GCR RATINGS

Credit Rating Announcement

GCR affirms New National Assurance Company Limited's national scale financial strength rating of A(ZA); Outlook Stable

Rating action

Johannesburg, 14 July 2020 - GCR Ratings ("GCR") has affirmed New National Assurance Company Limited's ("NNAC") national scale financial strength rating of A(ZA), with a Stable Outlook.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook/Watch
New National Assurance Company Limited	Financial strength	National	AZA)	Stable Outlook

The rating action follows a reduction in the South African Country and Insurance sector risk assessments.

The South African country risk score was lowered to 7.0 from 7.5 previously, in a market alert released on the 27th May 2020. Click here to access the link. On 4th June 2020, the South African Insurance sector risk score was also lowered to 8.0 from 8.75 previously. Click here to access link.

Combined, the above country and sector risk scores comprise the operating environment score, which is a key input into GCR's ratings.

Rating rationale

NNAC's national scale financial strength was affirmed with a Stable Outlook, reflecting support from very strong liquidity, while risk adjusted capitalisation was maintained within a rating adequate range, and both metrics are viewed to have sufficient buffers to withstand potential risks associated with the weak economy and the COVID-19 pandemic. Offsetting these strengths are moderately weak earnings and a very limited business profile.

NNAC's liquidity is a positive rating driver, supported by a sizeable and conservative investment portfolio, as well as relatively limited insurance risk uptake. In this respect, the investment portfolio evidences a high buffer above net technical liabilities, with cash and stressed financial assets coverage of net technical liabilities being maintained above 2.5x, while coverage of operational cash requirements increased to above 12 months during FY19. GCR believes the insurer has sufficient liquidity to cater for potential risks that may arise from the COVID-19 pandemic over the rating horizon.

Despite reduced earnings, risk adjusted capitalisation is expected to remain rating adequate, with SCR coverage projected at around 1.25x under the base case scenario. However, the rating is sensitive to reduced capitalisation metrics as a result of medium term growth in insurance risk or a weaker than expected earnings trend.

Following portfolio remediation measures implemented in recent years, the quality of NNAC's book is viewed to have improved, as reflected by consistent reductions in the net loss ratio from a high of 78% in FY15 to a fairly competitive 59% in FY19. As a result, after normalising for a large debt impairment in FY18, the insurer has posted thin positive underwriting margins over the past two years, while the return on NEP has averaged 6% (versus 3% in the prior two years). However, the expense base remains elevated even on a normalised basis, resulting in limited underwriting profit headroom in higher claiming periods. The impact of a high value claim in FY20, together with COVID-19 related pressure on premium volumes, is expected to result in reversion to an underwriting loss in FY20, while net profitability is expected to be further reduced by lower investment yields. GCR's view of earnings nevertheless factors in an expected normalisation post COVID-19 pandemic (albeit at relatively thin underwriting margins), which, if sustained, could result in a stronger earnings assessment going forward.

The busines profile is viewed to be rating negative, with potential for improvement in a more normalised operating environment. The corrective underwriting actions taken have seen NNAC's market share reduce to around 0.5% in FY19 from 1% two years ago, and growth is expected to be subdued in line with overall industry experience. Premium diversification is viewed to be healthy, with four lines of business considered to be material contributors, although net premium scale is fairly low in global terms, and business is concentrated within South Africa. In this regard, the ability of the insurer to reach critical mass while maintaining portfolio quality is likely to be a key consideration over the medium to longer term.

Outlook statement

Despite near term earnings pressure associated with the COVID-19 pandemic, the Stable Outlook considers the expected recovery from FY21 onwards, with the insurer likely to post a neutral to slightly positive underwriting margin over the medium term. Capitalisation and liquidity are viewed to be tolerant to current earnings pressure, with SCR coverage projected to register at around 1.25x and stressed investment coverage of net technical liabilities sustained above 2x, after accounting for expected base case stresses. The business profile assessment is likely to be stable over the outlook horizon, given market wide growth constraints.

Rating triggers

Positive rating action could follow over the longer term if a positive earnings trend can be established, while maintaining strong balance sheet metrics. The rating would likely be downgraded if earnings and capitalisation deteriorate below expectations.

Analytical contacts

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Insurance Companies, May 2019
GCR Ratings Scales, Symbols & Definitions, May 2019
GCR Country Risk Scores, May 2020
GCR Insurance Sector Risk Scores, June 2020

Ratings history

New National Assurance Company Limited					
Rating class	Review	Rating scale	Rating class	Outlook/Watch	Date
Financial strength	Initial*	National	A-(ZA)	Stable Outlook	September 2005
	Last	National	A(ZA)	Stable Outlook	November 2019

*Formerly claims paying ability.

Risk score summary

Rating Components and Factors	Risk scores
Operating environment	**15.00**
Country risk score	7.00
Sector risk score	8.00
Business profile	**(3.00)**
Competitive position	(2.50)
Premium diversification	(0.50)
Management and governance	0.00
Financial profile	**1.25**
Earnings	(0.25)
Capitalisation	0.00
Liquidity	1.50
Comparative profile	**0.00**
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total score	**13.25**

Glossary

Capitalisation	The provision of capital for a company, or the conversion of income or assets into capital.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Cash	Funds that can be readily spent or used to meet current obligations.
Claim	A request for payment of a loss, which may come under the terms of an insurance contract.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Investment Portfolio	A collection of investments held by an individual investor or financial institution.
Liquidity	The speed at which assets can be converted to cash. The ability of an insurer to convert its assets into cash to pay claims if necessary. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
National Scale Rating ("NSR")	National Scale credit ratings express risk in relative rank order, which is to say they are ordinal measures of credit risk and are not predictive of a specific frequency of default or loss.
Premium	The price of insurance protection for a specified risk for a specified period of time.
Rating Horizon	The rating outlook period
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term	Current; ordinarily less than one year.
Solvency	With regard to insurers, having sufficient assets (capital, surplus, reserves) and being able to satisfy financial requirements (investments, annual reports, examinations) to be eligible to transact insurance business and meet liabilities.
Underwriting	The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.
Underwriting Margin	Measures efficiency of underwriting and expense management processes.

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the rating is based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such rating is an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit rating has been disclosed to the rated party. The rating was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating. The rated entity participated in the rating process via virtual management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The information received from the rated entity and other reliable third parties to accord the credit rating included:

- Unsigned audited annual financial statements to 31 December 2019;
- Four years of comparative audited financial statements to 31 December;
- Budget and key forecast figures to 31 December 2020;
- Unaudited management accounts to 30 April 2020;
- Annual and Quarterly quantitative statutory returns at 31 December 2019 and 31 March 2020;
- A summary of the current reinsurance programme; and
- Other relevant documents