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GIC Re South Africa 'BB+/zaA+' Ratings Affirmed; Outlook Stable

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In our view, GIC Re South Africa Ltd. (GIC Re SA) remains supported by its parent GIC Re. This is reflected in its robust capital position, particularly via the planned capital injection in 2017 following the increase in 2016.

Operating performance is weak and its competitive position is limited. This mostly reflects the difficult operating conditions in GIC Re SA's core markets, notably the highly competitive South African sector.

We are affirming our 'BB+' global scale and 'zaA+' national scale ratings on GIC Re SA.

The stable outlook reflects our opinion that the company will remain well supported by its parent. Hence, we expect it to retain its strategic status to GIC Re.

On July 20, 2017, S&P Global Ratings affirmed its long-term counterparty credit and insurer financial strength ratings on GIC Re South Africa Ltd. (GIC Re SA) at 'BB+'. The outlook is stable.

At the same time, we affirmed our South Africa national scale rating at 'zaA+'.

The affirmation primarily reflects GIC Re SA's weak operating performance and its limited competitive position, offset by strong support from its parent, GIC Re. In particular, the company's financial profile is likely to benefit significantly from a planned capital injection of South African rand (ZAR) 910 million (US\$70 million) by the end of September 2017. This is likely to facilitate the buildup of the company's business position as well as its risk-adjusted capital.

In our view, the company's weak operating performance reflects its start-up-like characteristics. We recognize GIC Re SA recorded strong growth in its first three years of operation but has not managed to maintain bottom-line profitability. It has posted weak underwriting results, particularly compared to some of its peers in the region. At year-end March 2017, it posted a high combined (loss and expense) ratio of 126%. This, coupled with foreign exchange losses, led to a bottom-line loss (ZAR27 million). We forecast that the company is likely to post combined ratios above 100% over 2017 and 2018, partly reflecting the difficult operating conditions and competitive market.

After the planned capital injection, we believe that the company's capitalization will be better positioned to absorb potential large losses, and support our growth projections. We forecast that its risk-based capital (measured using our model) is likely to remain at the 'AAA' range over the next two to three years.

We believe premium growth of between 20%-40% is likely to be achieved over the coming three years through new business and growth in its existing business. The insurer continues to pursue an organic growth strategy within key regions, which has translated into strong premium growth within South Africa. We consider the economic and industry environment within South Africa (accounting for about 60% of its gross premium) to be challenging and highly competitive. Outside South Africa, core markets include Kenya and Nigeria. These regions are characterized by weaker economies and challenging operating environments.

In our opinion, GIC Re SA is exposed to foreign currency mismatches on its balance sheet caused by its exposure across Africa and investments denominated in U.S. dollars. This has led to bottom-line volatility. GIC Re SA has sought to introduce enhanced asset-liability matching in this regard. Nevertheless, its earnings are exposed to volatility from translation changes, particularly relating to African emerging markets given the volatility of the South African rand.

The entity maintains a conservative investment stance and well-diversified investment base. However, we consider its concentration in the South African financial sector introduces some financial risk.

We view the parent as providing retrocession support to the entity. This, combined with the capital injections, supports our assessment of GIC Re SA's financial flexibility.

We apply a one-notch negative adjustment to reflect the start-up nature of the reinsurer and the accompanying execution risk in a competitive market. The robust growth target amid difficult business conditions raises the possibility of accessing weaker quality business, thereby undermining profitability over the medium term.

We consider GIC Re SA to be of strategic importance to the parent given its integration with the parent and role within broader group strategy. We also believe GIC Re SA's ownership gives the group and the subsidiary greater financial flexibility through access to capital and liquidity when needed. We uplift our ratings on GIC Re SA by one notch due to support from the parent.

The outlook on the entity reflects our opinion that the company will remain well supported by the parent and retain its strategic status to GIC Re. In particular, we factor in the capital injection from the parent during the third-quarter of 2017. The outlook also reflects our expectation that the entity will continue to post a net income loss at year-end 2017, before breaking even during 2018 and 2019. This primarily reflects the difficult operating conditions in its key markets, exacerbated by the entity being a new entrant gaining scale in the mature South African market.

Downside scenario

We could lower the ratings over the next 12-24 months if the quantum or timing of the capital injection is smaller or lags our expectations, or we see group support weakening. This could also arise if earnings are weaker and/or volatility increases beyond our expectations. A further weakening of the competitive position could also place negative pressure on the ratings.

Upside scenario

We are unlikely to raise the ratings over the next 24 months, at least not until underwriting performance improves significantly.

RELATED CRITERIA AND RESEARCH

Related Criteria

General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables (/en_US/web/guest/article/-/view/sourceId/9657903) - June 01, 2016

General Criteria: National And Regional Scale Credit Ratings (/en_US/web/guest/article/-/view/sourceId/8709224) - September 22, 2014

General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions (/en_US/web/guest/article/-/view/sourceId/8343660) - November 19, 2013

General Criteria: Group Rating Methodology (/en_US/web/guest/article/-/view/sourceId/8336067) - November 19, 2013

Criteria - Insurance - General: Enterprise Risk Management (/en_US/web/guest/article/-/view/sourceId/7954499) - May 07, 2013

Criteria - Insurance - General: Insurers: Rating Methodology (/en_US/web/guest/article/-/view/sourceId/7916733) - May 07, 2013

General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers (/en_US/web/guest/article/-/view/sourceId/7629699) - November 13, 2012

Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model (/en_US/web/guest/article/-/view/sourceId/5900264) - June 07, 2010

General Criteria: Use Of CreditWatch And Outlooks (/en_US/web/guest/article/-/view/sourceId/5612636) - September 14, 2009

Related Research

South Africa Long-Term Foreign Currency Rating Cut To 'BB+' On Political And Institutional Uncertainty; Outlook Negative (<https://www.capitaliq.com/CIQDotNet/CreditResearch/SPResearch.aspx?articleId=&ArtObjectId=20027453&ArtRevid=26&sid=&sind=A&>), April 3, 2017

Insurance Industry And Country Risk Assessment: South Africa Property/Casualty (<https://www.capitaliq.com/CIQDotNet/CreditResearch/SPResearch.aspx?articleId=&ArtObjectId=9825316&ArtRevid=1&sid=&sind=A&>), Oct. 12, 2016

REGULATORY DISCLOSURES

Primary Credit Analyst: Trevor Barsdorf, Rating Analyst
Rating Committee Chairperson: Mark Nicholson
Date initial rating assigned: July 20, 2015
Date of previous review: July 7, 2016

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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.

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.

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.

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