GCR affirms Fidelity Shield Insurance Company Limited's rating of BBB(KE); Outlook Stable.

Johannesburg, 27 October 2017 — Global Credit Ratings has today affirmed the national scale claims paying ability rating assigned to Fidelity Shield Insurance Company Limited of $\text{BBB}_{(\text{KE})}$, with the outlook accorded as Stable. The rating is valid until October 2018.

SUMMARY RATING RATIONALE

Global Credit Ratings ("GCR") has accorded the above credit rating to Fidelity Shield Insurance Company Limited ("Fidelity Shield") based on the following key criteria:

Fidelity Shield's international solvency margin remained high at 89% at FY16 (FY15: 81%), supported by relatively well contained insurance risks historically. However, GCR notes potential for the international solvency margin to moderate over the medium term, on the back of anticipated increases in underwriting risk (stemming from strong growth envisaged), should capital growth remain constrained (given sustained earnings capacity pressure). The maximum net deductibles per risk and event are limited to conservative levels relative to capital while the panel of reinsurers reflects a moderately strong level of aggregate credit strength.

The insurer's risk based capital adequacy requirement ("CAR") coverage registered below the prescribed minimum of 100%, underpinned by elevated market exposure. As such, management has engaged the regulator and implemented a capital management strategy aimed at meeting minimum CAR coverage by FY17 (supported by expected disposals of non-strategic investment properties, with funds placed in liquid assets). GCR has factored the remedial measures put in place, including temporarily withholding dividend payments and conservative asset allocation, into the rating and outlook. However, the inability of the insurer to meet minimum regulatory requirements may impact negatively on the entity's credit profile going forward, should this result in regulatory action.

Earnings capacity is largely a function of investment income offsetting weak underwriting profitability, and remained under pressure over the last two years. This was largely due to a material reduction in underwriting profitability, with the two year underwriting margin equating to -15%, compared to -2% over the prior three year cycle. As such, the two year operating margin equated to -0.1%, compared to the prior three year margin of 19%. Earnings pressure is likely to persist over the outlook horizon, with realisation of sustained operational efficiencies deemed necessary to strengthen underwriting profitability.

The insurer's liquidity profile has evidenced variability over the review period, largely due to operational cashflow generation volatility. This was further compounded by cash outlays pertaining to the purchase of illiquid investments in FY15, together with constrained cash flow generation. As such, key liquidity metrics registered within moderately weak ranges over the last two years, as evidenced by claims cash coverage of 7 months (FY15: 6 months), and cash coverage of net technical liabilities of 0.3x. Liquidity metrics may remain within a moderately weak range over the outlook horizon, with potential liquidity relief derived from increased rental income volumes and the anticipated disposal of investment properties.

Asset quality is considered to be moderately weak, given the high weighting of illiquid assets in the investment portfolio. In this respect, high risk assets represented 106% of FY16 capital (FY15: 128%). This is further compounded by the moderately elevated exposure to aged debtors (representing 23% of FY16 capital).

Fidelity Shield's limited competitive position currently serves as a rating weakness. In this respect, the insurer's share of total short term insurance industry premiums equated to 1.4% in FY16. The successful scaling up of operations through proactive measurers recently implemented may positively contribute to the company's market profile over the medium term.

Earnings are heavily reliant on one line of business (motor), representing an unchanged 56% of gross premiums in FY16. Similarly, the risk base is heavily skewed towards motor, which accounted for more than 70% of net premiums. In GCR's view, this implies a relatively high degree of profit risk, particularly given the challenges associated with this class.

The rating may be upgraded if liquidity metrics strengthen materially and/or if earnings capacity evidences a sustained improvement. This would need to be supported by risk adjusted capitalisation measuring at adequate levels. Conversely, negative rating action may follow if statutory solvency registers below minimum requirements, resulting in regulatory action. Furthermore, a weakening in liquidity metrics and/or a reduction in capitalisation could lead to downward rating pressure.

NATIONAL SCALE RATINGS HISTORY		
Initial rating (October 2013)		
Claims paying ability: $BBB+_{(KE)}$		
Outlook: Stable		
Last rating (October 2016)		
Claims paying ability: $BBB_{(KE)}$		
Outlook: Stable		

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APPLICABLE METHODOLOGIES AND RELATED RESEARCH

Criteria for Rating Short Term Insurance Companies, updated July 2017

Fidelity Shield rating reports, 2013-2016

RATING LIMITATIONS AND DISCLAIMERS

SALIENT FEATURES OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

Fidelity Shield Insurance Company Limited participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit rating has been disclosed to Fidelity Shield Insurance Company Limited with no contestation of the rating.

The information received from Fidelity Shield Insurance Company Limited and other reliable third parties to accord the credit rating included:

The audited financial results as at 31 December 2016
Unaudited interim results to 30 June 2017
Budgeted financial statements for 2017
Financial Condition Report 2016
The current year reinsurance cover notes
Other relevant company specific information

The rating above was solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the rating.

GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S INSURANCE GLOSSARY

Capacity	The largest amount of insurance available from a company. In a broader sense, it can refer to the largest amount of insurance available in the marketplace.
Capital	The sum of money that is invested to generate proceeds.
Capitalisation	The provision of capital for a company, or the conversion of income or assets into capital.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Cash	Funds that can be readily spent or used to meet current obligations.
Claim	A request for payment of a loss, which may come under the terms of an insurance contract.
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.
Distribution Channel	The method utilised by the insurance company to sell its products to policyholders.
Enterprise Risk Management	ERM refers to an integrated or holistic approach to managing risk across an organisation, using clearly articulated frameworks and processes controlled from board level.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For an insurer, its exposure may also relate to the risk related to policies issued.
International Scale Rating ("ISR")	International local currency (International LC) ratings measure the likelihood of repayment in the currency of the jurisdiction in which the issuer is domiciled. Therefore, the rating does not take into account the possibility that it will not be able to convert local currency into foreign currency or make transfers between sovereign jurisdictions.
Intermediary	A third party in the sale and administration of insurance products.
Interest	Money paid for the use of money.
Investment Portfolio	A collection of investments held by an individual investor or financial institution.
Liquidity	The speed at which assets can be converted to cash. The ability of an insurer to convert its assets into cash to pay claims if necessary. 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.

Market Risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
Policyholder	The person in actual possession of an insurance policy.
Portfolio	All of the insurer's in-force policies and outstanding losses, with respect to described segments of its business.
Premium	The price of insurance protection for a specified risk for a specified period of time.
Rating Horizon	The rating outlook period
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
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.
Statutory	Required by or having to do with law or statute.
Subordinated Debt	Debt that in the event of a default is repaid only after senior obligations have been repaid. It is higher risk than senior debt.
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.
Underwriting Margin	Measures efficiency of underwriting and expense management processes.

For a more detailed glossary of terms please click here

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