BAJAJ FINSERV

4th Annual Report

2010-11

Bajaj Finserv Limited

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Board of Directors

Rahul Bajaj
Chairman

Nanoo Pamnani
Vice Chairman

Sanjiv Bajaj
Managing Director

Madhur Bajaj

Rajiv Bajaj

D J Balaji Rao

S H Khan

Naresh Chandra

Management

Sanjiv Bajaj
Managing Director

Ranjit Gupta
President (Insurance)

Kevin D'sa
CFO & President (Business Dev.)

Hemant Kaul
CEO, Bajaj Allianz General Insurance Company Limited

V Philip
CEO, Bajaj Allianz Life Insurance Company Limited

Rajeev Jain
CEO, Bajaj Finance Limited

Arpit Agarwal
CEO, Bajaj Financial Solutions Limited

Anand Gore
CEO, Infrastructure Finance

Company Secretary

Sonal R Tiwari

Auditors

Dalal & Shah
Chartered Accountants

Registered under the Companies Act, 1956

Bankers

Citibank N A
HDFC Bank
ICICI Bank

Registered Office

Bajaj Auto Limited Complex,
Mumbai-Pune Road,
Akurdi, Pune 411 035.

Corporate Office

Survey No.208/1-B, 6th Floor,
Behind Weikfield IT Park,
Off Pune-Ahmednagar Road,
Viman Nagar, Pune – 411 014.

Management Team

Hemant Kaul

Rajeev Jain

Sanjiv Bajaj

Kevin D'sa

V Philip

Ranjit Gupta

Arpit Agarwal

Anand Gore


चेतक

Chairman's Letter

Dear Shareholder

This is the fourth year of your Company's operations, and my fourth letter to you in the annual report.

India has done well in FY2011. Its real GDP growth is estimated at 8.6% — the second highest among all large economies of the world, bettered only by China.

Your Company, too, has done well. Let me touch upon some features of Bajaj Finserv's three major businesses: life insurance, general insurance and lending. The details are in the chapter on Management Discussion and Analysis (MD&A).

Bajaj Allianz Life Insurance Company (BALIC)

The second half of FY2011 was a difficult year for the life insurance business in India. Major changes were introduced by the Insurance Regulatory and Development Authority (IRDA), which are detailed in the MD&A. In principle, these were welcome changes as they were meant to benefit policyholders and encourage greater transparency in the disclosures made by insurance companies. However, these affected business in the second half of the year across the industry, and forced all companies to revisit their strategies and alter their business models.

Considering the industry-wide effects of changes that were brought about by the IRDA's sweeping notification, I dare say that BALIC did well for itself. Although BALIC's gross premium written for FY2011 was lower than FY2010, as was its new business premium, the company continued to remain profitable, unlike most others in the industry.

For FY2011, BALIC posted a shareholders' profit of ₹ 1,057 crore, of which your Company's share stood at ₹ 782 crore. This was a significant improvement over the previous year's figures, which were ₹ 542 crore and ₹ 401 crore respectively. Accumulated profits as on 31 March 2011 stood at ₹ 1,039 crore, and the shareholders' net worth was ₹ 2,249 crore.

In other words, despite a difficult year for the industry, BALIC has succeeded in pursuing profitable growth with returns to all stakeholders. In FY2012, it will continue to focus on improving employee productivity, policy persistency, operational processes, customer service levels and also examine how to increase share of the agency channel.

Bajaj Allianz General Insurance Company (BAGIC)

BAGIC is the second largest private general insurance company in India. Despite a difficult environment, largely on account of the drain created by Indian Motor Third Party Insurance Pool (the Motor Pool), gross written premium for FY2011 (excluding premiums from the Motor Pool) grew by over 15% to ₹ 2,905 crore. The company's net earned premium in FY2011 (excluding the Motor Pool) also grew by more than 15% to ₹ 1,931 crore. During the year, BAGIC sold 6.4 million policies.

Financially, however, the company fared worse than the previous year, due to the drag on account of the Motor Pool. Even so, it earned a profit. Despite additional provisioning of ₹ 199 crore towards losses from Motor Pool, BAGIC's PBT for FY2011 was ₹ 62 crore. Its PAT was ₹ 43 crore.

Bajaj Finance Limited (BFL)

The most stellar performance came from BFL, a listed company, earlier known as Bajaj Auto Finance Limited. As of July 2010, it is a subsidiary of your Company. With assets under management of over ₹ 7,571 crore, BFL is one of the leading, diversified non- banking finance companies in the country. In addition to two-wheeler financing, loans for consumer durables, personal loan cross-selling, vendor financing, mortgage-backed lending and construction equipment financing, BFL has started its infrastructure lending business. The company delivered superior results in FY2011.

Loan deployment rose by 106% to ₹ 9,435 crore. Total income for FY2011 was up by 53% to ₹ 1,406 crore. Profit after tax (PAT) increased by 178% to ₹ 247 crore. Consequently, its EPS increased from ₹ 24.43 in FY2010 to ₹ 67.47 in FY2011. Capital adequacy ratio as on 31 March 2011 was 20%, which is well above the RBI norms.

Other Developments

Bajaj Financial Solutions Limited (Bajaj FinSol), which offers financial products and advises clients on financial and wealth management, has received its operating licenses from both the SEBI and the IRDA, and has launched operations in four cities in February 2011.

I have been sometimes asked whether we will get into the banking business if the sector were to be opened up, as desired by Government. My answer is this: "We will examine it carefully, if such an opportunity were to arise."

Let me end this letter with some words of warning. FY2012 may be a difficult year for the economy — one that could be beset with high inflation and rising interest rates. If these were severe enough, growth would be lower than what we saw in FY2011. Therefore, your various subsidiaries would have to perform even better in a tougher economic environment. This bears keeping in mind.

My best wishes to every employee in your Company, and to those in BALIC, BAGIC, BFL, Bajaj FinSol and Bajaj FinSec. And thank you for your support

Rahul Bajaj
Chairman

Management Discussion and Analysis

Bajaj Finserv Limited ('Bajaj Finserv' or 'the Company') is the financial services arm of the Bajaj group. This is the Company's fourth annual report to its shareholders

Bajaj Finserv is the holding company under which various businesses reside. These are:

- **Protection**
  - Life Insurance, under the Bajaj Allianz Life Insurance Company (BALIC).
  - General Insurance, under the Bajaj Allianz General Insurance (BAGIC).
- **Lending**
  - Structured under Bajaj Finance Limited (BFL, earlier Bajaj Auto Finance), a company listed on the Bombay Stock Exchange and the National Stock Exchange.
- **Investments**
  - Asset Management. Bajaj Finserv plans to form an asset management company (AMC) with the Allianz group. In-principle approval has been received from the Securities and Exchange Board of India (SEBI).
- **Financial Advisory and Wealth Management**
  - Bajaj Financial Solutions Limited (Bajaj Finsol), which offers financial products and advises clients on financial and wealth management. The business has been launched in four cities in FY2011.

In addition, the Company has wind-farm assets, comprising 138 windmills in Maharashtra with an installed capacity of 65.2 MW.

The rest of this chapter gives details on each of these businesses and their rationale. Before doing so, it is useful to give a brief overview of the Indian economy during FY2011 and the macroeconomic prospects for FY2012.

During FY2011, India's GDP grew at 8.6%. It was the second highest growth rate among major countries in the world, bettered only by China. Growth occurred across all sectors, of which the most heartening were the performance of agriculture – a frequent laggard – as well as industry. Unfortunately, India also faced severe inflationary pressures coming across the entire spectrum of goods – foodstuff, hydrocarbons, commodities and manufactures. To combat this, the Reserve Bank of India has raised interest rates, often twice in a quarter – and in May 2011 upped to a hike of 50 basis points, instead of the usual 25 bps. Thus, growth may be moderated in FY2012 because of inflation and higher interest burden.

Protection

Bajaj Allianz Life Insurance Company Limited (BALIC)

Life insurance witnessed rapid growth from the time that the sector was opened up in FY2001 up to FY2010. Thereafter, it has slowed down largely on account of major regulatory changes enacted in FY2011.

The new changes have been introduced by the Insurance Regulatory and Development Authority (IRDA) for the benefit of policyholders and to impart greater transparency in the disclosures made by insurance companies.
Though these changes are welcome, they have posed a tremendous challenge to the insurance industry in the short term – forcing companies to revisit their strategies and radically revise their business models. Some of the major regulatory changes are listed below.

- Capping of expenses at the end of fifth year, leading to reduction in commission to agents and intermediaries.
- Lock-in period, including top-ups, extended from three years to five years
- Pension withdrawal/maturity to be compulsorily converted into annuity. All ULIP pension/annuity products shall offer a minimum guaranteed return of 4.5% per annum on the maturity date.
- Capping of surrender charges and time to revive lapsed policies reduced.

The Life Insurance Market

There is no doubt that these changes have resulted in a lower rate of growth for the industry as a whole and, more specifically, the private sector players (see Table 1a). However, it is also a fact that the new business premium of the industry has increased twelve fold since inception — from ₹ 9,707 crore in FY2001 to ₹ 125,826 crore in FY2011, of which over 31.3% is accounted for by the private sector. Tables 1a and 1b gives the past six year data on growth and market share in new business from FY2006.

Table1a: Growth in New Business Premiums, Life Insurance

	FY2011	FY2010	FY2009	FY2008	FY2007	FY2006
Private sector	2.6%	12.4%	1.0%	73.6%	89.9%	84.5%
LIC	21.9%	33.9%	-10.5%	5.8%	118.1%	29.6%
Industry	15.1%	25.5%	-6.3%	23.9%	110.1%	41.6%

Table1b: Market Share in New Business Premiums, Life Insurance

	FY2011	FY2010	FY2009	FY2008	FY2007	FY2006
Private sector	31.3%	35.1%	39.2%	38.1%	25.8%	26.5%
LIC	68.7%	64.9%	60.8%	61.9%	74.2%	73.5%
Industry	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

- During FY2011, the life insurance industry had a new business growth of 15.1% versus 25.5% in FY2010. The 23 life insurers mobilised a first year premium of ₹ 125,826 crore in FY2011 compared to ₹ 109,290 crore in the previous year.
- The market share of LIC has increased from 64.9% to 68.7%, while that of the private players has reduced by 3.8 percentage points from 35.1% to 31.3%.
- The industry witnessed negative growth of 9.7% in the second half of FY2011 versus the corresponding period in the previous financial year.

The regulatory changes became effective from1 September 2010, and these mainly affected the Unit Linked Insurance Products (ULIPs). Consequently, there has been a shift in the business mix across the industry – and mainly among the private players – from individual regular premium business towards individual single premium business and group business. This occurred during the second half of FY2011. Thus, during H2,FY2011, the industry saw a 26.8% decline in the individual regular premium business, with a 43.3% decline for the private companies. Tables 2 and 3 shows the growth across segments during H1 and H2 of FY2011.

Table 2: Growth in New Business Premiums in H1, FY2011 (Apr-Sep 2010)

	Private Sector	LIC	Industry
Individual Single Premium	138.7 %	114.7%	116.9%
Individual Non-Single Premium	15.5%	27.6%	20.7%
Group Single Premium	194.8%	8.6%	16.8%
Group Non-Single Premium	-9.6%		453.2%
Total	**26.0%**	**77.0%**	**59.7%**

Table 3: Growth in New Business Premiums in H2,FY2011 (Oct 2010 – Mar 2011)

	Private Sector	LIC	Industry
Individual Single Premium	171.4%	-42.6%	-18.8%
Individual Non-Single Premium	-43.3%	-7.6%	-26.8%
Group Single Premium	729.7%	11.6%	28.2%
Group Non-Single Premium	-10.1%		71.1%
Total	**-9.8%**	**-9.6%**	**-9.7%**

As mentioned earlier, for FY2011 as a whole, the life insurance industry registered a growth of 15.1%, and garnered new business premium of ₹ 125,826 crore. Table 4 gives the market data.

Table 4: Industry Performance for the Year Ended 31 March 2011

(₹ In Crore)

Insurer	NB, YTD Mar 11	Market Share	Group as a % of NB
ICICI Prudential	7,861	6.2%	31.0%
SBI Life	7,571	6.0%	36.8%
HDFC Standard	4,065	3.2%	14.0%
Bajaj Allianz	3,462	2.8%	25.2%
Reliance Life	3,035	2.4%	12.4%
Birla Sun Life	2,077	1.7%	21.0%
Other Private	11,310	9.0%	12.8%
Private Total	**39,381**	**31.3%**	**22.7%**
LIC	86,445	68.7%	39.6%
Total	**125,826**	**100%**	**34.3%**

The fall in new business premium growth has made most industry players review their business models. This has resulted in:

- Shift in new business mix from regular premium ULIPs to single premium ULIPs and the traditional life products.
- Fixed expenses have become a constraint, resulting in companies cutting down on their branches and distribution networks.
- Insurers are focusing more on ensuring that existing customers continue to pay their renewal premiums.
- Some agents moving away from the industry due to lower commission levels.

Performance of BALIC

BALIC's gross premium written for FY2011 was ₹ 9,610 crore, which was 15.8% lower than ₹ 11,420 crore of FY2010. Renewal premium reduced from ₹ 6,969 crore in FY2010 to ₹ 6,144 crore in FY2011.

BALIC strategically chose not to chase new business (NB) at high costs. Thus, new business premium for FY2011 was ₹ 3,466 crore versus ₹ 4,451 crore in the previous year.

Within the private sector, BALIC's market share of NB premium was 8.8% for FY2011. The company is fourth among the private life insurers on NB premium for FY2011. It ranks second among the private life insurers based on the number of new policies issued – 1.54 million policies in FY2011 versus 2.23 million in the previous year.

ULIPs contributed 58% of BALIC's NB premiums in FY2011, compared to 84% in the previous year. In the first half of the year, ULIPs accounted for 69% of the NB premium (versus 80% in the same period last year); in the second half of FY2011, ULIP's share of NB premiums was 51% (86% in the same period last year).

Due to the new regulation, almost all ULIP products had to be re-filed.

Financial Performance

BALIC's financial performance in FY2011 and FY2010 is summarised in Table 5.

Table 5: Financial Performance of BALIC

(₹ In Crore)

Particulars	FY2011	FY2010
Gross written premium	9,610	11,420
New business premium	3,466	4,451
Renewal premium	6,144	6,969
APE*	2,427	3,659
Policyholder surplus/(deficit) (After transfer to Shareholder)	16	10
Shareholder Profit/(Loss)**	**1,057**	**542**
Profit/(Loss)	962	427
Net contribution to policy holders account	32	69

* Annualised Premium Earning (APE) = 10% of Single Premium and 100% of First Premium

** Shareholders' profit for the year is ₹ 1,057 crore – this comprises of current year Shareholders' profit of ₹ 122 crore, distribution of surplus from policyholders' account to shareholder of ₹ 825 crore and ₹ 111 crore on account of release from "Reserve for Lapsed unit linked policies unlikely to be revived".

For FY2011, thanks to tight control over operating expenses, BALIC posted a shareholders' profit of ₹ 1,057 crore, of which Bajaj Finserv's share stood at ₹ 782 crore. The previous year's figures were ₹ 542 crore and ₹ 401 crore respectively.

During FY2011, the company wrote off the opening accumulated losses of ₹ 18 crore. Accumulated profits as on 31 March 2011 stood at ₹ 1,039 crore, and the shareholders' net worth was ₹ 2,249 crore.

As is evident from Table 5, despite a difficult year of the industry, the company has succeeded in pursuing profitable growth with returns to all stakeholders. In fact, BALIC has been the most profitable life insurance company in the private sector.

In FY2012, BALIC will continue to focus on improving employee productivity, policy persistency, operational processes, customer service levels and also examine steps to increase share of the agency channel in overall company premium.

Investments

As on 31 March 2011, BALIC's assets under management (AUM) stood at ₹ 39,330 crore, which included unit linked funds of ₹ 32,884 crore. The unit-linked funds have increased by 16%, from ₹ 28,415 crore as on 31 March 2010. This has been due to the generally upward trend of the markets. Unit linked funds have performed well — with the major funds yielding returns that were in line with the benchmark. Table 6 gives the data.

Table 6: Performance of BALIC's AUM

(₹ In Crore)

UL Returns as on 31 March 2011 Funds	As at 31 March 2011	Absolute Returns FY2011	FY2010
Equity Index Fund II	9,386	10.8%	72.4%
Unit Gain Plus - Equity Index	204	11.1%	72.5%
Unit Gain – Equity Plan	377	9.7%	70.2%
Equity Growth Fund	8,406	12.7%	69.5%
Equity Plus	1,106	10.2%	73.3%
Equity Gain	797	10.2%	70.5%
CNX NSE Nifty Index		**11.1%**	**73.8%**
Asset Allocation Fund	4,119	8.2%	34.7%
Crisis Balanced Fund Index		**9.4%**	**47.3%**

Note:

The funds given in Table 6 contribute 70% - 75% of total unit-linked AUM of BALIC.

The traditional portfolios are carefully managed, keeping in mind the regulatory asset allocation requirements. The yield on non-unit linked instruments invested in FY2011 was 8.27%, versus 8.37% in the previous year.

Capital and Capital Adequacy

BALIC's equity base (including share premium) was at ₹ 1,211 crore, with no fresh infusions in FY2011. The company's solvency ratio was 366% as on 31 March 2011, versus the minimum regulatory requirement of 150%. The company has one of the best capital utilisation rates in the industry, as measured by the ratio of gross written premium to capital infused.

Challenges

The recent changes in regulations and guidelines have made life insurance companies re-think their strategy, mainly in terms of balancing growth with profitability. The major challenges for all companies are:

- Maintaining and improving persistency.
- Increasing productivity among agency force.
- Maintaining a balance between intermediary needs and profitability.

In addition, the industry may face some other challenges such as:

- Possibility of further regulations, mainly on the non-ULIP portfolio.
- Persistency linked agency termination.
- Guidelines on agency recruitment.

These might have an impact on the overall business of the industry.

Bajaj Allianz General Insurance Company Limited (BAGIC)

General Insurance in India

Since the entry of private sector companies in general insurance from 2000, the industry has grown from four public sector companies to 24 entities: 15 in the private sector; four public sector corporations; three specialised health insurance companies; the Export Credit and Guarantee Corporation; and the Agricultural Insurance Corporation.

Gross written premiums of the industry, excluding the specialised insurers, have grown from ₹ 12,390 crore in FY2002 to ₹ 34,984 crore in FY2010, and have crossed ₹ 42,569 crore in FY2011. The compound annual growth rate is around 15%.

Nevertheless, penetration remains very low at 0.6% of GDP – versus 1.67% for Asia as a whole, 3.1% for Europe and 4.9% for North America. Equally, the per capita spend on general insurance remains below comparable emerging countries, leave aside the developed nations.

With India's real GDP expected to grow at a CAGR of 8% over the next five to seven years, spends on general insurance are bound to increase. The potential is vast, and insurers need to figure out ways to profitably tap this growth.

The general insurance industry has been adversely affected in FY2011 because of significant upward revision in the Motor Pool Loss Reserves. It needs explaining.

The Indian Motor Third Party Insurance Pool (or the Motor Pool) is an arrangement where all general insurers cede the premium related to third party risks of commercial vehicles and their related losses to the Motor Pool. These are then distributed back to the general insurers in proportion to their market share.

The IRDA has directed all general insurers to provide for the Motor Pool losses at 153%, versus 126% that was provided in the past. In order to absorb this enhanced provisioning, solvency requirements have also been relaxed at a reducing scale for financial years up to FY2013. This has hurt the industry.

For BAGIC, the good news is that even after absorbing this enhanced provisioning, the company has maintained its solvency ratio at 173% for the year ended 31 March 2011 — which is above the normal regulatory requirement of 150%.

The recent decision of IRDA to increase the premium on third party risks of commercial vehicles and indexing the future annual increase is a welcome move.

The general insurance industry posted a growth of nearly 22% for FY2011. Almost all companies achieved positive growth, and most were in the double-digit territory. The industry's and BAGIC's growth rates are shown in Table 7.

Table 7: Gross Direct Premium Written in India

(₹ In Crore)

	FY2011	FY2010	FY2009	FY2008	FY2007
Bajaj Allianz	2,905	2,515	2,650	2,404	1,803
Private Sector	17,567	14,341	12,569	11,196	8,729
Public Sector	25,002	20,643	18,079	16,900	16,291
Industry	42,569	34,984	30,648	28,096	25,020
Growth Rates					
Bajaj Allianz	15.5%	-5.1%	10.2%	33.3%	41.7%
Private Sector	22.5%	14.1%	12.3%	28.3%	62.8%
Public Sector	21.1%	14.2%	7.0%	3.7%	8.6%
Industry	21.7%	14.1%	9.1%	12.3%	22.9%

Source: IRDA website and the IRDA Handbook of Insurance Statistics. Excludes specialised insurers

BAGIC's Business Performance, FY2011

Under testing conditions, BAGIC has focused on profitability by:

- Strong underwriting with careful selection of risk – and underwriting only those businesses which met its profitability hurdle rates.
- Emphasising uniformly high quality of customer services.
- Establishing a renewal vertical dedicated to analysing portfolios and actively following up on profitable renewals.
- Strengthening marketing efforts in retail channels such as agency and bancassurance.

The gross written premium, or GWP, for FY2011 (excluding premiums from the Motor Pool) was ₹ 2,905 crore, compared to ₹ 2,515 crore recorded in FY2010, or a growth of 15.5% with a market share of 6.8%.

The net earned premium for FY2011 (excluding premiums from the Motor Pool) was ₹ 1,931 crore versus ₹ 1,671 crore in FY2010, or a growth of 15.6%. During FY2011, BAGIC sold 6.4 million policies, compared to 6 million in FY2010. The number of claims reported in FY2011 was 561,720 versus 525,258 in FY2010.

Business Mix and Channel Performance

BAGIC's focus continues to be on retail business, where it has strengths in distribution and claims handling. The business mix is given in Table 8.

Table 8: BAGIC's Business Mix

Line of Business Mix	FY2011	FY2010	FY2009
Motor	59.0%	57.5%	56.8%
Health	11.7%	11.7%	12.6%
Fire	13.2%	13.7%	12.9%
Engineering	3.8%	4.0%	4.8%
Marine	2.7%	3.0%	3.3%
Others	9.6%	10.1%	9.6%
Total	**100%**	**100%**	**100%**