GCR RATINGS

Credit Rating Announcement

GCR affirms Santam Limited's international and national scale financial strength ratings of BB+ and AAA(ZA) respectively; Outlooks revised to Stable from Negative on solvency resilience

Rating action

Johannesburg, 10 November 2021 - GCR has affirmed Santam Limited's ("Santam") international scale financial strength rating of BB+, with the Outlook revised to Stable from Negative. GCR has also affirmed Santam's national scale financial strength and national scale long term issuer ratings of AAA(ZA) and AA+(ZA) respectively, with the Outlooks revised to Stable from Negative. Furthermore, national scale long term issue ratings of Santam's outstanding subordinated callable notes (Stock Codes SNT03, SNT04, SNT05) have been affirmed at AA-(ZA), with Outlooks revised to Stable from Negative. Simultaneously, GCR has withdrawn the national scale long term issue rating of AA-(ZA) on SNT02 notes, which were redeemed in full on 12 April 2021.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook/Watch
Santam Limited	Financial strength	National	AAA(ZA)	Stable Outlook
	Financial strength	International	BB+	Stable Outlook
	Long term issuer	National	AA+(ZA)	Stable Outlook
SNT02	Long term issue	National	WD	--
SNT03			AA-(ZA)	Stable Outlook
SNT04			AA-(ZA)	Stable Outlook
SNT05			AA-(ZA)	Stable Outlook

Rating rationale

The rating affirmation reflects Santam's resilient financial profile and business persistency amidst Covid-19 headwinds. The insurer managed capital within a rating adequate range despite elevated earnings pressure and maintained its market position in both domestic and external markets. Furthermore, we believe that a level of clarity on contingent business interruption ("CBI") claims has been attained, thereby reducing risks to our forward-looking view on earnings.

The Santam group maintained solvency levels of slightly above 160% at both FY20 and 1H F21 under the Economic Internal Model ("EIM"), against a 150% to 170% internal target range. Capital was largely supported by positive internal capital generation and the retention of full profits, while insurance exposures and market charges (reduced by the impairment of the Saham investment and lower equity prices) were well contained. Although solvency is supported by subordinated debt, qualifying as Tier II capital (24% of equity at 1H F21), the impact on capital quality is somewhat balanced by our positive view on financial flexibility. Looking ahead, we expect the insurer's EIM SCR coverage ratio to oscillate around the midpoint of the target range over the medium term, given reduced risk to earnings, a supportive dividend policy and premium growth pressures.

Notwithstanding underwriting susceptibility to catastrophe risks and large claims, earnings display through-the-cycle stability with the elevated CBI claims trimming the five-year rolling average underwriting margin by a moderate 2 percentage points to 5.4% in FY20. Noting increased clarity on a number of parameters for the settlement of CBI claims, following the 3Q F21 judgement on the indemnity period and the triggering of reinsurance responses, we view reserving risk to have reduced significantly from end-FY20 enhancing earnings predictability. In this respect, we project an improvement in the underwriting margin to c.6% in FY21 (1H F21: 5.5%; FY20: 1.4%), albeit with suppressed investment yields likely to confine the return on revenue within the 7% to 9% band over the medium term.

Liquidity remains a key rating sensitivity, given the maintenance of a slim surplus (after stressing risk assets) over net technical liabilities in the wake of elevated CBI claims. Nonetheless, we see subsiding reserving risks and a more liquid asset profile as potential risk mitigants. Testament to this, cash and stressed assets coverage of net technical liabilities increased towards the upper boundary of our 1.0x to 1.2x range at FY20, with the unstressed assets coverage of net technical liabilities having been maintained at a stable 1.93x at 1H F21. In this respect, the displayed trend could support an improvement in the factor's assessment if sustained over the rating horizon.

Santam evidences a broad-based business model, with its major brands ranking among the leading in intermediated, alternative risk transfer and direct businesses. The insurer also holds prominent positions in specialist businesses and leads risk uptake in multiple risk classes. The model has supported a market share of short-term industry gross premiums of c.24% and relative market share that is well in excess of our 6x threshold. Nonetheless, gross premium growth could remain slower than anticipated, evidencing risk of underperforming wider market trends. In this respect, progress in enabling broker platforms and enhancing direct and specialist business strategies among other growth initiatives represent key factors in defending market position over the medium to longer term.

The ratings derive upliftment from implied parental support, given relevance to Sanlam Limited group's strategy, history of performance, and contribution towards earnings diversification.

The negative one notch spread on the national scale long-term issuer credit rating reflects the regulatory subordination of senior unsecured creditors to policyholders. A further negative two notch spread on the notes reflects the subordinated status and mandatory deferability of the notes (if there is a Regulatory Deficiency Redemption or Interest Deferral Event).

Outlook statement

We expect Santam to maintain the EIM SCR within the target band of 150% to 170% in line with the group capital management strategy. This should be largely consistent with rating adequate SAM Standard Formula SCR and liquidity coverage. The business profile shows good levels of persistency that support through-the cycle underwriting margins within our modelled 5% to 7% range. In this respect, our view on earnings is unlikely to change over the medium term.

Rating triggers

The national scale financial strength rating is at the ceiling and the international scale rating is unlikely to improve over the medium term, given operating environment constraints. Conversely, negative rating action could follow increased pressure on liquidity or failure to manage earnings capacity in line with 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, October 2021
GCR Insurance Sector Risk Scores, September 2021

Ratings history

Rated Entity / Issue	Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Santam Limited	Financial strength	Initial*	National	AAA(ZA)	Stable Outlook	May 2009
		Last		AAA(ZA)	Negative Outlook	December 2020
	Financial strength	Initial*	International	A-	Stable Outlook	July 2013
		Last		BB+	Negative Outlook	December 2020
	Long term issuer	Initial	National	AA+(ZA)	Stable Outlook	November 2019
		Last		AA+(ZA	Negative Outlook	December 2020
SNT02**	Long term issue	Initial	National	AA-(ZA)	Stable Outlook	November 2019
		Last		AA-(ZA)	Negative Outlook	December 2020
SNT03**	Long term issue	Initial	National	AA-(ZA)	Stable Outlook	November 2019
		Last		AA-(ZA)	Negative Outlook	December 2020
SNT04**	Long term issue	Initial	National	AA-(ZA)	Stable Outlook	November 2019
		Last		AA-(ZA)	Negative Outlook	December 2020
SNT05	Long term issue	Initial/last	National	AA-(ZA)	Negative Outlook	December 2020

*Formerly claims paying ability.
** Ratings were not accorded to individual notes prior to November 2019.

Risk score summary

Rating components and factors	Risk score
Operating environment	**14.00**
Country risk score	6.50
Sector risk score	7.50
Business profile	**3.25**
Competitive position	1.50
Premium diversification	1.75
Management and governance	0.00
Financial profile	**(0.25)**
Earnings	0.75
Capitalisation	0.00
Liquidity	(1.00)
Comparative profile	**1.00**
Group support	1.00
Peer analysis	0.00
Total score	**18.00**

Glossary

Assets	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Capital	The sum of money that is invested to generate proceeds.
Capitalisation	The provision of capital for a company, or the conversion of income or assets into capital.
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.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Distribution Channel	The method utilised by the insurance company to sell its products to policyholders.
Gearing	Gearing (or leverage) refers to the extent to which a company is funded by debt and can be calculated by dividing its debt by shareholders' funds or by EBITDA.
International Scale Rating LC	International local currency (International LC) ratings measure the likelihood of repayment in the currency of the jurisdiction in which the issuer is domiciled. Therefore, the rating does not take into account the possibility that it will not be able to convert local currency into foreign currency or make transfers between sovereign jurisdictions.
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.
Premium	The price of insurance protection for a specified risk for a specified period of time.
Rating Horizon	The rating outlook period
Statutory	Required by or having to do with law or statute.
Subordinated Debt	Debt that in the event of a default is repaid only after senior obligations have been repaid. It is higher risk than senior debt.
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 ratings are based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings are an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to the rated entity. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings. 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 Santam Limited and other reliable third parties to accord the credit ratings included:

- The audited financial statements to 31 December 2020;
- Four years of comparative audited financial statements to 31 December;
- Reviewed interim results to 30 June 2021;
- Budgeted and forecast financial statements to 31 December 2021;
- Santam group and company Own Risk and Solvency Assessment Report to 31 December 2020;
- Santam group statutory return to 30 June 2021; and
- Other related documents.