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Old Mutual Ltd.

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Table Of Contents

Old Mutual Ltd.

Credit Highlights

Overview	
Key strengths	**Key risks**
Leading life, savings, and property/casualty (P/C) insurance provider in South Africa.	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.

COVID-19-related losses and South African macroeconomic pressures pose potential financial risks. There is still significant uncertainty regarding the overall impact of the pandemic on mortality and persistency experience, business interruption claims, and new business and investment losses. Additionally, while Old Mutual Limited (OML) is well capitalized, both according to our risk-based capital model ('A' level) and on a regulatory basis (177% as of half-year 2021), 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 2021-2022.

We believe 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.

We expect OML's financial leverage and fixed-charge coverage will remain strong. At end-2020, OML's leverage was about 15% and the fixed-charge coverage was only about 0.1x on account of weaker earnings largely due to the effect of the pandemic. We expect OML's leverage will increase but remain below 20%, and the fixed-charge coverage ratio to improve to about 4x over the next two years as the company levers up, with profits improving as economic growth gradually returns.

Outlook: Stable

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 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 grow by 4.2% in 2021, then by 2.6% and 1.5% in 2022 and 2023, respectively.
- Inflation of 4.4%-4.5% through 2023.
- Unemployment, which stood at 29.2% at end-2020, will remain in the range of 29%-31% through 2023.
- Please refer to Credit Conditions Emerging Markets Q3 2021: Slow Vaccination Prevents A Robust Recovery, June 29, 2021

Table 1

Economic Forecast Summary | South Africa								
	2016	**2017**	**2018**	**2019**	**2020**	**2021f**	**2022f**	**2023f**
Key Indicators								
GDP (Real, YOY%)	0.4	1.4	0.8	0.2	-7.0	4.2	2.6	1.5
CPI (Avg, YOY%)	6.3	5.3	4.6	4.1	3.3	4.4	4.5	4.5
CPI (Q4 Avg, YOY%)	6.6	4.7	4.9	3.7	3.2	4.8	4.5	3.4
Unemployment (%)	26.7	27.5	27.1	28.7	29.2	31.4	30.1	29.7

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**	**2020**	**2021f**	**2022f**
S&P Global Ratings capital adequacy	Strong	Satisfactory	Satisfactory	Satisfactory	Satisfactory	Satisfactory
EBITDA fixed charge coverage (x)	5.3	11.7	13.3	0.1	3x-4x	3x-4x
Financial leverage (%)	10.9	11.4	13.5	15.4	c.20	c.20

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.

Business Risk Profile: Satisfactory

OML, through its 100% ownership of OMLACSA, is the leading player in the life and savings insurance industry in South Africa. It reported consolidated gross premiums earned of South African rand (ZAR) 81.6 billion (about $5.6 billion using the Dec. 31, 2020, exchange rate) and assets under management of ZAR881.6 billion at year-end 2020. 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 players 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.

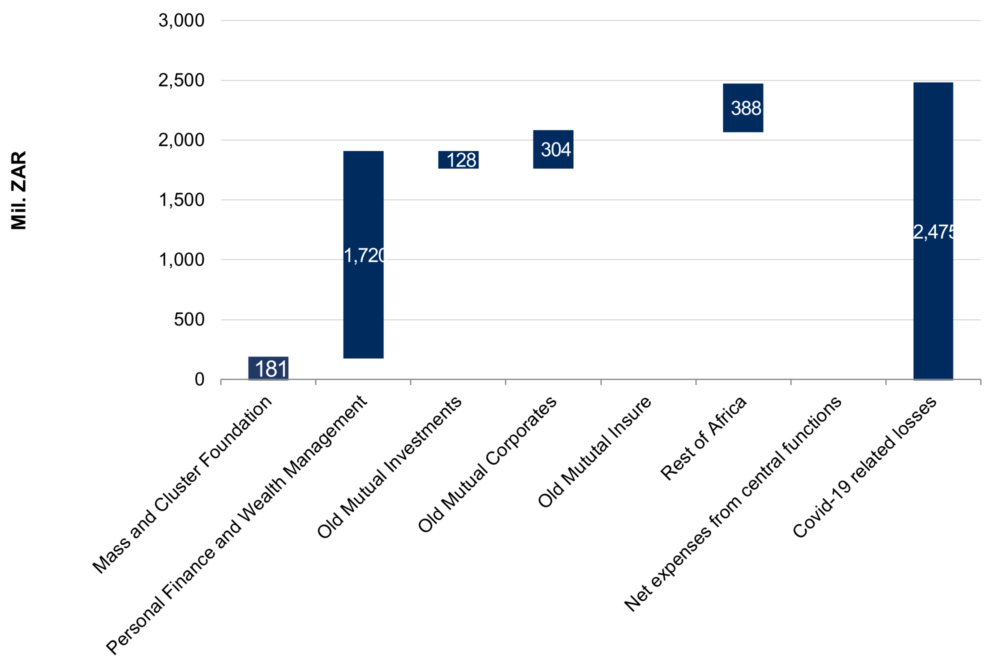
OML's operating performance has started to show signs of recovery in 2021 after incurring pandemic-related losses in 2020. For the six months ending June 30, 2021, results from operations improved to ZAR2.2 billion from ZAR1.5 billion over the same period last year. New business value and margins improved to ZAR740 million and 2.3%, respectively, for half-year 2021, from ZAR125 million and 0.5% at half-year 2020. That said, the impact of COVID-19 continues to have significant bearing on results.

At half-year 2021, OML reported COVID-19-related losses of ZAR2.5 billion compared to ZAR2.8 billion in half-year 2020, encompassing exposure from mortality and persistency experience, business interruption claims, and investment and credit losses. Factoring in these losses, the high court ruling against a peer short-term insurer led to provisions of ZAR791 million for business interruption claims at year-end 2020; however, there were no further business interruption related provisions made in half-year 2021. We anticipate that OML's top-line will grow as the economy recovers over the next two years. However, we remain cautious about the dampening effects of macroeconomic factors, such as rising unemployment and lower disposable income, which could 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

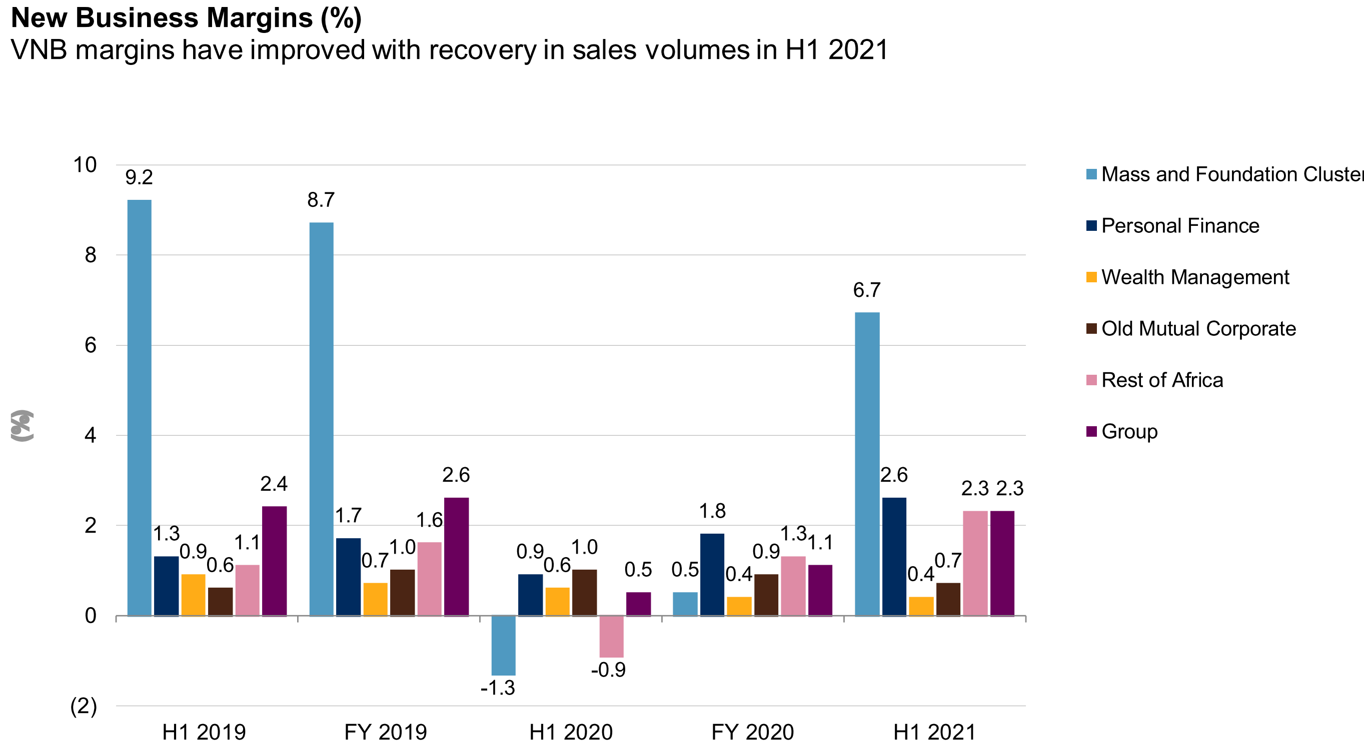
OML's Reported Covid-19 Related Losses At Half-Year 2021 Results

Earnings are likely to be pressured in 2021 but not turn into a capital event



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

Chart 2



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

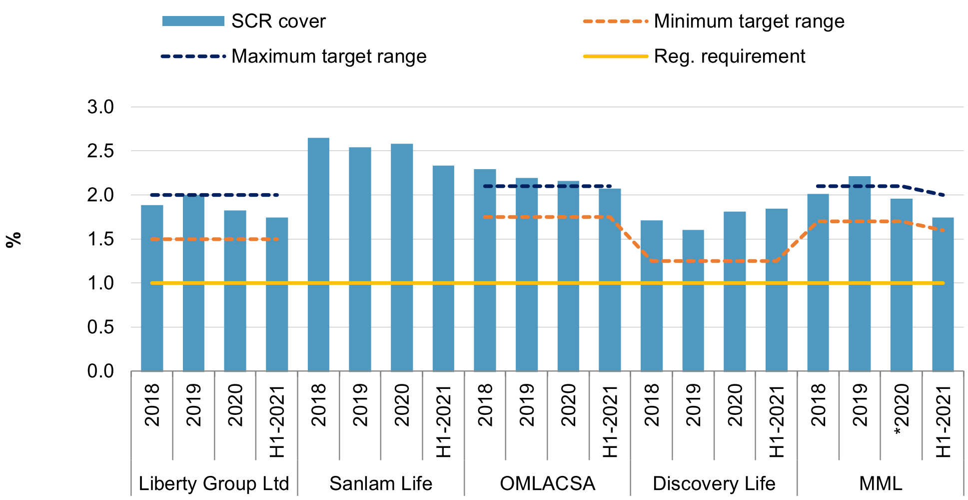
Financial Risk Profile: Fair

At half-year 2021, OML reported a net profit of ZAR3,351 million. Given OML's large balance sheet, pandemic-related losses over recent months have not materially weakened its capital adequacy--this was also partly supported by its disciplined approach to dividends. 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 that it will take management actions to maintain its sound balance sheet.

Chart 3

Top-Tier South African Life Insurance Solvency Capital Requirement Coverage Ratios

OML Group and OMLACSA are comfortably in their target range as of H1-2021



Source: S&P Global Ratings, Audited Financial Statements. Data as of Dec. 31, 2020. *1Q 2020 Sanlam Life Insurance Ltd (Stated target range only available for Sanlam Life covered business excl 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, 2021; 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 (c.50% of invested assets). Smoothed-bonus reserves comprise nearly 42% of OML's reserves, while unit-linked funds, mostly without investment guarantees, make up nearly 49% and nonprofit reserves the remainder (less than 10%). The investment guarantee reserves are dynamically hedged and backed with discretionary margins to buffer against any residual market risk.

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 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 year-end 2020, OML reported a group solvency ratio of 177% with OMLACSA reporting 206%. OML therefore sits comfortably within its target range of 165%-195%, with OMLACSA within its 175%-210% target.

Supporting the balance sheet strength is the modest financial leverage at about 15% for end-2020. We expect that leverage will increase but remain below 20% and fixed-charge coverage will improve as earnings recover to about 4x over the next two years. 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 77% of OML's total assets, and 68% of its gross earned premiums, at end-2020. 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

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

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Related Research

Appendix

Old Mutual Ltd. Credit Metrics History

(Mil. ZAR)	2020	2019	2018	2017
S&P Global Ratings capital adequacy*	Satisfactory	Satisfactory	Satisfactory	Strong
Total invested assets	881677.0	865184.0	829814.0	814964.0
Total shareholder equity	69323.0	77925.0	81420.0	183445.0
Gross premiums written	81571.0	80758.0	78729.0	72323.0
Net premiums written	72462.0	72760.0	72046.0	65630.0
Net premiums earned	72462.0	72760.0	72046.0	65630.0
Reinsurance utilization (%)	11.2	9.9	8.5	9.3
Net income (attributable to all shareholders)	(5348.0)	9655.0	42708.0	20364.0
Return on revenue (%)	(15.8)	(22.0)	51.7	N/A
Return on assets (excluding investment gains/losses) (%)	(2.2)	(3.3)	3.4	N/A
Return on shareholders' equity (reported) (%)	(7.3)	12.1	32.3	N/A
P/C: net combined ratio (%)	114.6	109.0	104.7	N/A
P/C: net expense ratio (%)	47.9	44.9	43.9	N/A
EBITDA fixed-charge coverage (x)	0.1	13.3	11.7	5.3
Financial obligations/EBITDA adjusted	116.7	0.8	0.9	2.0
Financial leverage including pension deficit as debt (%)	15.4	13.5	11.4	10.9
Net investment yield (%)	4.5	5.1	4.8	N/A
Net investment yield including investment gains/(losses) (%)	6.5	10.2	2.5	N/A

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

Ratings Detail (As Of October 5, 2021)*

Operating Companies Covered By This Report	
Old Mutual Ltd.	
Issuer Credit Rating	
South Africa National Scale	zaA+/--/zaA-1
Old Mutual Life Assurance Co. (South Africa) Ltd.	
Financial Strength Rating	
Local Currency	BB/Stable/--
Issuer Credit Rating	
Local Currency	BB/Stable/--
South Africa National Scale	zaAAA/--/zaA-1+
Subordinated	
South Africa National Scale	zaA+
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.