HDFC Life Tackling Change

My teams and I remain key contributors in managing the business and being the conscience keeper of the organisation, says Vibha Padalkar Executive Director and CFO, HDFC Life. Speaking to Jayadipta Chatterji she details how she helped the company become one of the lowest cost service providers in the insurance industry

If you ask HDFC Standard Life (HDFC Life) how it has managed to stay ahead of its peers in the private life insurance industry, it will say that it tries to stay nimble and adaptive to change, be they macroeconomic, changes in customer preferences, regulatory, or any other.

The company put up an impressive performance in FY 2013, despite two rounds of new regulations introduced by the Insurance Regulatory Development Authority (IRDA). The first one in September 2010, was on market-linked ULIPs and pension products. The regulations had come six months after a spat between IRDA and stock market regulator the Securities Exchange Board of India (SEBI), which observed in December 2009, that pension products do not have a life cover and are akin to mutual funds. Eventually, through an Ordinance, the matter was settled that IRDA was to regulate these products. Soon after this, stringent regulations strengthening the 'insurance component' in the products were introduced. The second set announced in February 2013, is on traditional products that typically offer a sum assured, with bonuses linked to the sum assured. "The industry has had to amend its business model several times over because of regulatory changes. Hopefully, these are now done with and we should have stability in our business model going forward," says Executive Director and CFO Vibha Padalkar.

But stability will be elusive in the immediate term at least. "We will have to launch a completely new suite of products as a result of the new regulations. This will slow down the industry. Going forward we have a muted outlook for FY2014," she adds. The immediate imponderable then is how will the industry cope with the new regulations? Also, interest rates have not softened yet, and fixed deposits (FDs) and other competing financial asset classes continue to be attractive and will compete with the insurance industry. Finally, with the elections coming up, FDI relaxation seems even more remote, possibly pushing back further the company's long held plans of doing an IPO.

Insurance regulation 2012

Two significant changes in the recent rules are first, a minimum guaranteed surrender value (GSV) which insurers will have to pay should a policy holder exit the policy at an early stage. IRDA has specified the percentage of minimum GSV that will be paid out. Second, the minimum death benefit under all products should not be less than the sum assured on death and additional benefits (if any). This minimum sum assured is defined based on age of the life assured. The new rules will come into effect by October 1, 2013. For HDFC Life this will be a non-event for two reasons. First, several of its products can pass the self-certification requirement. Second, HDFC Life has launched its new products ahead of the October 1 deadline. It has five products in the market (four in the individual insurance category, and one group) approved by IRDA, which are compliant with the product regulations and three of these are already in the market. The most recent ones are two traditional pension plans launched in June. The company is averaging one new approval every two weeks.

A déjà vu for industry

For industry it is déjà vu, having faced a similar situation in 2010, and companies expectedly should have got wiser after the first round of regulatory changes. However, going by the response of many companies this has not happened yet. Several companies back then had put off filing new products under the revised guidelines, expecting the proposed changes to be rolled back. "Some of our peers believed that the regulator will roll back the new regulations, but this did not happen," affirms Ms Padalkar.

Back in 2010, IRDA had brought in a paradigm change in regulations, capping ULIP charges, fixing the sum assured at 10 times the annual premium and reducing the surrender charges. It also said pension products will have a minimum guaranteed return which it will specify from time to time. "IRDA had clearly introduced the changes in order to offer a better value proposition to customers and to enhance the look and feel of the products it regulates as being 'insurance' products and not mere 'investment' products. Overnight, our margins dropped from being in the high 20s, to low single digits," she recalls.

An impressive performance

By FY2013, the company had increased its operations and made investments in a sustainable future, and still managed to reduce (not increase) its operating cost to gross written premium ratio from 29 per cent in 2008-9, when Ms Padalkar joined the company (pre-Lehman fall), to 16 per cent in 2010-11; and even lower to 11.5 per cent in 2012-13, making it one of the lowest-cost service providers in the private insurance space. Its new business premium income (WRP) grew 15 per cent over the year ago period. In contrast, private industry grew 2 per cent, while the overall industry de-grew by 2 per cent, largely because LIC de-grew by 2 per cent. HDFC Life expanded its market share in the individual insurance space to 17.5 per cent, doubling from 8.9 per cent in the five years from 2009. Its assets under management (AuM) are about Rs 40,000 crore, exhibiting a high growth of 24 per cent over the past year, in a fairly volatile market, and with regulatory changes.

The industry and market share

The industry has three identifiable phases starting from its de-regulation in December 1999. The first phase started from 2000 when HDFC Life came in as the first private entrant followed by other private players, upto 2004. In this period largely traditional products were sold, and the Sensex was in the 2000-6000 range. In the second phase from 2004-08, the four years of the bull run, the Sensex crossed 20,000 and it was ULIPs all the way. People just could not get enough of them. Also, insurance companies expanded their branches in an unchecked manner and hired lots of people. It was a pure topline game and companies sold as much as they could in this period, and then the Lehman crisis happened. In 2008, she joined the company and steered it through its third phase from 2009-2013. In this phase there was more emphasis on a lot of belt tightening, and companies reduced their unviable branches and non-productive manpower. Traditional products made a comeback, given their perceived sense of offering stable returns with capital protection.

In terms of market share, LIC is the big daddy but its share went down consistently during private industry's heydays in FY2009 when it fell to 43 per cent, and private industry rose to 57 per cent. Post Lehman crisis, private industry's share fell, reaching 38 per cent in FY13, when LIC's share was 62 per cent. However, since September 2012, LIC has been de-growing month-on-month. In keeping with its vision, HDFC Life is among the top two players on most parameters today, from holding the fifth position in the private insurance space about five years ago. Its closest competitors are ICICI Prudential and SBI Life.

So what are the reasons for the impressive performance in FY2013?

Ms Padalkar insists that the performance was a team effort executing the CEO's vision of being among the top three companies in the private insurance industry. His focus has been on achieving profitable growth and not growth at any cost. Emphasis is on getting several parameters right, and not just the top line. For example, the company's emphasis on growing renewal premium, persistency, new business expense ratios, and AuM growth among others. The top management is aligned to the board's vision of building good business while achieving long-term profitability.

The reasons for the impressive performance are the following:

- First, HDFC Life was able to see the writing on the wall and anticipate that regulations were going to drastically change in order to arrest some wrong practices that were prevalent in the industry pre-2010. The company was nimble footed and responded to the situation speedily. It launched the new products ahead of the deadline, and imparted fresh training to its frontline sales persons. Also, the cost rationalisation measures that it introduced were in place well ahead of the changeover to the regime of much lower margins, post-September 2010. So, by the time the regulations were out, "We hit the ground running as against some of our peers who were in denial," she says. So HDFC Life benefitted from an early mover advantage and having to play catch-up thereafter, proved difficult for some others.
- Second, the company grew each one of its distribution channels individually, and not just its bancassurance channel where it has a tie up with banks such as HDFC Bank, Indian Bank, and Saraswat Bank. The aim was to de-risk its distribution, which today includes newer channels such as the direct and broker channels. In FY'13, these two channels comprised 12 per cent of its business, up from 8 per cent the year ago, which is a substantial increase. The company expects growth from these channels (and other smaller ones) to continue, going forward.
- Third is product innovation and the focus to own distinct customer and product segments, such as, the NAV-guaranteed plan and the Smart Woman Plan. Both have helped it to establish a differentiation in the market vis-à-vis other companies.
- Fourth is its concentration on persistency. It has enjoyed consistently high persistency rates in the industry, where persistency is the percentage of what it sold in the previous years, which it has renewed in the current year. For an insurance company, profitability is highly dependent on policies getting renewed year-on-year given the high upfront acquisition costs. HDFC Life has formed a special persistency cell which undertakes a lot of predictive analysis, that allows a fairly certain assessment of a particular customer profile's higher propensity to surrender a policy; based on the age, the place of residence, distributor channel, type of policy, and product. Armed with this information, it proactively engages with customers to persuade them to hold on to their policies as it in their interest to continue to pay the premium and retain the policy as a long-term savings. Preserving persistency has paid off for the company.
- Fifth is its focus on cost efficiencies actively driven by Ms Padalkar and her team, from the start of the global financial crisis and then the new IRDA regulations. The company has one of the lowest new business acquisition cost structures in the industry.

Finance control, compliance, and corporate governance initiatives

Driven by the ambition to lead a team that prides itself on accuracy, compliance, timeliness, responsiveness to ever-changing business, economic, and regulatory needs, and high-quality corporate governance, Ms Padalkar introduced several initiatives. These are standing the company in good stead, especially now in the face of another round of new regulations from IRDA. She has ensured that her teams continue to be key contributors in managing the business and being the conscience keeper of the organisation.

Given the widespread nature of the industry with customers and distributors spread across the country; and its large and ever changing (due to high attrition which is an industry phenomenon) workforce of over 15000 people, robust financial controls and compliance measures are vital in order to keep track of the millions of transactions; in hundreds of locations; via several different modes of collection; and over 400 branches. These measures have led to faster revenue collection (of over Rs 11,000 crore in FY13), and equally faster investment of funds (with Assets under Management crossing Rs 40,000 crore), as well as speedy deployment to vendors and service providers in the company's enormous distribution network.

Her starting point was that there should be no surprises whether positive or negative such that a high level of predictability instills in the board and analyst community, confidence in the management. This required the company to be more process dependent and automated, and less person-dependent. Weak areas identified by the internal audit and the process assurance teams are worked upon on an ongoing basis and root-cause analysis and controls strengthened. On the control aspect, inefficiencies that creep into the system are continuously monitored and weeded out. It has now been ingrained in employees to question every rupee that is proposed to be spent and the RoI expected. As the company's ESOP plan is fairly widespread, employees adapted to this way of thinking quite easily!

Some measures in financial control are the following:

Cost cutting

When Ms Padalkar joined the Company (in FY09), the operating cost ratio was 29 per cent which then reduced sharply in FY11 to 16 per cent, reaching 11.5 per cent in FY 13.

Post the Lehman crisis which in India resulted in a paradigm change in ULIP regulations in September 2010, with margins of Indian insurance companies plummeting, several cost containment initiatives were rolled out under her watchful eye. These included first, eliminating non-productive infrastructure, including re-negotiating lease rentals with landlords and reducing the number of branches from around 600 to 400. Second, a larger chunk of employee costs including that of the CEO and CFO became variable with payout subject to achievement of the company's as well as individual, targets. This was with the aim to reduce fixed costs, especially during a downturn, for example, in FY2009 when topline growth was muted, but employee costs remained fixed in the short term. Third, several initiatives such as centralised procurement (to harness the power of its scale and presence across the country), process re-engineering to eliminate waste (for example redesigning the policy document in order to cut the number of pages by over 40 per cent without compromising on relevant information provided to the customer), conducting reverse auctions, and re-negotiating with distributors, among others were rolled out. This was backed up with regular monthly comparisons of budgets and carrying out course corrections where required. Ms Padalkar is aware that further cost reductions will be possible with value re-engineering and through the smart use of technology.

By up-skilling staff and managers (including sponsoring managers to complete international professional qualifications, for example, ICAI, London, and obtain IFRS global qualifications); encouraging lateral movements into other functions to help broaden perspectives; and with better use of technology, she rationalised the finance headcount from 246 to 147. Despite this reduction in the number of people, the finance team's productivity has gone up with a steep reduction in the book closure date from 18 to 8 days (this year the target is seven days) post month-end; and scaling up the quality of analysis provided in a much shorter time frame. She proudly states that two of her direct reportees have won the CFO Next 100 award from CFO Forum India. These measures have helped to improve employee morale, and reduced attrition rates specifically among high performers.

The cost of the finance function as a percentage of revenue has reduced by 29 per cent CAGR over the past three years, falling from Rs 22.1-16.1 crore, in absolute terms.

Technology

Shortly after joining the organisation, Ms Padalkar made a business case for, and led the introduction of a world class ERP software system to process financial transactions. This led to a shorter accounts' closing cycle, superior MIS, and a robust control environment within which financial transactions are processed. Now the management is aware of business risks far earlier and is able to insert mitigants to reduce their impact. It has also enabled 100 per cent on-time vendor payments, and payment of distributor commissions on a weekly basis (as against monthly, which is the industry norm).

She also led the finance team in implementing the unique Business Warehouse ERP (BW) and Business Planning ERP modules. The former has significant capability to analyse a large database to generate meaningful manage-

ment information and reports required for regulatory submission. The latter allows for greater flexibility and 'plug and play' capability, while preparing business plans. This is especially important in a highly competitive industry with frequently changing regulatory requirements.

Another unique technology solution implemented ('ICM') is for calculation and payment of distributor commission of over Rs 500 crore per annum. HDFC Life is the first company in India to deploy this on a large scale (countrywide). This system also provides distributors high quality information at their finger tips.

Her mid and back-office investments' team has a mechanism for investing company funds against limits set, where actual investments must conform to mandated norms and be reviewed regularly by various management committees including the investment committee. Her team is now implementing a world-class, risk control software (MSCI BARA) to track and report financial risk exposure to the investment portfolio.

The 'Point of Sale' (POS) system is the first of its kind in the domestic life insurance industry, developed in conjunction with the company's re-insurer, Swiss Re. As against the traditional system of visiting and sometimes revisiting prospective customers for their personal information (medical and non-medical) and risking annoying them, here, the sales person works with a fairly simple system underlying which is a high powered robust and interactive, underwriting rule engine. It reduces turnaround time, administrative work, and therefore, manpower, and has the potential to reduce policy conversion time to a fourth. Currently, 70 per cent of the new business is processed on the POS platform, and the company is planning to take this up to about 100 per cent.

Other financial controls

Ms Padalkar spearheaded the implementation of two authorisation matrices across the hierarchy of the organisation. One is for expense approval and authorising discretionary spends. A similar matrix is for authorising contracts and signing agreements on behalf of the company. This has led to a lot of rigour in the expense process, making her confident that no material payment can happen without proper authorisation and legal documents to back them.

The company follows a robust system of business case evaluation by the finance team, where proposed investments or spends have to cross certain internal hurdles, such as, the internal rate of return (IRR), payback, and RoI among others. This has become part of the company's DNA today. Post-spend performances are tracked to see how the business projections eventually pan out. This helps it to learn from past experiences and be smarter about the investment choices that it makes, going ahead.

Other compliance matters

Under Ms Padalkar's leadership, her teams run several initiatives that are vital to ensure that the company is compliant with regulations and there is adequate control on the business. The compliance initiatives that help it to maintain a strong governance framework are the following:

First, all significant decisions taken by the management are reported to the board. Second, as part of self-certification, officials across the company certify quarterly to the compliance officer that they have conducted checks as required of them. All deviations are reported to the board and are investigated and corrected.

Third, Ms Padalkar chairs the whistle blower and anti-sexual harassment committees which meet once a quarter or as required, and handle issues and cases as they occur. Their findings and action taken reports are formally presented to the risk committee of the board. The process of receiving complaints, independent investigations to be carried out, and actions to be taken as per the company's malpractice matrix are well laid out and strictly adhered to. This provides employees and other stakeholders a high level of comfort in their dealings with the company.

Fourth, the risk management team she heads monitors corporate risks faced by the organisation against the risk appetite set at the start of each year. It also works with department heads to identify functional level risks, maintain formal risk registers, and put in risk mitigants.

Fifth, the entire mid-office and back-office of investments, including the Rs 40,000 crore AuM is monitored and managed by a robust system. A daily concurrent audit done by an external audit firm, especially on the daily NAVs declared, which is a regulatory requirement, is also undertaken. Investment breaches are strictly monitored against investment guidelines on what securities the dealer can invest in. The company has set stricter investment limits for itself (over and above what is required by the regulator) in order to avoid any regulatory violations.

Sixth, the entire legal and company secretarial teams also report to her. They work against tight turnaround time to put together contracts for businesses so that no payment happens without adequate legal documentation for sums beyond a certain threshold. The teams -legal, procurement, and accounts - work seamlessly to ensure that no material payment goes through without proper authorisation and legal backup documentation. The legal team also represents the company in court, appearing in various cases of policy holders, and based on its learnings, also works with operations to help strengthen internal processes to ensure success in future litigations.

Seventh, her team responsible for Anti-money Laundering (AML) compliance ensures compulsory training in AML guidelines for all employees. AML training is part of the online induction module for a new joinee. If an employee does not complete this training within 30 days of joining, the system auto trigger disables his or her access to sign-in attendance, and all HR portals. The team also does various analyses to detect patterns that indicate possible AML violations.

Corporate governance

Under Ms Padalkar's guidance, HDFC Life has adopted stringent corporate governance norms and ensures that they are sustained internally. The strong governance framework put in place, *"commits to sound corporate practices based on the company's vision, values, and principles to build the confidence of its various stakeholders, thereby, paving the way for its long term success and sustenance".*

The company has a 13-member professional board, comprising promoters (HDFC and Standard Life), independent and executive members. It maintains a sound governance ecosystem, and the quality and timeliness of information to the board has improved substantially. This includes the quality of the agenda, meeting deliberations, and recording of minutes.

As the CFO and Executive Director, she is present at all board and committee meetings either as a member or a permanent invitee. She is trusted by the board and engages with it and the audit committee to which she presents the financial results. The board relies on her judgment and opinion on complex tricky matters, both financial and non-financial.

Among the initiatives taken to maintain governance norms are, first, the company secretarial team ensures that the minutes go to the board within a certain turnaround time. The board packs are sent out at least seven days before the meeting and there is a lot of rigour and formality in the board process. Second, although Clause 49 is not applicable to the company, most parts have been adopted voluntarily, including having a stringent employee dealing policy. The senior management cannot deal in securities that the company deals in, which are nearly all the securities, and this is strictly monitored to ensure insider trading does not take place. The senior management cannot sell company shares without proper approval. These norms are all in place in preparation for an IPO, so that the transition can be seamless when it happens, she explains.

With M&A and investor relations also part of her responsibilities she meets investors or analysts regularly, and is proud that HDFC Life makes the highest voluntary disclosures about its performance on its company website. "We try to be as transparent as possible and are way ahead of our peer group in this aspect," she says. This will be mandatory, should the company list on the stock exchanges, and it started making disclosures three years ago. She realises that this activity aids in building a level of honesty and transparency with the analyst community.

Ops is the real nerve centre

Over the last year, she has been given additional charge of operations in the company, and has been busy getting into the details of managing it efficiently. She admits that as the CFO she is always on the lookout for inefficiencies in processes and areas that can contribute to cost savings without compromising on quality. She says she is excited and 'charged up' about the enhanced role, as she believes that operations form the real nerve centre of a company. Finance folk will benefit immensely from their learning in sales and operations, she feels. Her exposure to operations will also add to her personal development as it is a completely new area that she is learning about.

Conclusion

Ms Padalkar joined HDFC Life in 2008 enthused by the idea of doing an IPO for the first Indian insurance company, but five years later this is still a dream. If it does happen she will have completed two IPOs, having done the first one at WNS Global Services in 2006. At the time, it was the first overseas IPO of an Indian BPO company. She is the winner of several awards, including the ICAI CFO-Woman of the year award, but she insists that her experiences and learning from the people that she has worked with in her career are her real rewards. Grit and confidence in herself she learnt from her parents, and the sleep test helps her when she is at the crossroads and has to make a difficult decision. If it will give her sleepless nights no amount of cajoling will make her accept a business decision.

A product of India's liberalisation era after she came back from London to Mumbai, and has never looked back. Except, when comparing the two cities! The lack of infrastructure in Mumbai paled in comparison to the struggle of being an Asian woman in London's financial circles (which demonstrated far less acceptance 20 years ago). In no time, she had embraced the saree, and learnt to jump on to the Mumbai local train and grab not just a seat, but the one facing the direction of the wind. ■