

CREDIT RATING ANNOUNCEMENT

GCR affirms Santam Limited's international and national scale financial strength ratings of BB+ and AAA_(ZA) respectively; Outlooks Stable

Rating action

Johannesburg, 20 November 2023 - GCR has affirmed Santam Limited's (Santam) international scale financial strength rating of BB+, with a Stable Outlook. 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 Stable Outlooks. Furthermore, the national scale long term issue rating of Santam's subordinated callable notes (Stock Code SNT05) has been affirmed at AA-_(ZA), with a Stable Outlook. Simultaneously, GCR has withdrawn the national scale long term issue rating of AA-_(ZA) on the SNT03 notes, which were redeemed in full on 12 April 2023.

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
SNT03	Long term issuer	National	AA+ _(ZA)	Stable Outlook
			WD _(ZA)	--
SNT05	Long term issue	National	AA- _(ZA)	Stable Outlook

Rating rationale

Santam's ratings are underpinned by a very strong business profile, relatively stable earnings and sound capitalisation and liquidity. The insurer's stand-alone credit profile derives further uplift from implied group support, given relevance to Santam Limited's strategy, history of performance, and a level of operational integration.

Santam maintained a very strong market position in the South African short term insurance industry, with the group's share of conventional gross premiums registering at a stable 24% in fiscal year 2022. This is complemented by the alternative risk transfer (ART) book, which generated very strong growth on the back of increasing demand for self-insurance structures. As a result, the group's share of ART business has been maintained at about 30% over the past two years. Despite some pressure in the interim period to 30 June 2023 due to affordability challenges and corrective underwriting actions, organic growth is likely to be reasonably aligned with nominal GDP growth over the outlook horizon, while there is also potential for a substantial year on year increase following the uptake of the MTN devices book. The group is well diversified across lines of business, with four classes registering premiums of between USD100m and USD950m in 2022 and is also viewed to benefit from broad and diversified distribution channels.

Santam's earnings profile remained healthy, with the five-year average combined ratio registering at about 95% in 2022, slightly up from the previous cross cycle average of 94%. In this regard, earnings have reflected higher volatility in recent years due to the higher severity of catastrophe claims, including the COVID-19 contingent business interruption outlier, as well as severe weather events. This resulted in the insurer reporting a combined ratio of between 92% and 97% over the past three years, versus a prior three-year average of about 93%. Despite a level of claims pressure continuing into the first half of 2023, corrective underwriting actions including geo-coding, re-pricing or cancellation of underperforming risks, and containment of power surge and attritional motor claims are expected to see the underwriting margin improve going forward. We therefore expect the cross cycle combined ratio to register between 93% and 95% over the outlook horizon, with net earnings continuing to benefit from sound realised investment returns.

The GCR capital adequacy ratio (CAR) remained within an intermediate range of about 1x at 31 December 2022, largely impacted by the group's targeted return on capital. However, the Internal Economic Model (IEM) coverage ratio remained comfortably within the 145% to 165% target range, at 159% at 30 June 2023 (31 December 2022: 156%). Following the conclusion of the SAN-JV sale, Santam declared a special dividend during the second half of 2023. This is nevertheless expected to be largely offset by the associated reduction in the market risk charge and we expect solvency levels to remain within the current range, given the insurer's capital management framework.

The GCR liquidity coverage ratio was stable at about 1.4x at fiscal year-end 2022, with strong operational cash flow generation offsetting growth in policyholder liabilities. Santam backs policyholder liabilities and subordinated debt with cash and interest securities, which collectively represented c. 67% of the investment portfolio at 31 December 2022. Given consistency in the investment strategy, we expect liquidity metrics to remain comfortably within the 1.2x to 1.5x range, potentially supporting an improved liquidity assessment going forward.

The negative one notch spread on the national scale long-term issuer rating reflects our view that policyholders take preference above other creditors in South Africa. 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 145% to 165% in line with the group capital management strategy. This should be largely consistent with maintaining the SAM Standard Formula SCR coverage ratio and the GCR CAR within rating adequate ranges. Earnings are expected to strengthen on the back of corrective underwriting actions supporting cross-cycle combined ratios within the targeted 90% to 95% range, comparing favourably with peers.

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 continued pressure on earnings, with the combined ratio registering above 95% on a sustained basis. The international scale rating is also more sensitive to a weakening in the operating environment.

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Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
 Criteria for Rating Insurance Companies, July 2022
 GCR Ratings Scales, Symbols & Definitions, May 2023
 GCR Country Risk Scores, August 2023
 GCR Insurance Sector Risk Scores, February 2023

Ratings history

Santam Limited						
Rated entity	Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Santam Limited	Financial strength	Initial*	National	AAA _(ZA)	Stable Outlook	May 2009
		Last		AAA _(ZA)	Stable Outlook	November 2022
	Financial strength	Initial*	International	A-	Stable Outlook	July 2013
		Last		BB+	Stable Outlook	November 2022
SNT03	Long term issuer	Initial	National	AA+ _(ZA)	Stable Outlook	November 2019
		Last		AA+ _(ZA)	Stable Outlook	November 2022
	Long term issue	Initial	National	AA- _(ZA)	Stable Outlook	November 2019
		Last		AA- _(ZA)	Stable Outlook	November 2022
SNT05	Long term issue	Initial	National	AA- _(ZA)	Stable Outlook	December 2020
		Last		AA- _(ZA)	Stable Outlook	November 2022

*Formerly claims paying ability.

Risk score summary

Rating components & factors	Score
Operating environment	13.50
Country risk score	6.50
Sector risk score	7.00
Business profile	3.00
Competitive position	3.00
Management and governance	0.00
Financial profile	0.00
Earnings	0.25
Capitalisation	0.00
Liquidity	(0.25)

Comparative profile

Group support	2.00
Peer comparison	0.00
Total risk score	18.50

Glossary

Assets	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Capital	The sum of money that is invested to generate proceeds.
Catastrophe	An event, which causes a loss of extraordinary magnitude.
Claim	1. A request for payment of a loss, which may come under the terms of an insurance contract (insurance). 2. A formal request or demand (corporate finance).
Combined Ratio	Measures the ability to conserve profits through the expense line.
Country Risk	The range of risks emerging from the political, legal, economic and social conditions of a country that have adverse consequences affecting investors and creditors with exposure to the country, and may also include negative effects on financial institutions and borrowers in the country.
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.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Dividend	The portion of a company's after-tax earnings that is distributed to shareholders.
Environment	The surroundings or conditions in which an entity operates (Economic, Financial, Natural).
Insurance	Provides protection against a possible eventuality.
International Scale Rating	An opinion of creditworthiness relative to a global pool of issuers and issues.
Issue Ratings	See GCR Rating Scales, Symbols and Definitions.
Issuer Ratings	See GCR Rating Scales, Symbols and Definitions.

Issuer	The party indebted or the person making repayments for its borrowings.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. 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.
Net Profit	Trading/operating profits after deducting the expenses detailed in the profit and loss account such as interest, tax, depreciation, auditors' fees and directors' fees.
Policyholder	The person in actual possession of an insurance policy.
Premium	The price of insurance protection for a specified risk for a specified period of time.
Pricing	A process of determining the price of a debt security.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Redemption	The repurchase of a bond at maturity by the issuer.
Reinsurance	The practice whereby one party, called the Reinsurer, in consideration of a premium paid to him agrees to indemnify another party, called the Reinsured, for part or all of the liability assumed by the latter party under a policy or policies of insurance, which it has issued. The reinsured may be referred to as the Original or Primary Insurer, or Direct Writing Company, or the Ceding Company.
Senior	A security that has a higher repayment priority than junior securities.
Short Term	Current; ordinarily less than one year.
Solvency	With regard to insurers, having sufficient assets (capital, surplus, reserves) and being able to satisfy financial requirements (investments, annual reports, examinations) to be eligible to transact insurance business and meet liabilities.
Subordination	The prioritising of the payment of interest and principal payments to tranches (senior, junior etc. Senior tranches are paid before junior tranches.
Underwriting Margin	Measures efficiency of underwriting and expense management processes.
Underwriting	The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.
Yield	Percentage return on an investment or security, usually calculated at an annual rate.

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- The audited financial statements to 31 December 2022;
- Four years of comparative audited financial statements to 31 December;
- Reviewed interim results to 30 June 2023;
- Forecast summary to 31 December 2023;
- Santam statutory return to 31 December 2022 and 30 June 2023; and
- Other related documents.

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