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Old Mutual Ltd.

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Credit Highlights

Overview	
Key strengths	**Key risks**
Leading life, savings, and property/casualty (P/C) insurance provider in South Africa.	Potential losses from COVID-19-related exposures.
A sound balance sheet, thanks to prudent capitalization, reserve buffers, and product structures.	Weaker asset quality of balance sheet, given that the majority of assets are locally denominated and South Africa's economic conditions.
Healthy financial leverage and fixed-charge coverage metrics.	Heightened economic risk in South Africa weighs on revenue and earnings, as is the case for local peers, such as Sanlam and Liberty.

S&P Global Ratings believes Old Mutual Ltd. (OML) will retain its market leading positions within the South African life and P/C markets. OML is the dominant South African life insurer, particularly in lower socioeconomic groups. It also has robust positions within higher socioeconomic groups and the South African P/C insurance market.

COVID-19-related losses and South African macroeconomic pressures pose potential financial risks. There is still significant uncertainty regarding the potential impact of the pandemic on mortality and persistency experience, business interruption claims, and new business and investment losses. Additionally, while OML is well capitalized, both according to our risk-based capital model ('A' level) and on a regulatory basis (182% as of half-year 2020), its significant exposure to lower-rated assets ultimately constrains our assessment of its financial risk profile. Our base-case assumption is that OML will maintain its financial profile and capital adequacy over 2020-2021.

Notwithstanding the global recession, we expect OML's financial leverage and fixed-charge coverage will remain strong. At end-2019, OML's leverage and coverage was about 14% and 13x, respectively. We expect OML's leverage will remain below 20% over the next two years. We anticipate that the fixed-charge coverage ratio could drop below 4x in 2020 on account of the pandemic-related impact on net earnings, but will recover to over 4x in 2021.

Outlook

The stable outlook on OML (with OMLACSA being core to OML) reflects our stable outlook on South Africa (local currency BB/Stable/B; foreign currency BB-/Stable/B). We rate OMLACSA one notch above the 'BB-' long-term foreign currency rating on South Africa. This reflects our belief that OMLACSA's largely loss-absorbing liability profile allows it to withstand the stress associated with a foreign currency sovereign default.

In our base case, we assume that OML and OMLACSA, over the next 12 months, will maintain the strength of their balance sheets in the face of the current health emergency and the strong competitive standing in the South African market.

We cap our global scale ratings on OMLACSA at the 'BB' long-term local currency rating on South Africa. This is because, in our view, OMLACSA's asset and liability concentration in the domestic economy makes it susceptible to the financial and macroeconomic stresses associated with a local currency sovereign default.

Downside scenario

We could lower the ratings on OML (and OMLACSA) if we were to lower our local currency sovereign credit ratings on South Africa.

We could also lower the ratings if:

- Dividends and other capital outflows reduce capital adequacy;
- Earnings fundamentals deteriorate (for example, the new business margin fell below industry average on a prolonged basis);
- Deterioration in the risk exposure, for example, a weakening in the credit quality of assets; or
- The balance sheet weakens to the extent that OML failed to pass our sovereign foreign currency default stress scenario.

For OMLACSA, specifically, we could take a negative rating on if we no longer viewed it as core to OML.

Upside scenario

We could raise the rating on OML (and OMLACSA) over the next 12 months if we were to raise our local currency sovereign credit ratings on South Africa.

Given the linkages between the sovereign credit rating and that on OML, it is unlikely that an improvement in OML's stand-alone characteristics would, by itself, lead to an upgrade.

Key Assumptions

- South African real GDP will contract by 8.2% in 2020, then rebound by 5% and 2.3% in 2021 and 2022, respectively.
- Inflation of 3%-5% through 2022.
- Unemployment, which stood at 28.7% at end-2019, will increase to 30%-34% through 2022.

Table 1

Economic Forecast Summary | South Africa								
	2015	**2016**	**2017**	**2018**	**2019**	**2020F**	**2021f**	**2022f**
Key indicators								
GDP (Real, YoY%)	1.2	0.4	1.4	0.8	0.2	(8.2)	5.0	2.3
CPI (Average, YoY%)	4.6	6.3	5.3	4.6	4.1	3.3	4.0	4.4
CPI (Q4 Average, YoY%)	4.9	6.6	4.7	4.9	3.7	3.4	4.0	4.4
Unemployment (%)	25.4	26.7	27.5	27.1	28.7	33.8	30.8	30.1

f--Forecast. GDP--Gross domestic product. CPI--Consumer price index. YOY--Year on year. Q--Quarter. Source: S&P Global Economics, S&P Global Ratings, Oxford Economics.

Key Metrics					
(Mil. ZAR)	**2017**	**2018**	**2019**	**2020f**	**2021f**
Net income	20,364	42,708*	9,655	0-1,500	About 5,000
S&P Global Ratings capital adequacy	Strong	Satisfactory	Satisfactory	Satisfactory	Satisfactory
EBITDA fixed-charge coverage (x)	5.3	11.7	13.3	<4.0	>4.0
Financial leverage (%)	10.9	11.4	13.5	<20.0	<20.0

ZAR--South African rand. f--Forecast. Data reflects S&P Global Ratings' base-case assumption. Figures relate to Old Mutual Limited, data not available prior to 2017. EBITDA fixed-charge coverage is calculated excluding collateral held. 2018 and prior capital adequacy nomenclature is based on old criteria. *Net income for 2018 includes the accounting impacts of the transactions executed to complete the managed separation, including the distribution of Quilter plc and the unbundling of Nedbank.

Business Risk Profile

OML, through its 100% ownership of OMLACSA, is the leading player in the life and saving insurance industry in South Africa. It reported consolidated gross premiums earned of South African rand (ZAR) 81 billion (about $5.7 billion using the Dec. 31, 2019, exchange rate) and assets under management of ZAR865 billion at year-end 2019. OMLACSA holds a leading position in both the retail ("Mass and Foundation Cluster") and corporate segments.

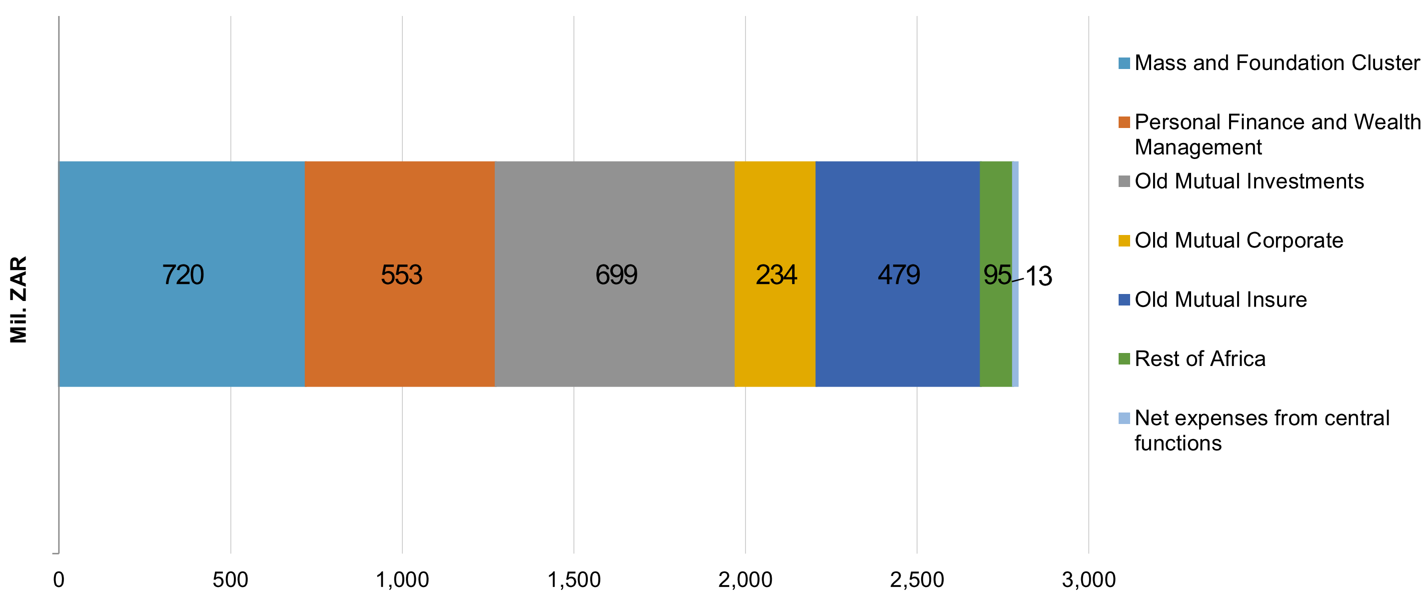
In the retail market, OMLACSA is leading the traditional player in the low-income segment ("Mass and Foundation Cluster"), while it holds top-three positions in most of the middle-income segments. OMLACSA is a top-three player in the high-net-worth business, and is the market leader in the corporate segment. OMLACSA draws its strength from its large product offering in both the with-profit segment, where it leads the market, and in unit-linked offers.

In addition to South Africa's main life insurer, OMLACSA, OML also owns a number of African insurance operations across East/West Africa and the Southern African Development Community (SADC) region, albeit these are small in both absolute and relative terms for OML. OML also owns 100% of Old Mutual Insure (OMI), a South African P/C insurer. Its key peers are Liberty, Discovery, MMI, and Sanlam in the life and savings market and Santam in the P/C sector.

At half-year 2020, OML identified COVID-19-related losses of ZAR2.8 billion, encompassing exposure from mortality and persistancy experience, business interruption claims, and investment and credit losses. We note uncertainty around estimation of the losses, given the effects of the pandemic on the economy and judgement of court cases for business interruption policies. Factoring in these losses, results from operations declined to ZAR1.5 billion, a fall of 66% over the same period last year. New business value and margins fell to ZAR125 million and 0.5% respectively, from ZAR862 million and 2.4% at half-year 2019. The high court ruling on Nov. 25, 2020, against the insurer could lead to further provisions for business interruption claims. We anticipate that the OML's top-line may remain pressured over the next two years, as social distancing impacting face-to-face sales and macroeconomic factors, such as rising unemployment and lower disposable income, feed through to retail and corporate customers. We believe that the company will undertake initiatives to manage its cost structure and maintain underwriting discipline in response. In our base case, we expect that OML will be able to maintain a sound operating performance and its leading market position over the next two years.

Chart 1

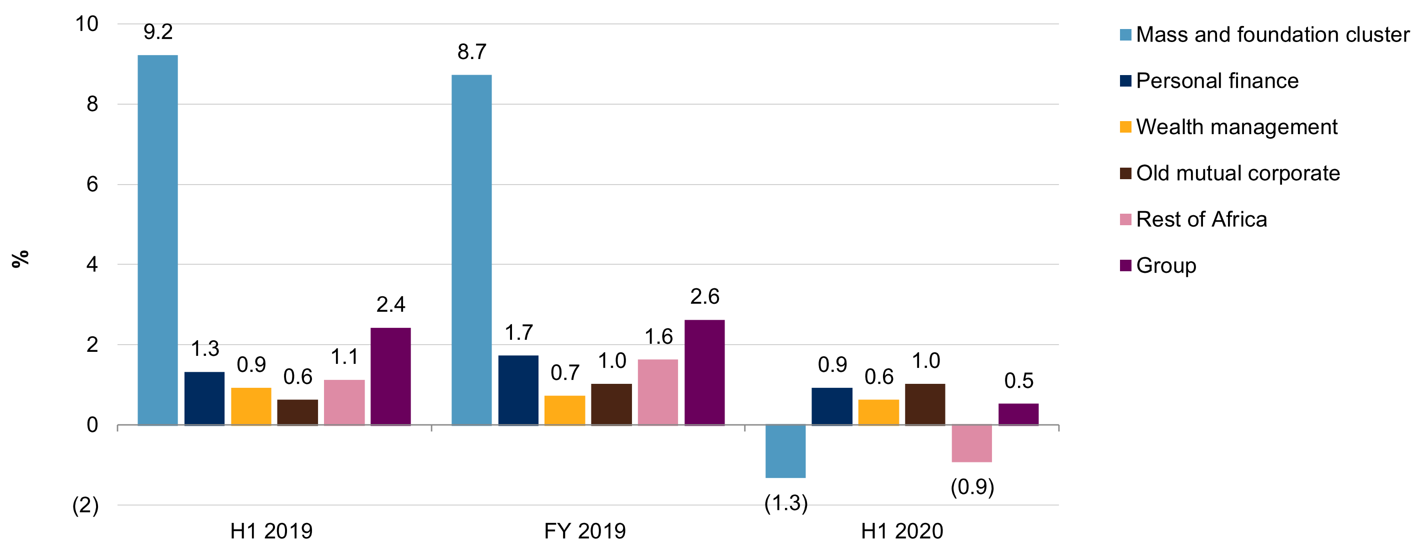
OML's Reported COVID-19-Related Losses at Half-Year 2020 By Segment
Total earnings of ZAR2.8 billion



ZAR--South African rand. Source: S&P Global Ratings.

Chart 2

New Business Margins (%)
H1 2020 margins impacted by lower sales volumes due to the lockdown, relative to high fixed distribution costs



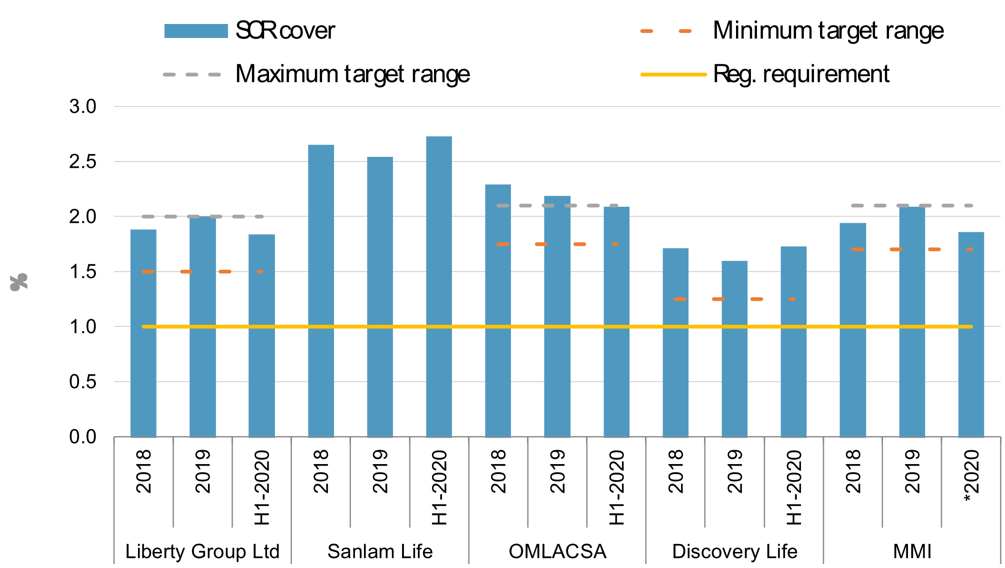
H1--First half. FY--Fiscal year. Source: S&P Global Ratings.

Financial Risk Profile

The impact from the pandemic and market turmoil has led to a significant net loss of ZAR5,998 million (including ZAR8,547 million of impairment losses recognized for Nedbank) at half-year 2020 compared with net profits of ZAR5,952 million at half-year 2019. Given OML's large balance sheet, the losses at half-year have not materially deteriorated its capital adequacy, partly supported by deferring the decision on dividends to year-end. We note that OML continues to face uncertainties such as potential exposures from business interruption claims and credit risk. Our current assumption is that COVID-19-related losses will not lead to a capital event for OML, and it will take management actions to maintain its sound balance sheet.

Chart 3

Top-Tier South African Life Insurance Solvency Capital Requirements
OML Group and OMLACSA comfortably met target as of H1 2020



1H--First half. Source: S&P Global Ratings, Audited Financial Statements. Data as of Dec. 31, 2019. *1Q 2020. Sanlam Life Insurance Ltd. (Stated target range only available for Sanlam Life covered business excluding strategic participations, discretionary capital and other capital not allocated to covered business); Old Mutual Life Assurance Company (South Africa) Ltd. 2020 SCR as of June 30, 2020; Momentum Metropolitan Holdings Limited (MMi) year-end is June 30.

The resilience of OML's balance sheet to market volatility is supported by substantial buffers within OMLACSA's with-profit policyholder funds (WPF). Such buffers, in particular the bonus-smoothing reserves and the nonvested part of the bonuses, could offset the potentially high volatility due to substantial investment in equities within the WPF (60%-70% of invested assets). Smoothed-bonus reserves comprise nearly half of OMLACSA's reserves, while unit-linked funds, mostly without investment guarantees, make up a similar level and nonprofit reserves the remainder (less than 15%).

This liability profile, which includes significant mechanisms for sharing profits and losses with policyholders (including the ability to make negative bonus declarations, as well as market risk hedging programs), contributes to our view of the balance sheet's resilience to investment market volatility. In addition, most products pay market value on termination. The loss-sharing feature was seen in action when OML declared a minus 5% bonus in April 2020 in its absolute growth portfolio, demonstrating the capital levers to absorb unprecedented market volatility. That said, we continue to believe that the highly competitive nature of the savings market and high policyholder expectations might discourage OML from making full use of the loss-sharing mechanisms in less extreme stress events.

OML's capital adequacy is constrained by its lower asset quality. The average credit quality of OML's asset portfolio is within our 'BB' rating range because the significant majority of its assets are held as bank deposits (in local banks) and local currency sovereign bonds. OML also maintains substantial asset exposure to high-risk assets, such as equities, properties, loans, and speculative-grade and unrated bonds, although the profit-and-loss sharing mechanisms described above also mitigate this. On a regulatory basis, at half-year 2020, OML reported a group solvency ratio of 182% with OMLACSA reporting 208%. OML therefore sits comfortably within its target range of 155%-175%, with OMLACSA within its 175%-210% target.

Supporting the balance sheet strength is the modest financial leverage at 14% for end-2019. We expect that leverage will remain below 20% over the next two years. We anticipate that the fixed-charge cover could fall below 4x in 2020 on account of COVID-19-related provisions and losses but improve to above 4x in 2021. Our view of OML's anchor is influenced by our view of its capital levels, balance sheet strength, and underwriting margins compared with most of its similarly rated peers.

Other Key Credit Considerations

Governance

We believe that OML benefits from sound governance and risk management. We note that with the pandemic and subsequent lockdowns, the company has transitioned into a remote working and operating model. We note the focus on developing a strong IT infrastructure and an agile operating model, which could enable OML to become more cost efficient and maintain its market position.

Liquidity

OMLACSA's liability bias toward smoothed with-profit business and the related heavy exposure to equities support heavy charges under our liquidity analysis, compared with insurers with asset allocations mostly geared toward investment-grade bonds. Still, OMLACSA and OML boast exceptional liquidity thanks to the liquid nature of investments backing liabilities, and because of their ability to apply market value adjustments in case of a lapse surge in a stressed market.

Ratings above the sovereign

We cap our global scale ratings on OMLACSA at the 'BB' long-term local currency rating on South Africa. This is because, in our view, OMLACSA's asset and liability concentration in the domestic economy makes it susceptible to the financial and macroeconomic stresses associated with a local currency sovereign default.

Factors specific to the holding company

We base our ratings on OML on the overall creditworthiness of the OML group and OML's structural subordination as a nonoperating holding company.

Group support

OMLACSA is, and will likely remain, by far the largest subsidiary of OML, representing approximately 78% of OML's total assets, and 70% of its gross earned premiums, at end-2019. We therefore assess OMLACSA as core to the group.

Accounting considerations

OML reports under International Financial Reporting Standards (IFRS), and will therefore be required to implement IFRS 17 in due course regarding the valuation of its insurance liabilities.

Rating Score Snapshot

Business Risk Profile	Satisfactory
Competitive position	Strong
IICRA	Moderately high
Financial Risk Profile	Fair
Capital and earnings	Satisfactory
Risk exposure	Moderately high
Funding structure	Neutral
Anchor*	bbb-
Modifiers	
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Financial Strength Rating§	BB

*This is influenced by our view of Old Mutual's capital levels and underwriting margins compared with most of its similarly rated peers. §Note that the financial strength rating applies to the main operating company, OMLACSA.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- 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

Related Research

- Old Mutual Life Assurance Co. (South Africa) Ltd. Proposed Unsecured Subordinated Notes Rated 'zaA+', Nov. 6, 2020
- Various South Africa-Based Insurers Downgraded Following Sovereign Downgrade; National Scale Ratings Affirmed, May 4, 2020

Appendix

Old Mutual Ltd.--Credit Metrics History

(Mil. ZAR)	2019	2018	2017
S&P Global Ratings' capital adequacy*	Satisfactory	Satisfactory	Strong
Total invested assets	865,184	829,814	814,964
Total shareholder equity	77,925	81,420	183,445
Gross premiums written	80,758	78,729	72,323
Net premiums written	72,760	72,046	65,630
Net premiums earned	72,760	72,046	65,630
Reinsurance utilization (%)	9.9	8.5	9.3
Net income (attributable to all shareholders)	9,655	42,708	20,364
Return on revenue (%)	(22.0)	51.7	N/A
Return on assets (excluding investment gains/losses) (%)	(3.3)	3.4	N/A
Return on shareholders' equity (reported) (%)	12.1	32.3	N/A
P/C: net combined ratio (%)	109.0	104.7	N/A
P/C: net expense ratio (%)	44.9	43.9	N/A
EBITDA fixed-charge coverage (x)	13.3	11.7	5.3
Financial obligations / EBITDA adjusted	0.8	0.9	2.0
Financial leverage including pension deficit as debt (%)	13.5	11.4	10.9
Net investment yield (%)	5.1	4.8	N/A
Net investment yield including investment gains/(losses) (%)	10.2	2.5	N/A

*Note that the financial strength rating applies to the main operating company, OMLACSA. 2018 and prior capital adequacy nomenclature is based on old criteria. P/C--Property and casualty. N/A--Not available.ZAR--South African rand.

Ratings Detail (As Of December 3, 2020)*

Operating Company Covered By This Report	
Old Mutual Ltd.	
Issuer Credit Rating	
South Africa National Scale	zaA+/--/zaA-1
Domicile	South Africa

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.