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Old Mutual Life Assurance Co. (South Africa) Ltd.

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Old Mutual Life Assurance Co. (South Africa) Ltd.

Rationale

Operating Company Covered By This Report
Financial Strength Rating
None

Business Risk Profile

- Strong footing as a leading, fully-fledged life and saving products provider in the Republic of South Africa, complemented by promising, albeit small and fragmented, market positions abroad.
- Exposure to South Africa's dampened economic prospects, which are likely to weigh on growth and exacerbate competition within the market.

Financial Risk Profile

- OMLACSA has a resilient balance sheet thanks to its prudent capital and reserve buffer policies and its product and liability structures, the vast majority of which allow flexible guarantees and include mechanisms to share profits and losses with policyholders.
- Adequate financial flexibility due to low financial leverage and healthy fixed-charge coverage.

Other Factors

- Adequate enterprise risk management (ERM), thanks to explicit risk tolerances monitoring through capital-at-risk, earning-at-risk, cash-at-risk, and operational risk metrics.
- Extensive management experience and expertise, a clear strategy, and an adequate structure.
- Should a severe default stress occur--such as our hypothetical sovereign stress scenario--we expect OMLACSA's policyholder funds to share the bulk of losses.
- Limited impact from OM PLC dismantlement on business and financial risk profiles, thanks to an already silo-based management of the segments to be separated and to unaffected dividends to parent.
- We could lower the national scale ratings on OMLACSA if we took a similar action on our sovereign ratings on South Africa. We could also lower the national scale ratings if we saw exceptional dividends exhausting capital; unexpected negative consequences of OM PLC's dismantling; or earning fundamentals deteriorating, for example, Old Mutual Emerging Markets' reported consolidated return on equity below 15% or a new business margin below 2.5%.

Base-Case Scenario

Macroeconomic Assumptions

- Real GDP growth in South Africa around 1.5% per year on average over the next three years.
- Savings on GDP to remain above 16% over the next three years.

Company-Specific Assumptions

- Gross premiums earned to rise by 5%-10% per year.
- Funds under management growth to increase by 5%-10% per year.
- Inorganic growth to decelerate compared with recent years.
- Dividend levels to increase against 2015, reflecting recent historical year-on-year growth.

Key Metrics

Old Mutual Life Assurance Co. (South Africa) Ltd. Key Metrics

	--Fiscal year ends Dec. 31--					
(Mil. ZAR)	**2017f**	**2016f**	**2015**	**2014**	**2013**	**2012**
Gross premiums earned	48,000-53,000	45,500-48,000	43,523	35,001	34,594	30,627
Net income	7,500-8,500	7,500-8,500	3,050	13,276	4,592	12,747

ZAR--South African rand. f--Forecast data reflects S&P Global Ratings' base-case assumption. Net income forecasts excluding mark-to-market impact.

In particular, we highlight the following:

- Capital adequacy to remain at least in the upper adequate range in line with levels at year-end 2015.
- Life new business margin (NBM) to remain above 3%.
- Fixed charge cover to remain above 8x.
- Financial leverage ratio to remain around 10%.

Company Description

Old Mutual Life Assurance Co. (South Africa) Ltd. (OMLACSA) is the leading player in the life and saving insurance industry in South Africa, with South African rand (ZAR) 44 billion gross premiums earned for fiscal year 2015 and ZAR620 billion assets at year-end 2015. It is the largest business within Old Mutual Emerging Markets (OMEM). OMEM's other main business is Mutual & Federal (M&F), the second-largest property/casualty (P/C) company established in South Africa, with ZAR12 billion gross premiums written in 2015. OMEM holds other life and P/C business in Africa--mostly Namibia, Zimbabwe, and Kenya--as well as in Mexico, China, and India. OMEM's offer also includes wealth management solutions through Old Mutual Wealth (OMW), and asset management services through Old Mutual Investment Group, the in-house asset manager serving group companies as well as third-party funds.

OMEM's ultimate parent is London-based OM PLC, a worldwide financial services group providing insurance and wealth management solutions, banking, and asset management services. On March 11, 2016, OM PLC announced its plan to split into four separate businesses: OMEM, South Africa-based and -listed bank Nedbank, U.K.-based OMW, and U.S.-based and listed institutional asset management OMAM. The group announced expected completion of the managed separation phase by year-end 2018.

Business Risk Profile

OMLACSA's business risk profile reflects the moderate insurance industry and country risk assessment and strong competitive position, mainly due to the company's leading player status in the life and saving insurance industry in South Africa.

Insurance industry and country risk: Moderate

Our insurance industry and country risk assessment (IICRA) for the South African life insurance market is moderate. This is mostly due to the country's dampened economic prospects, which will likely weigh on real growth in the life sector and lead to more intense competition within the market. This compares unfavorably with most of the life insurance markets we assess, where the IICRA is intermediate and neutral to the ratings. As such, the IICRA is a relative weakness for the rating. With regards to the wider OMEM Group, our IICRA assessment remains moderate given the large contribution of OMLACSA to OMEM's assets, liabilities, and earnings. We also assess South Africa's P/C IICRA as moderate. Furthermore, OMEM's exposures outside South Africa represent less than 10% of liabilities and 20% of new business volumes. While we do not assess IICRAs for most of the African markets outside of South Africa where OMEM operates, we view them unlikely to modify our overall assessment, given their limited weight on OMEM's risk profile, relative to South Africa.

Competitive position: Strong

Our view on OMEM's competitive position is largely driven by the strength of OMLACSA's competitive position in South Africa. OMLACSA provides a fully-fledged life, savings, and wealth management solutions in the market and is holding leading positions in the retail and corporate segments. In the retail market, OMLACSA is leading the traditional players in the low income segment, while it holds top-3 positions in most of the middle income segments. OMLACSA's is a top-3 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. Diversified, and at majority controlled, distribution abilities add to OMLACSA's competitive strengths, including employee sales, tied agents, agency franchise distribution, and Personal Finance Advice (PFA). M&F's No. 2 position in the P/C market complements OMEM's foothold and product offering in South Africa. OMEM's positions outside South Africa are small, fragmented, and much less profitable than OMLACSA. Still, they sow the seeds for future diversification. OMEM has leading positions in small markets such as Zimbabwe, Malawi, and Namibia, and second-tier positions in Kenya, as well as a presence in Nigeria. Overall, we expect OMEM to post sound operating profit measures over the coming two years, with reported consolidated return on equity of above 20% and new business margins of above 3%, in line with its closest South African peers.

Table 1

Old Mutual Life Assurance Co. (South Africa) Ltd. Competitive Position					
	--Fiscal year ended Dec 31--				
(Mil. ZAR)	**2015**	**2014**	**2013**	**2012**	**2011**
Gross premiums earned	43,523	35,001	34,594	30,627	26,367

Table 1

Old Mutual Life Assurance Co. (South Africa) Ltd. Competitive Position (cont.)					
	--Fiscal year ended Dec 31--				
(Mil. ZAR)	**2015**	**2014**	**2013**	**2012**	**2011**
Change in gross premiums earned (%)	24.35	1.18	12.95	16.16	5.07
Net premiums earned	42,447	34,003	33,694	29,816	25,548
Change in net premiums earned (%)	24.83	0.92	13.01	16.71	4.70
Total assets under management	588,912	542,089	515,511	474,930	430,949
Reinsurance utilization (%)	2.47	2.85	2.60	2.65	3.11

ZAR--South African rand.

Financial Risk Profile

Capital and earnings: Upper Adequate

Our view of OMEM's balance-sheet resilience is mostly supported by the substantial buffers existing 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% to 70% of invested assets). Smoothed-bonus reserves consist of one-half of OMLACSA's reserves, while unit-linked funds, mostly without investment guarantees, make up 40% of reserves.

This liability profile, which includes significant mechanisms for sharing profits and losses with policyholders, contributes to our view of the balance sheet's resilience to investment market volatility. In addition, most products pay market value on termination. That said, the highly competitive nature of the saving market and high policyholder expectations might discourage OMEM from making full use of the loss-sharing mechanisms in case of stress. We therefore view OMEM's consolidated capital adequacy as upper adequate.

Overall, we regard OMEM's consolidated capital position as weaker than OMLACSA's stand-alone position because of the recent acquisitions and foreign investments, and because of exposures to weaker asset qualities. Prospectively, our base-case assumption is that OMEM's dividends to parent OM PLC are likely to be a drag on capital adequacy, in light of OMEM's expected growth. Therefore, we expect capital adequacy, based on our measure, to decline over the next three years, but to remain commensurate with an upper adequate assessment. In using our capital adequacy model criteria listed below, we have applied a criteria interpretation that allows us to assume the duration mismatch assumption for South African life insurers is two years.

Risk position: Intermediate

We view the risk position as intermediate, that is, neutral to the ratings. OMLACSA's substantial asset exposure to high-risk assets, such as equities, properties, loans, and speculative-grade and unrated bonds is mitigated by the profit-and-loss features of its main product lines. The largest sector exposure is banking, and excluding government securities, the other sector and obligor exposure is largely diversified. Our assessment also depends on the credit quality of assets. A deterioration of the average credit quality of bonds to lower than 'BBB' could have a negative impact on our view of OMLACSA's creditworthiness.

Table 2

Old Mutual Life Assurance Co. (South Africa) Ltd. Risk Position					
	--Fiscal year ended Dec 31--				
(Mil. ZAR)	2015	2014	2013	2012	2011
Total invested assets	588,912	542,089	515,511	474,930	430,949
Net investment income	22,373	20,513	19,135	23,291	18,422
Net investment yield (%)	3.96	3.88	3.86	5.14	4.32

ZAR--South African rand.

Financial flexibility: Adequate

We view OMEM's financial flexibility as adequate. Its financial leverage is low and its fixed-charge coverage is healthy, despite the hybrid debt issuances during 2015. We view OMLACSA as self-sufficient for capital generation to fund organic growth, per our base-case assumptions. Consequently, we see its need for external capital as limited. OMEM has determined a budget for external growth and does not rely on its parent to fund acquisitions. On the downside, heavy cash dividends to the parent are a constraint on its abilities to increase capital buffers. We expect the process of splitting up OM PLC to be neutral to OMEM's financial flexibility, as OMEM and particularly OMLACSA do not rely on capital from OM PLC to finance its growth. Nevertheless, we could reassess our view on financial flexibility when we gain a clearer view of OMEM's future shareholder structure.

OM PLC's plans to reduce its debt materially during the period of the managed separation and not exceed OMEM planned dividend payments. OM PLC intends to fund debt redemptions mainly through asset disposals. OM PLC's consolidated outstanding debt amount to £1.7 billion, including OMEM's outstanding debt. We do not expect such debt levels to hamper OMEM's financial flexibility.

Other Assessments

Enterprise risk management: Adequate

We view the ERM importance to the rating as high, given the substantial market risk in OMEM's assets, and its broad geographic exposures and complex structure. Our adequate views are mostly driven by practices in place for OMLACSA that OMEM replicates for its foreign businesses. OMEM has explicit capital-at-risk and earning-at-risk, cash-at-risk and operational risk tolerances. OMEM also has adequate processes in place to maintain its risk positions within tolerances. Furthermore, OMEM has an extensive key risk identification program where it groups the main risks into different tolerance levels and that complements management actions. Risk reporting is extensive and granular. Management and board awareness of risk taking is high, as evidenced by extensive risk focus in the quarterly board review.

Management and governance: Satisfactory

We assess OMEM's management and governance as satisfactory. OMEM's management has extensive experience and expertise in its chosen markets and risks. It has a clear strategy and adequate structure and skills to be able to execute it. We do not expect the announced dismantling of OM PLC to distract OMEM's management and strategy. OMEM's management stands on its own and relies on limited input from OM PLC with regards to operational management. As for its strategy, OM PLC's managed separation phase could lead OMEM to be more inward-looking and to reassess its fragmented positioning outside South Africa. However, we do not expect the separation to lead to a substantial change to OMEM's strategic focus in South Africa or its selective growth abroad.

Liquidity: Exceptional

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

We think that collateral posting risk is manageable and that risks arising from contingent liabilities are unlikely to materially affect liquidity.

Rating Above the Sovereign Test: Pass

OMLACSA holds approximately 95% of its assets in South Africa. However, the bulk of its life liabilities are with-profit or unit-linked and feature substantial loss-sharing abilities with policyholders. Should a severe default stress occur--such as our hypothetical sovereign stress scenario--we expect OMLACSA's policyholder funds to share the bulk of losses. We would expect shareholder funds to suffer substantially under such a scenario, but not be fully exhausted. Therefore, OMLACSA and OMEM withstand our foreign currency sovereign default stress test. However, we do not view OMLACSA as passing the more-severe local currency stress test scenario.

Support

Group support

The company covered by this report is OMLACSA. We view OMLACSA as core to the OMEM group.

The OM PLC Group already operates as a conglomerate of four separate businesses: OMEM, Nedbank, OM Wealth, and OM asset management (OMAM). There are limited business interactions between these segments, and in that regard we expect the dismantling to be neutral for OMEM's and OMLACSA's business operations. On the financial side, the most direct impact would be the likely reduction of OMLACSA's stake in Nedbank. As part of our analysis, we write down OMLACSA's shares in Nedbank as an affiliate based on its value in OMLACSA's accounts. The remaining uncertainty is the stake that OM PLC would retain in OMEM at the end of the dismantlement process, and what would OMEM's shareholder structure be like (listed, controlled by OM PLC, or by another owner). In our base case, we assume that OMEM and OMLACSA will not be negatively affected by the separation, due to the independence of their strategy and their board, their expected capital policy, and the stringent regulatory rules in South Africa. As this process develops, we could change our views depending on how OMEM's future ownership structure gains in clarity.

Accounting Considerations

OMEM does not post detailed consolidated accounts. We base our analysis on the OMLACSA financial statements and the OM PLC consolidated financial statements. The latter includes detailed information on OMEM activities, including a segmental contribution profit and loss and balance sheet of OMEM.

OM PLC also publishes supplementary market consistent embedded value information on its emerging business, which is managed under OMEM.

Related Criteria And Research

Related Criteria

- S&P Global Ratings' National And Regional Scale Mapping Tables, June 1, 2016
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Related Research

- South African Life Insurer Old Mutual Life Assurance Co. Assigned 'zaAAA/zaA-1' South Africa National Scale Ratings, April 26, 2016

Ratings Detail (As Of July 13, 2016)	
Operating Company Covered By This Report	
Old Mutual Life Assurance Co. (South Africa) Ltd.	
Counterparty Credit Rating	
South Africa National Scale	zaAAA/--/zaA-1
Subordinated	
South Africa National Scale	zaAA+
Domicile	South Africa

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's 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.

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