ANNUAL REPORT FOR POLICY HOLDERS

Economic Update

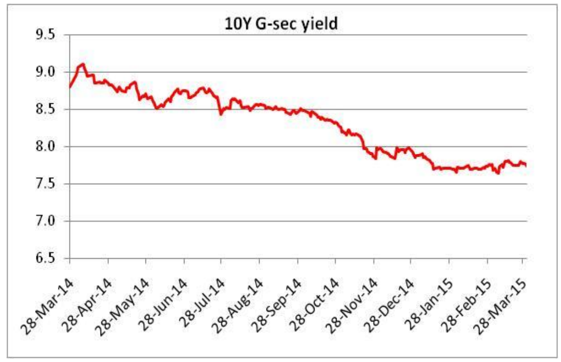
The macro economy experienced a significant turnaround during the year and economic parameters improved significantly after experiencing the turmoil in FY14. The Most significant event of the year was result of general election 2014. After a very long period, the elections delivered a verdict where a single party got absolute majority and National Democratic Alliance (NDA – II) led by BJP, came to power with Mr. Narendra Modi as the Prime Minister. The government embarked upon the medium term plan of reforms to achieve sustainable long term higher growth. Ease of doing business was on the top of the agenda and 'Make in India' was launched to give push to manufacturing sector. Long awaited measures to increase FDI in defense & insurance were cleared by the parliament. The government showed the intent to take bold decisions and get the economy moving on higher growth path. The Government also announced a new coal policy and for first time in history, India auctioned natural resources (coal) smoothly.

The big development of the global markets was the sharp fall in Oil prices. Brent Crude oil prices, which were trading around USD 107 per barrel, at the end of March 2014, had eased to levels of USD 53 per barrel by March 2015. The fall in prices was caused by a supply glut as US shale oil producers added to the oil supply in a market where demand growth was weak.

Domestically, economic parameters continued to improve in FY15. In a major overhaul, the Government announced a new GDP series based on improvised GVA (Gross Value Addition) method. As per new series Indian economy grew at 7.3% in FY15 as against 6.9% in FY14. Trade deficit continued to show improvement as crude prices fell significantly in second half of the year. Current account deficit (CAD) continued to improve and was at 1.3% of GDP for the year. Fiscal consolidation continued and for FY15 fiscal deficit was pegged at 4.1% of GDP.

RBI continued to target CPI as nominal anchor to monetary policy and followed inflation timelines approved by new government as part of new monetary policy framework. These timelines are 8% target for Jan'15, 6% for Jan'16 and 4% for Jan'18. Tight monetary policy, steep fall in commodities and crude prices lead to significant fall in inflation. WPI inflation fell from 6% in March'14 to -2% in March'15. CPI inflation eased from 8.2% to 5.3% in same period. Due to significant fall in inflation, RBI lowered policy rates twice by 25 bps each in January and March'15.

RBI also bought more than USD 50 billion dollars to increase foreign exchange reserves. As on March'15 India's forex reserves stood at USD 341billion. The improvement in macro indicators (GDP, CPI inflation, trade deficit, CAD, forex reserves etc) had an impact on the performance of the currency as well. During the year, the Indian Rupee was among the best performing Emerging Market currency. India received record FII flows of USD 27 billion in fixed income market as lower trade deficit, stable currency and high potential along with political stability attracted global investors. Further flows were restricted as FIIs exhausted sovereign debt limits of USD 30 billion. FII inflows in the equity segment were also strong and stood at USD 18 billion. Domestic investors, too, were positive on equities and Mutual Fund inflows in the equity markets stood at USD 6 billion during the year.



Market Update

Fixed Income Markets

Bond yields traded in the wide range of 8.5% to 9% in first half of the year. However, as CPI inflation started to ease in the later part of the year, yields eased significantly and market started to believe that RBI would commence easing monetary policy. Bond yields fell sharply during the second and third quarter of the year. However, even though RBI lowered policy rates by 50 bps in last quarter, bond yields did not fall further and curve steepened in last month. RBI continued to stress on 6% CPI inflation target and signaled that further easing would happen if inflation continued to ease thus creating enough room for RBI to loosen monetary policy. Also, RBI significantly altered its open market policy and turned net seller of G-sec to suck out liquidity created through forex intervention. However, significant FIIs buying helped balancing the demand for government debt. The 10-year benchmark G-Sec yield ended the year at 7.76%% in March'15 as against 8.80% in March'14.

Portfolio positioning: Duration strategy and Risk management

The funds were managed dynamically through the year with active duration management. During the first half of the year funds' durations were low due to uncertainty on the inflation front. The durations were ramped up during the year and were increased significantly in second half. The funds maintained a heavy duration overweight with respect to the benchmark due to improving

macroeconomic parameters and expectations of monetary policy easing by RBI. The fall in yields, and the resultant price gains, helped our funds outperform the benchmark returns. The asset allocation in the bond funds tilted in favour of GSecs during the year, as the corporate bond spreads compressed during the year. At narrow spreads, we saw relative value in GSecs. All investments were maintained as per our investment policy and all prudential limits and regulatory guidelines were adhered to at all points during the year.
Credit risks in the portfolios were also monitored closely. Addition of new credit exposures were made after a thorough analysis and due diligence process. Existing credits were monitored regularly for any developments that could be beneficial or detrimental to the companies' financials.

EQUITY MARKETS

The equity investment philosophy at HDFC Life is blend of bottoms up and top down approach. The global and domestic macroeconomic factors determines sector allocation while valuation determines stock selection within the sector. Equity markets had a great FY15 with BSE100 rising by 28% and CNX Midcap rising by 51%. Our portfolios delivered strong outperformance to benchmark. As we expected decisive electoral mandate and strong government at the centre our portfolios from the beginning of the year was biased towards cyclical sectors where we believed valuations were beaten down and risk reward was favorable. Hence, we were overweight Banks, Cement, Construction, Industrial Manufacturing, Agrochemicals and Oil PSU companies while being underweight on defensive sectors like Consumer Goods and IT. The only defensive sector we were overweight was Pharma which outperformed broader markets. We did however reduce our exposure to PSU Banks in favor of Private Banks as asset quality for PSU Banks deteriorated far worse than our expectations.

During the course of the year we maintained similar sector stance as the vicious economic cycle of 2010-2013 of slowing growth, elevated level of inflation and high current account and fiscal deficit was turning into virtuous cycle with improving growth, declining inflation and declining current account and fiscal deficits on back of sharp decline in commodity prices. We believe decline in commodity prices mainly oil prices can drive multi layered benefits for Indian economy with lower current account deficit, lower subsidies and easing of inflationary pressures. The market delivered strong returns in FY15 in spite of disappointing corporate earnings. We believe that after years of slack economic growth, India is on its path of economic recovery. As growth improves, commodity prices and inflation remain benign and interest rates ease, profits growth is likely to accelerate.

Portfolio Risk Management

We follow robust risk management policies in our funds. The portfolio deviations with respect the respective benchmark is maintained within defined risk limits. We have defined stock and sector level underweight / overweight positions limits vis-a-vis the benchmark and we actively track such deviations. Deviations are highlighted to portfolio manager and corrective action, if required, is taken in timely manner. Even though we maintained overweight stance on cyclical sectors through the year we operated within defined internal risk limits. We have also upgraded our risk system to MSCI Barra for portfolio performance attribution to strengthen our risk management practices.