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Ratings

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Old Mutual Ltd.

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Old Mutual Ltd.

Credit Highlights

Operating Companies Covered By This Report
Financial Strength Rating
None

Overview

Strengths	Risks
Strong footing as a leading, fully-fledged life, savings, and P/C (property/casualty) product provider in South Africa.	Elevated levels of economic risk in South Africa, which weighs negatively on revenues and earnings, in common with peers.
A resilient balance sheet, thanks to prudent capital and reserve buffers and product structures.	Economic conditions in South Africa lead to a weaker balance sheet asset quality, given the majority of assets are locally denominated.
Healthy financial leverage and fixed-charge coverage metrics.	

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 in lower socioeconomic groups. It also has robust positions within higher socioeconomic groups and the South African P/C insurance market.

We believe that the macroeconomic situation in South Africa will continue to pressure earnings. While OML is well capitalized on a regulatory basis, its significant exposure to lower-rated assets ultimately constrains financial risk profile.

Notwithstanding the macroenvironment situation, we expect OML's financial leverage and fixed charge coverage levels to remain strong. At end-2018, OML's leverage and coverage was 11.4% and 11.7x, respectively, and we expect these to remain broadly unchanged over the next two years.

Old Mutual Life Assurance Co. (South Africa) Ltd. (OMLACSA) is considered core to OML. OMLACSA is, and will likely remain, by far the largest subsidiary of OML, representing approximately 86% of OML's total assets, and 70% of its gross earned premiums, at end-2018.

Outlook

The stable outlook on OML (with OMLACSA being core to OML) reflects our stable outlook on South Africa. 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.

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 view a negative rating action as unlikely over the next 12 months due to the company's relatively robust stand-alone credit profile. However, we could lower the ratings on OML (and OMLACSA) over this timeframe if we were to lower our local currency sovereign credit ratings on South Africa.

We could also take this action if we saw:

- Exceptional dividends reducing capital;
- Earnings fundamentals deteriorating (for example, the new business margin sustainably fell below 2.5%);
- Deterioration in the credit quality of assets;
- A weakened balance sheet to the extent that OML failed to pass our sovereign foreign currency default stress scenario; or
- For OMLACSA, specifically, we would take a negative rating on OMLACSA 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

- S&P Global's economists assume that South African 2019 real GDP will increase by 0.6%, then to 1.9% in 2022.
- We also assume that inflation will remain within 4%-5% through 2022.
- Our economists also forecast that unemployment, which stood at 27.1% at end-2018, will increase modestly over the forecast period to 28.1%.

Table 1

Economic Forecast Summary | South Africa								
	2015	**2016**	**2017**	**2018**	**2019F**	**2020F**	**2021F**	2022F
Key Indicators								
GDP (Real, YOY%)	1.2	0.4	1.4	0.8	0.6	1.6	1.9	1.9
CPI (Avg, YOY%)	4.6	6.3	5.3	4.6	4.3	4.9	4.7	4.7
CPI (Q4 Avg, YOY%)	4.9	6.6	4.7	4.9	4.3	4.7	4.7	4.7
Unemployment (%)	25.4	26.7	27.5	27.1	28.3	28.3	28.2	28.1

F--Forecast. Source: S&P Global Economics, S&P Global Ratings, Oxford Economics.

Table 2

Key Metrics				
(Mil. ZAR)	**2017**	**2018**	**2019F**	**2020F**
Gross premiums earned	72,323	78,729	>80,000	>84,000
Profit before tax	7,122	8,450	>12,000	>12,000
Net income	20,364	42,708	>10,000	>10,000
Reported shareholders equity	183,445	81,420	N/A	N/A
Total assets	3,046,886	884,455	N/A	N/A
S&P Global Ratings capital adequacy	Strong	Satisfactory	Satisfactory	Satisfactory
EBITDA fixed charge coverage (x)	5.3	11.7	>10	>10
Financial leverage (%)	10.9	11.4	10-15	10-15

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.

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) 79 billion and ZAR884 billion of assets under management at year-end 2018. OMLACSA holds a leading position in both the retail ("Mass and Foundation Cluster") and corporate segments. Following the completion of the managed separation of Old Mutual PLC'S various business units during the second half of 2018, Old Mutual Ltd. (OML), of which OMLACSA is by far and away the largest component, is now a separate, listed entity on the Johannesburg Stock Market.

In addition to the main South African 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 leading South African P/C insurer.

Reflecting the ongoing challenging macroeconomic environment in South Africa, we anticipate revenue growth (gross earned premiums) of 0%-5% in each of the next two years.

OMLACSA's domestic life insurance franchise is complemented by OMI. After elevated catastrophe losses in first-half 2019, we anticipate improvements in the underlying performance of this business, albeit we note that performance has regularly underperformed expectations over the past decade. In H1 2019, OMI reported results from operations (RFO) of ZAR141 million (H1 2018 RFO was ZAR370 million).

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's 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.

Financial Risk Profile

OML's balance-sheet resilience is supported by substantial buffers within OMLACSA's with-profit policyholder funds (WPF). Such buffers, in particular the bonus-smoothing reserves and the non-vested 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 non-profit reserves the remainder (less than 10%).

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. That said, 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 all bar the most extreme stress events. We therefore view OML's capital adequacy as healthy but constrained by the asset risk borne by the balance sheet. Our view of Old Mutual's anchor is influenced by our view of its capital levels and underwriting margins compared with most of its similarly rated peers.

OML's capital adequacy is constrained by its lower asset quality. The average credit quality of OML's asset portfolio is within the 'BB' 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 H1 2019, OML reported a group solvency ratio of 166% with OMLACSA reporting 218%. OML therefore sits comfortably within its target range of 155%-175%, with OMLACSA topping its 175%-210% target. We therefore expect further capital repatriations from OMLACSA to the OML holding company within the next two years.

OML's financial leverage is relatively low and its fixed-charge coverage is healthy (excluding collateral held as at end-2018) at 11.7x at end-2018. 2018 financial leverage was 12% and we expect this to remain 10%-15% even after the June 2019 ZAR2 billion subordinated issuance. As part of our 2019 criteria implementation, we revised the equity content on three of OMLACSA's hybrid to intermediate (from minimal), totaling approximately ZAR1.8 billion nominal value. However, these three hybrids will lose their equity content during 2020, once their residual maturity drops below 10 years.

Other Key Credit Considerations

Governance

Overall, we consider governance to be neutral for the rating. We note that OML's former CEO is currently in a legal dispute with OML and its board of directors regarding the termination of his employment contract. Despite the adverse publicity that this case has attracted, we do not consider this to be material to the overall creditworthiness of OML.

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 to 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.

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.

Ratings 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: 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

- Insurance Holding Company Old Mutual Ltd. Assigned 'zaAA-'/'zaA-1+' South Africa National Scale Ratings, Oct. 8, 2019
- Old Mutual Life Assurance Co. (South Africa) Ltd. 'BB+' Ratings Affirmed; Outlook Stable, Aug. 12, 2019

Ratings Detail (As Of November 13, 2019)*	
Operating Companies Covered By This Report	
Old Mutual Ltd.	
Issuer Credit Rating	
South Africa National Scale	zaAA-/--/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	zaAA-
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.

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