Research Update:

African Reinsurance Corp. 'A-' Ratings Affirmed On Strong Capital; Outlook Stable

May 30, 2019

Overview

- African Reinsurance Corp. (Africa Re) continues to demonstrate a prominent business position within the African reinsurance market. The group's high geographic diversification within the region, anchored by its special status, supports the resilience of its operating performance, despite recent losses in select markets.
- We are therefore affirming our 'A-' global scale ratings on Africa Re.
- The stable outlook on Africa Re reflects our view that it will continue to generate net income in line with historical averages, and maintain strong levels of capital and weighted-average credit quality.
- We are also affirming our 'A-' rating on the guaranteed subsidiary based in South Africa, African Reinsurance (South Africa) Ltd.

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Rating Action

On May 30, 2018, S&P Global Ratings affirmed its 'A-' long-term issuer credit and insurer financial strength ratings on Nigeria-based African Reinsurance Corp. (Africa Re). The outlook is stable.

At the same time, we affirmed our financial strength credit rating on the guaranteed subsidiary, African Reinsurance Corp. (South Africa) Ltd.

Rationale

The affirmation reflects our view that Africa Re continues to maintain its strong competitive position within Africa. We consider Africa Re's role as a supranational entity to promote and support the growth of the African insurance and reinsurance markets, given its focus and development mandate in the continent, generally higher-risk countries. In our view, Africa Re's special status also provides a significant competitive advantage as it allows the reinsurer to access business as a "locally admitted" insurer in many regions. Africa Re has a strong brand and reputation with many cedents across Africa, a key differentiator relative to other international and regional players on the continent.

As a result of the above, Africa Re's underwriting portfolio is still highly diversified, which supports overall net profitability. However, the group reported sustained poor underwriting result due to losses within South Africa and other regions in 2018 that weakened the net result. We believe that the various turnaround strategies and actioned underwriting plans will support improved operating performance in the next 12-24 months. We anticipate that this, combined with more selective growth in those select underperforming regions, will enable the group to generate a net combined ratio of around 95% for 2019. Thereafter, we project a net combined ratio toward the lower 90% mark in 2020 and 2021, compared with 96% in 2018 (five-year average: 93%). Africa Re's low combined ratio relative to the regional peer group and international regional players continues to support the rating.

The robust levels of capital sufficiency (as measured by our capital model) within the group are a rating strength. Africa Re has incrementally built up its capital base, with total adjusted capital expected to approach US$1 billion over the next two to three years. We also expect the company's capital levels to remain at the 'AAA' confidence level, despite any adjustment to the capital management strategy.

However, the weighted-average credit quality of Africa Re's investment portfolio continues to constrain the rating. Given Africa Re's territorial coverage and exposure, the group has investments in regions with lower investment quality. We estimate the weighted-average credit quality to be 'BBB', albeit improving toward the upper limit of this range in 2018. Notwithstanding the improvement, this constrains the overall rating of the group, given its susceptibility to financial and macroeconomic stresses in these regions given the insurer's asset and liability exposures.

Africa Re also carries high receivable balances toward select regions. Significant portions of these receivables have a duration beyond one year. Even if these balances are stripped from total adjusted capital, the entity remains comfortably above the 'AAA' confidence level. Furthermore, Africa Re's management has significantly strengthened its risk control practices related to the management of these balances. The absolute amount declined in 2018 and we expect further improvement over the medium term, with management aiming to ensure the duration is no longer than one year by 2022. This, coupled with African Re's liquid asset portfolio, has further improved the group's liquidity, which we assess as exceptional.

Africa Re's financial risk profile is also weakened by the foreign currency mismatches on its balance sheet caused by its exposures across Africa and investments denominated in U.S. dollars, as well as the accompanying bottom-line volatility. However, we note the prudent reserving practices related to this volatility, as well as tightened risk control practices demonstrated over recent periods, which somewhat mitigate this volatility.

Outlook

The stable outlook reflects our view that Africa Re will retain its competitive position across its key markets. Our base-case expectation is that Africa Re will generate a combined ratio no higher than 95%. We expect levels of capital sufficiency to remain at historical levels and well above the 'AAA' sufficiency as per our capital model. We also expect Africa Re will maintain credit counterparties of similar strength within its investment portfolio and quality of cedents.

Upside scenario

We see a positive rating action as unlikely in the next 12-24 months. However, we could raise the ratings on Africa Re if its risk exposures improves, namely to higher weighted-average credit quality at the 'A' range from the current high 'BBB' level, combined with enhanced risk controls.

Downside scenario

We would lower the rating on Africa Re over the next 12-24 months if:

- Its competitive position deteriorated as a result of volatile operating performance in key markets.
- Its average credit quality deteriorated to the 'BB' level.
- Sustained earnings volatility translated into losses that weakened our capital assessment beyond our expectations.

Ratings Score Snapshot

African Reinsurance Corp.

Ratings Score Snapshot

	To	From
Financial Strength Rating	A-/Stable/--	A-/Stable/--
Anchor	a-	a-
Business Risk Profile	Satisfactory	Satisfactory
IICRA	High Risk	High Risk
Competitive Position	Strong	Strong
Financial Risk Profile	Strong	Strong
Capital and Earnings	Very Strong	Very Strong
Risk Position	Moderate Risk	Moderate Risk
Financial Flexibility	Strong	Strong
Modifiers	0	0
ERM and Management	0	0
Enterprise Risk Management	Adequate	Adequate
Management and Governance	Satisfactory	Satisfactory
Holistic Analysis	0	0
Liquidity	Exceptional	Strong
Support	0	0
Group Support	0	0
Government Support	0	0

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria

- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- Criteria | Insurance | General: Enterprise Risk Management, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed	
African Reinsurance Corp.	
Issuer Credit Rating	
Local Currency	A-/Stable/--
African Reinsurance Corp.	
African Reinsurance Corp. (South Africa) Ltd.	
Financial Strength Rating	
Local Currency	A-/Stable/--

Regulatory Disclosures

African Reinsurance Corp.

- Primary Credit Analyst: Trevor Barsdorf, Associate
- Rating Committee Chairperson: Johannes Bender
- Date initial rating assigned: Nov. 26, 1996
- Date of previous review: May 30, 2018

African Reinsurance Corp. (South Africa) Ltd.

- Primary Credit Analyst: Trevor Barsdorf, Associate
- Rating Committee Chairperson: Johannes Bender
- Date initial rating assigned: Nov. 28, 2014

- Date of previous review: May 30, 2018

Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

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Glossary

- Anchor: The starting point for rating an insurer, based on S&P Global Ratings' assessments of the business and financial risk profiles.
- Business risk profile (BRP): Assesses the risk inherent in the insurer's operations and therefore the potential sustainable return to be derived from those operations.
- Capital and earnings: Measure of an insurer's ability to absorb losses.
- Combined ratio: The ratio of the sum of loss expense, loss adjustment expense, and operating expenses divided by premiums earned.
- Competitive position: An assessment based on an insurer's operating performance, branding, market position, diversification and control over its distribution channels.
- Date initial rating assigned: The date S&P Global Ratings assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Ratings last reviewed the credit rating on the entity.
- Earnings before interest and taxation (EBIT): Profit before tax and interest expenses.
- Enterprise risk management (ERM): Our assessment of ERM examines whether insurers execute risk management practices in a manner that effectively limits future losses.
- Financial flexibility: The balance between an insurer's sources and uses of external capital and liquidity over the current and next two years.
- Financial risk profile (FRP): The consequence of decisions that management makes in the context of its business risk profile and its risk tolerances.
- Financial strength rating (FSR): A forward-looking opinion about the financial security

characteristics of an insurer with respect to its ability to pay under its insurance policies and contracts, in accordance with their terms.

- Fixed-charge coverage: Addresses an insurer's ability to service interest on financial obligations out of EBITDA.
- Foreign exchange risk exposure: Assesses currency mismatches between assets and liabilities (including equity). The criteria define a significant mismatch as more than about 10% of total insurer's liabilities.
- High-risk assets: Volatile or illiquid assets.
- Insurance Industry And Country Risk Assessment (IICRA): Addresses the risks typically faced by insurers operating in specific industries and countries, and is generally determined at a country or regional level.
- Issuer credit rating (ICR): A forward-looking opinion about an obligor's overall creditworthiness, focusing on its capacity and willingness to meet its financial obligations in full and as they come due.
- Return on revenue (ROR): Total revenue is used to capture net premiums from underwriting activities as well as investment income and fees generated as a result of those underwriting activities. Where total revenue is not reported, it is the sum of the net premiums earned, net investment income, and other income.
- Risk position: Assesses material risks not incorporated in the capital and earnings analysis and specific risks that could affect the volatility of an insurer's TAC.
- Return on equity (ROE): Measures the return available to stockholders.
- Calculated as reported net income divided by the year-end average of reported stockholders' equity for the past two years.
- Stand-alone credit profile (SACP): S&P Global Ratings' opinion of an insurer's creditworthiness, in the absence of extraordinary intervention from its parent, affiliate, or related government.
- Total adjusted capital (TAC): S&P Global Ratings' measure of the capital an insurer has available to meet capital requirements.
- Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria.

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