and deducts them from total available capital - the numerator of the regulatory RBC ratio. RoU assets are also subject to a 1% operational-risk charge in calculating the regulatory RBC ratio. Most of HNBA's operating leases were on its branch network and motor vehicles.

Fitch believes that the insurers' underwriting performance will continue to improve in the near term helped by prudent pricing and underwriting practices. The non-life combined ratio improved to 101% in 2019 from 102% in 2018 (2017: 104%; 2016: 108%). Life pre-tax return on assets (ROA) - excluding realised and unrealised gains - averaged close to 6% over the last three years due to satisfactory operating performance and a one-off surplus transfer of LKR381 million to shareholders' funds, in line with a direction issued by the regulator in 2018. We expect life ROA to moderate to mid-single digit levels in the medium term.

Fitch views HNBA's investment policy as conservative, with a large allocation to quality domestic fixed-income securities and low exposure to equity investments. Term deposits at leading banks and non-bank financial institutions formed 37% of the investment portfolio, domestic corporate bonds made up 23% and government securities made up 37% in 2019. Less than 1% of the portfolio comprised equities.

RATING SENSITIVITIES

Upgrade rating sensitivities:

- An improvement in HNBGI's RBC ratio above 200% while maintaining HNBA's RBC ratio well above 300%, on a sustained basis; and

- Maintenance of the insurers' favourable business profile in terms of sustaining their business franchises and distribution sources.

Downgrade rating sensitivities:

- Deterioration in the RBC ratio of HNBA and HNBGI to below 250% and 160%, respectively, for a sustained period; or

- Deterioration in the business profile in terms of a weakening business franchise and distribution capabilities, for instance due to weaker association with the banking parent.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
HIDE RATING ACTIONS			
HNB Assurance PLC	Natl Ins Fin Str A(lka) Affirmed		A(lka)
HNB General Insurance Limited	Natl Ins Fin Str A(lka) Affirmed		A(lka)

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

National Scale Ratings Criteria (pub. 18 Jul 2018)
Insurance Rating Criteria (pub. 18 Nov 2019)

ADDITIONAL DISCLOSURES

Solicitation Status
Endorsement Policy

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