Max Financial Services EV Disclosures

September 2016

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This release is a compilation of financial and other information all of which has not been subjected to audit and is not a statutory release. This may also contain statements that are forward looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially from our expectations and assumptions. We do not undertake any responsibility to update any forward looking statements nor should this be constituted as a guidance of future performance.

Market Consistent Embedded Value - Introduction

Max Life's Embedded Value (EV) is based on a market consistent methodology.

A market consistent methodology approach better reflects the embedded value of an insurance company by explicitly allowing for insurance and economic risks rather than using an implicit overall allowance for risks through a Risk Discount Rate (RDR) in the traditional approach.

Although the results are developed using a market consistent methodology, they are not intended to be compliant with the MCEV Principles issued by the Stitching CFO Forum Foundation (CFO Forum) or the Actuarial Practice Standard 10 (APS10) issued by the Institute of Actuaries of India.

The EV as at March 2015 was reviewed by Milliman and their opinion was shared along with the disclosure at March 2015. This disclosure follow the same methodology.

The valuation does not take into account any changes in the future cash flow projections as a result of the proposed merger between HDFC Life and Max Life.

Key Messages

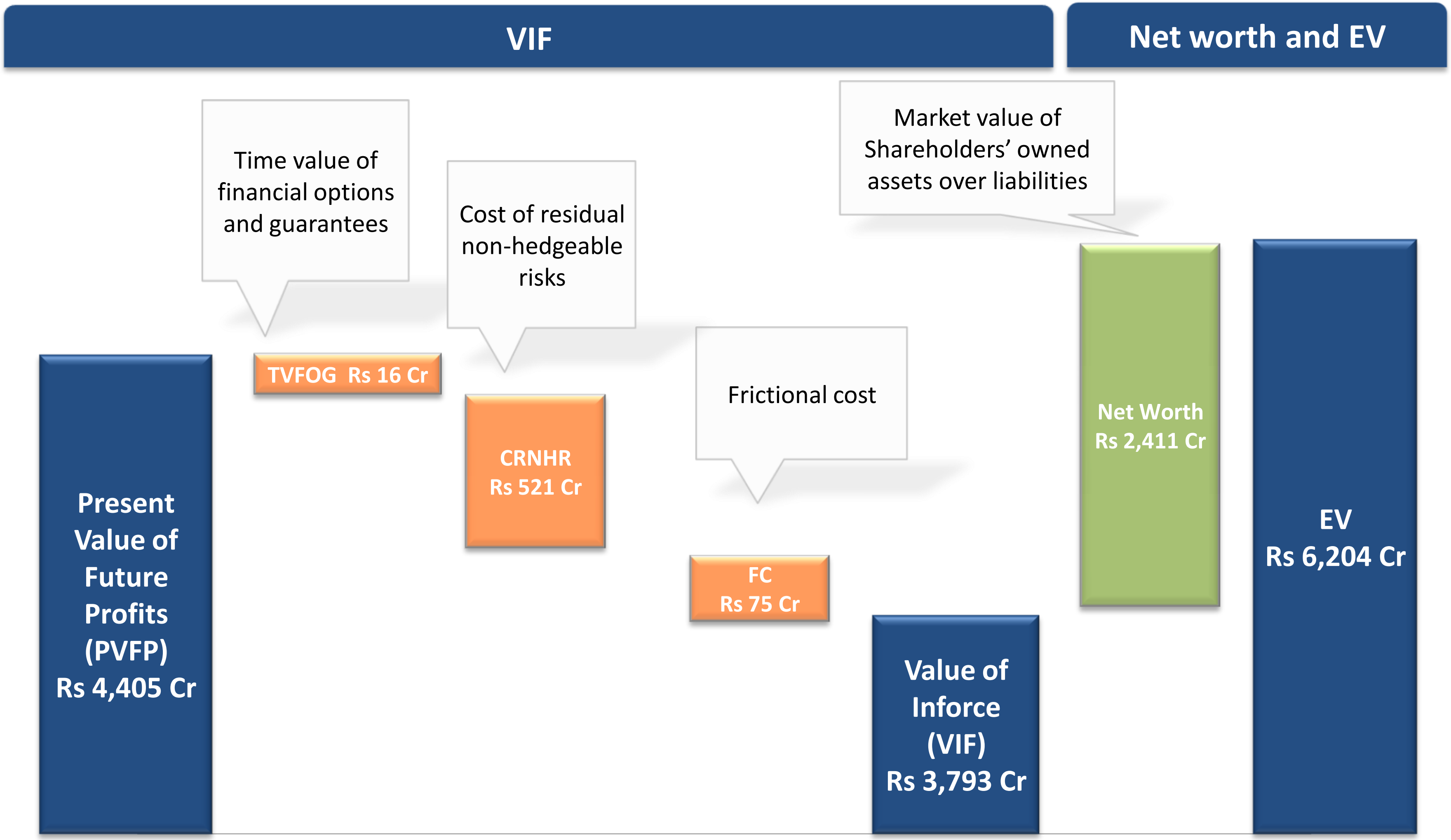
The EV as at 30th September 2016 is Rs 6,204 Cr, before allowing for the shareholder dividend payout[1] for H1 FY17.

The annualised return on EV[2] (RoEV) over H1 FY17 is 22.0 per cent while the annualised operating RoEV is 17.0 per cent.

The Value of New Business (VNB) written during H1 FY17 is Rs 183 Cr and the portfolio new business margin is 19.2 per cent (before cost overrun) and 18.5 per cent (after cost overrun).

Notes:
[1] EV post interim shareholder dividend will be Rs 6,035 Cr.
[2] The Return on EV is calculated before capital movement during the year e.g. interim dividends.

Overview of the components of the EV as at 30th September 2016



1. The deductions for risks to arrive at the VIF represent a reduction of 14% in the PVFP. The largest deduction is in respect of CRNHR.
2. Within CRNHR, persistency risk constitutes the largest risk component.

Note: Figures may not add up due to rounding

Value of New Business and New Business Margins as at 30th September 2016

Figures in Rs Cr.

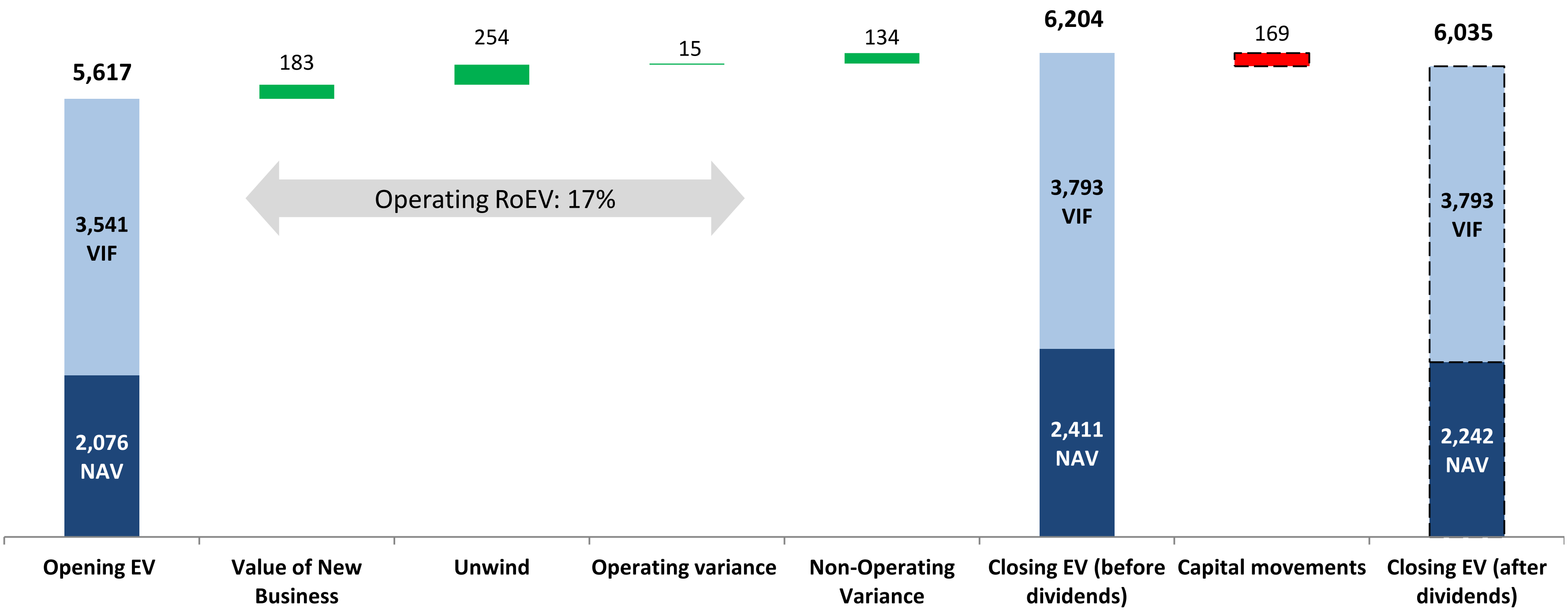
Description	H1 FY17
APE [1]	951
Value of New Business (VNB)	183
New Business Margin (before cost overrun)	19.2%
New Business Margin (post cost overrun)	18.5%

- The VNB is accumulated from the point of sale to the end of the reporting period (i.e. 30th September 2016), using the beginning of respective quarter's risk free yield curve.
- During H1 FY17, there was an acquisition operating cost over-run chargeable to shareholders of Rs 7 Cr, which implies a VNB of Rs 176 Cr and a new business margin of 18.5%, post over-runs.
- Increase in new business margin from 18.3% (reported as at 31st March 2016, before cost over-run) to 19.2% for H1 FY17 is primarily due to increase in proportion of non-participating products.

[1] Annual Premium Equivalent (APE) is calculated as 100% of regular premium + 10% of single premium.

EV movement analysis: March 2016 to September 2016

Figures in Rs Cr.



- Annualised operating return on EV of 17.0% is mainly driven by new business growth and unwind of discounting.
- Operating variance mainly constitutes the operating cost overrun chargeable to shareholders and the shareholder expenses which are more than offset by the positive impact of mortality experience variance and modeling enhancements.
- Non-operating variances are mainly driven by equity and interest rate movements since March 2016.
- The interim shareholder dividend will be accounted post 30th September 2016. Post the payment of the interim dividend, the closing EV will be Rs 6,035 Cr.

Sensitivity analysis as at 30th September 16

Sensitivity	EV		VNB	
	Value (Rs Cr)	% change	Value (Rs Cr)	% change
Base Case	**6,204**	**-**	**183**	-
Lapse/Surrender -10% increase	6,095	(2%)	172	(6%)
Lapse/Surrender -10% decrease	6,321	2%	195	6%
Mortality -10% increase	6,128	(1%)	177	(4%)
Mortality -10% decrease	6,280	1%	190	4%
Expenses-10% increase	6,152	(1%)	174	(5%)
Expenses -10% decrease	6,256	1%	192	5%
Risk free rates -1% increase	5,994	(3%)	194	6%
Risk free rates -1% reduction	6,353	2%	170	(7%)
Equity values- 10% immediate rise	6,254	1%	183	Negligible
Equity values- 10% immediate fall	6,154	(1%)	183	Negligible

1. Reduction in interest rate curve leads to an increase in the value of assets which offsets the loss in the value of future profits.
2. Risk free rate sensitivities allow for the change in cost of hedging due to derivative arrangements. The cost of hedging reduces under the risk free rate reduction sensitivity and increases under the risk free rate increase sensitivity.

Definitions of the EV and VNB

Market consistent methodology

- The EV and VNB have been determined using a market consistent methodology which differs from the traditional EV approach in respect of the way in which allowance for the risks in the business is made.
- For the market consistent methodology, an explicit allowance for the risks is made through the estimation of the Time Value of Financial Options and Guarantees (TVFOG), Cost of Residual Non-Hedgeable Risks (CRNHR) and Frictional Cost (FC) whereas for the traditional EV approach, the allowance for the risk is made through the Risk Discount Rate (RDR).

Components of EV

The EV is calculated to be the sum of:

- Net Asset value (NAV) or Net Worth: it represents the market value of assets attributable to shareholders and is calculated as the adjusted net worth of the company (being the net shareholders' funds as shown in the audited financial statements adjusted to allow for all shareholder assets on a market value basis, net of tax).
- Value of In-force (VIF) : this component represents the Present Value of Future expected post-tax Profits (PVFP) attributable to shareholders from the in-force business as at the valuation date, after deducting allowances for TVFOG, CRNHR and FC. Thus, VIF = PVFP – TVFOG – CRNHR – FC.

Covered Business

- All business of Max Life is covered in the assessment except one-year renewable group term business and group fund business which are excluded due to their immateriality to the overall EV.

Components of VIF (1/2)

Present Value of Future Profits (PVFP)

- Best estimate cash flows are projected and discounted at risk free investment returns.
- PVFP for all lines of business except participating business is derived as the present value of post-tax shareholder profits from the in-force covered business.
- PVFP for participating business is derived as the present value of shareholder transfers arising from the policyholder bonuses *plus* one-tenth of the present value of future transfers to the participating fund estate and one-tenth of the participating fund estate as at the valuation date.
- Appropriate allowance for mark-to-market adjustments to policyholders' assets (net of tax) have been made in PVFP calculations to ensure that the market value of assets is taken into account.
- PVFP is also adjusted for the cost of derivative arrangements in place as at the valuation date.

Cost of Residual Non-Hedgeable Risks (CRNHR)

- The CRNHR is calculated based on a cost of capital approach as the discounted value of an annual charge applied to the projected risk bearing capital for all non-hedgeable risks.
- The risk bearing capital has been calculated based on 99.5 percentile stress events for all non-hedgeable risks over a one-year time horizon. The cost of capital charge applied is 5% per annum. The approach adopted is approximate.
- The stress factors applied in calculating the projected risk capital in the future are based on the latest EU Solvency II directives recalibrated for Indian and Company specific conditions.

Components of VIF (2/2)

Time Value Of Options and Guarantees (TVFOG)

- The TVFOG for participating business is calculated using stochastic simulations which are based on 1,000 stochastic scenarios provided by Moody's Analytics.
- Given that the shareholder payout is likely to be symmetrical for guaranteed non-participating products in both positive and negative scenarios, the TVFOG for these products is taken as zero.
- The cost associated with investment guarantees in the interest sensitive life non-participating products are allowed for in the PVFP calculation and hence an explicit TVFOG allowance has not been calculated.
- For all unit-linked products with investment guarantees, extra statutory reserves have been kept for which no release has been taken in PVFP and hence an explicit TVFOG allowance has not been calculated.

Frictional Cost (FC)

- The FC is calculated as the discounted value of tax on investment returns and dealing costs on assets backing the required capital over the lifetime of the in-force business. Required capital has been set at 170% of the Required Solvency Margin (RSM) which is the internal target level of capital, which is higher than the regulatory minimum requirement of 150%.
- While calculating the FC, the required capital for non-participating products is funded from the shareholders' fund and is not lowered by other sources of funding available such as the excess capital in the participating business (i.e. participating fund estate).

Key Assumptions for the EV and VNB (1/2)

Economic Assumptions

- The EV is calculated using risk free (government bond) spot rate yield curve taken from FIMMDA[1] as at 30th September 2016. The spot rates beyond the longest available term of 30 years are assumed to remain at 30 year term spot rate level. The VNB is calculated using the beginning of respective quarter's risk free yield curve (i.e. 31st March 2016 and 30th June 2016).
- No allowance has been made for liquidity premium because of lack of credible information on liquidity spreads in the Indian market.
- A flat rate adjustment is made to the yield curve such that the market value of government bonds is equal to discounted value of future cash flows of those bonds.
- Samples from the un-adjusted 30th September 2016 spot rate yield curve used:

Year	1	2	3	4	5	10	15	20	25	30 +
Sep16	6.78%	6.80%	6.84%	6.97%	6.96%	6.93%	7.45%	7.33%	7.67%	7.34%
Mar16	7.29%	7.39%	7.49%	7.55%	7.77%	7.48%	8.22%	8.00%	8.30%	8.13%
Change	(0.51%)	(0.59%)	(0.65%)	(0.58%)	(0.81%)	(0.55%)	(0.77%)	(0.67%)	(0.63%)	(0.79%)

Demographic Assumptions

The lapse and mortality assumptions are approved by a Board committee and are set by product line and distribution channel on a best estimate basis, based on the following principles:

- Assumptions are based on last one year experience and expectations of future experience given the likely impact of current and proposed management actions on such assumptions.
- Aims to avoid arbitrary changes, discontinuities and volatility where it can be justified.
- Aims to exclude the impacts of non-recurring factors

[1] Fixed Income Money Market and Derivatives Association of India

Key Assumptions for the EV and VNB (2/2)

Expense and Inflation

- Maintenance expenses are based on the recent expense studies performed internally by the Company. The VIF is reduced for the value of any maintenance expense overrun in the future. The overrun represents the excess maintenance expenses expected to be incurred by the Company over the expense loadings assumed in the calculation of PVFP.
- Future CSR related expenses have been taken to be 2 per cent of post tax (risk adjusted) profits emerging each year.
- Expenses denominated in fixed rupee terms are inflated at 6.25% per annum.
- The commission rates are based on the actual commission payable, if any.

Tax

- The corporate tax rate is assumed to be 14.42% for life business and nil for pension business.
- For participating business, the transfers to shareholders resulting from surplus distribution are not taxed as tax is assumed to be deducted before surplus is distributed to policyholders and shareholders.
- Service tax is assumed to be 15% (including all relevant cess).
- The mark to market adjustments are also adjusted for tax.

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