Himalayan Reinsurance Limited: [ICRANP-IR] A- (assigned)

June 6, 2022

Facility/Instrument	Rated Amount (NPR million)	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 Minus) to Himalayan Reinsurance Limited (HRL), indicating adequate degree of safety regarding timely servicing of financial obligations. Such issuers carry low credit risk. The sign of + (plus) or – (minus) appended to the rating symbol indicates the entity's relative position within the rating categories concerned. The rating is only an opinion on the general creditworthiness of the rated entity and is not specific to any debt instrument.

Rationale

The assigned rating factors in the consolidated reinsurance industry in Nepal and the recent regulatory provision strongly supporting the business profile of Nepalese reinsurers[1] including HRL. The healthy growth and underwriting performance of the domestic insurance companies (mainly general insurers) and the regulatory provision ensuring a share of the premium (and risk) ceded by domestic industry to HRL, is likely to reflect positively on the scalability and profitability of HRL going forward. The rating also positively factors in the adequate ownership profile of HRL comprising of two public sector undertaking (PSU) banks (Nepal Bank Ltd. and Rastriya Banijya Bank Ltd collectively holding ~15% stake) and established private sector business houses (mainly private institutions related to Mr. Shahil Agrawal and Mr. Sulav Agarwal). The rating also positively factors in the experienced management team of the company comprising of seasoned professionals with experience in foreign insurance/reinsurance industry. The traction developed by the management team with the industry stakeholders both inside and outside Nepal is also likely to support HRL's business prospects. The rating also factors the adequate quality of investment of HRL's largely comprising of interest earning deposit with banks.

However, the rating remains constrained by HRL's limited track record of operations (operating since July 2021), its relatively small scale and its untested claims paying ability so far. As of end of May 2022, HRL's retrocession coverage (especially the catastrophic coverage) remains moderate considering the company's current level of operations and risks insured by it. Since the company's growth prospect has been bolstered by recent regulation changes, its ability to secure adequate retrocession arrangements to build a risk-bearing ability commensurate with the expected uptick in business volume remains to be seen. Inability to do so could render the company vulnerable to solvency issues in the event of any major losses/catastrophe. HRL's ability to ensure the adequate solvency ratio (1.4 times for FY2021) post proposed IPO, will also remain a rating monitorable.

HRL's currently operates on a small scale mainly dealing in facultative businesses, which are relatively less profitable as compared to treaty business. The assigned rating factors in the expected improvement in company's growth and profitability prospects, given the strong regulatory support accorded to it. Therefore, any changes in the said regulatory provision will also remain among the key rating sensitivities.

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1 As per the circulars released by the Insurance Board Nepal in May 2022, domestic insurers have to directly cede 10% of their business each to the two domestic reinsurers viz. State owned Nepal Reinsurance Company Limited and Himalayan Reinsurance Limited; in addition to setting aside 15% of the treaty share in reinsurance each to the domestic reinsurers till FY2023. For FY2024 and onwards the proportion of direct cession is to be progressively lowered by 2% every year while for treaty reinsurance the share for both domestic reinsurers are to be increased to 20% each.

Key rating drivers

Credit Strengths

Strong ownership profile – The company is promoted by two class-A PSU banks, Nepal Bank Ltd (~7%) and Rastriya Banijya Bank Ltd (~7%) along with the strong representation from individuals/private institutions (mainly private institutions related to Mr. Shahil Agrawal and Mr. Sulav Agarwal). Mr. Shekhar Golchha (the current president of FNCCI[2]), also a shareholder in HRL, is the current chairman of the company.

Regulatory and policy support for the domestic reinsurance companies – The circulars released by the insurance sector regulator in May 2022 requiring Nepalese insurance companies to directly cede 10% of their premium (and risk) and ensure a minimum of 15% share in the reinsurance treaty each to the two domestic reinsurers (including HRL) has significantly bolstered the business prospects for HRL and reduced the competitive pressure on HRL from the relatively larger and established state owned Nepal Reinsurance Company Limited. Also, the insurance board has directed the domestic reinsurers to insure all their motor, agriculture, micro and miscellaneous (except travel and medical) risk with the domestic reinsurers. The domestic reinsurers will also get the priority in all facultative reinsurances emanating from the domestic insurance companies. These regulations have enhanced the competitive positioning of HRL and reduced the competitive pressure from Nepal Re since the incremental business prospects , going forward, is expected to remain largely similar for the two domestic reinsurers.

Credit Challenges

Limited track record of operations – HRL has been operating since July 2021 and therefore has a limited track record. Hence, the company's ability to scaleup the business, manage a profitable operation and meet the claims and other liabilities over a longer timeframe remains untested.

Moderate profitability, supported by investment earnings – HRL's has reported net profit of ~NPR 196 million during 9M FY2022 largely aided by healthy return on investment despite the underwriting deficit (~NPR 130 million of underwriting deficit, contributed by sizeable unexpired risk reserve). The company's scale of operation and profitability is expected to improve going forward, given the recent regulation ensuring adequate flow of bundled risk from domestic insurers to HRL.

The company's higher management expense ratio (on a small scale of operation, albeit on improving trend) and provision for unexpired risk reserve (URR) currently remains a drag to underwriting surplus. Nonetheless, adequate quality of investment with healthy returns have aided the company's financial performance. Recent hardening of interest rates in the Nepalese banking sector is expected to support the company's incremental investment yield. The company had investment portfolio of ~NPR 7.3 billion as of mid-April 2022, almost entirely invested in the FDRs/debentures of commercial banks.

Moderate retrocession arrangement; ability to secure adequate retrocession remains to be seen–While HRL's net retention per risk remains low vis-a-vis sizeable net-worth of the company, its total retrocession coverage (especially catastrophic coverage) remains on a lower side considering the company's growing portfolio of insured risks, raising rating concerns.

Moreover, HRL is expected to witness a significant uptick in the inflow of fresh business (risks) following the regulation change in May 2022. The need for retrocession arrangement has also increased as the recent circular prohibits the

2 Federation of Nepalese Chambers of Commerce and Industry domestic reinsurers to turn down any business coming under the direct cession provision. As such, the ability of the company to secure adequate retrocession arrangements commensurate with the currently insured/expected business volume and manage its risk adequately will remain a key rating sensitivity. Continuation of its retrocession strategy (especially on the total coverage front) could render the company vulnerable to the solvency issues in the event of any major losses/catastrophe. The company's current Risk and Catastrophic reinsurance coverage have been taken from the consortium of reinsurers led by Hannover Ruck SE - Hannover Re (rated AA superior by AM Best).

Ensuring regulatory minimum solvency ratio – HRL's solvency margin as of mid-July 2021 stood at 1.4 times, which remains low as the calculations for the solvency is done based on minimum licensing capital of NPR 10 billion while HRL currently has a paid up capital of NPR 7 billion (pending the IPO issuance program). Nonetheless, its ability to maintain comfortable regulatory solvency position through timely conclusion of the IPO process will remain a rating monitorable. However, HRL has been maintaining the mandatory technical reserves and restricted reserves[3] as prescribed by the regulatory authority (Insurance Board of Nepal).

Geographical concentration risk – Though the company's business is not restricted to the domestic geography, its business, nonetheless, is likely to remain concentrated within Nepal over the medium term; more so given the expected uptick in the domestic business volume after the recent regulations. This coupled with the need to mandatorily reinsure all risks coming to HRL under direct cession will increase the lumpiness of claims in the event of any risk materialization/catastrophe (unless adequately managed through retrocession).

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

Established in July 2021, Himalayan Reinsurance Ltd. (HRL) is second reinsurance company in Nepal and the first with majority private ownership. The paid-up capital and the net worth of HRL as of mid-April 2022 stood at ~NPR 7,000 million and ~NPR 7,206 million, respectively. At present, the entire equity shares of the company are held by promoter shareholders. The promoter holding is expected to dilute to 70% after the proposed IPO. As of date, the major promoters in Himalayan Re include Amber Provestment Pvt. Ltd. (9.69%), Nepal Bank Ltd. (7.14%), Rastriya Banijya Bank Ltd. (7.14%), Infinity Holdings (6.43%) among others.

During FY2021, HRL reported a profit after tax of ~NPR 9 million over an asset base of NPR 7,015 million as of mid-July 2021. The company has reported a profit after tax of ~NPR 196 million during 9M FY2022 over an asset base of NPR 7,747 million as of mid-April 2022.

3 Technical reserve includes reserve towards unpaid claims & unexpired risk; restricted reserves include Insurance reserve and Insurance fund

Key financial indicators:

Amount in NPR million	FY2021 (Audited)	3MFY2022 (Provisional)	9MFY2022 (Provisional)
Number of months in operation	**<1**	**3**	**9**
Gross premium written (GPW)	0.1	80.8	526.0
Net premium written (NPW)	0.1	80.8	475.0
Net premium earned (NPE)	0.1	10.1	178.2
Premium retention (NPW/GPW)	100%	100%	90%
Claims ratio (Net claims incurred/NPE)- A	0%	135%	53%
Management expense ratio (Management expense/NPE)-B	3521%	429%	69%
Commission expense ratio (Commission expense/NPE)-C	77%	151%	58%
Combined ratio (A+B+C)	3598%	714%	179%
Underwriting surplus	(2.0)	(62.2)	(130.2)
Investment earnings	23.8	131.1	411.0
Average yield on investments		7.5%	7.6%
Profit after tax (PAT)	9.4	47.7	196.5
Return on average equity	6.4%	2.7%	3.7%
Return on average assets	6.4%	2.7%	3.6%

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About ICRA Nepal Limited:

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