GCR downgrades CGIC's rating to $AA_{(ZA)}$ on elevated credit insurance sector impact from the COVID-19 pandemic; Outlook Negative

Rating action

Johannesburg, 31 July 2020 – GCR Ratings ("GCR") has downgraded Credit Guarantee Insurance Corporation of Africa Limited's ("CGIC") national scale financial strength rating to $AA_{(ZA)}$ from $AA+_{(ZA)}$, with the Outlook accorded as Negative.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook/Watch
Credit Guarantee Insurance Corporation of Africa Limited	Financial strength	National	$AA_{(ZA)}$	Negative Outlook

The rating action follows a reduction in the South African country and insurance sector risk assessments.

The South African country risk score was lowered to 7.0 from 7.5 previously, in a market alert released on the 27th May 2020. Click here to access the link. On 4th June 2020, the South African Insurance sector risk score was also lowered to 8.0 from 8.75 previously. Click here to access link.

Combined, the above country and sector risk scores comprise the operating environment score, which is a key input into GCR's ratings.

Rating rationale

CGIC's national scale financial strength rating downgrade reflects a weakening credit profile due to elevated pressure on the financial profile, with the COVID-19 pandemic having exacerbated an already weak economy, translating into increased stress in credit markets. This resulted in weaker earnings, which significantly suppressed risk adjusted capitalisation at 2Q F20. The rating considers group support from the majority shareholder, Old Mutual Insure Limited, and the broader Old Mutual Limited Group, with expressed financial support viewed to limit downside risks to capitalisation and ensuring regulatory compliance over the medium term. GCR has placed the rating on Negative Outlook to reflect high rating sensitivity to projected earnings and liquidity trends in FY20 and FY21, given challenging competitive and economic conditions and, in particular, heightened risk within credit markets.

CGIC's interim earnings weakened on the back of a high claims experience, undermining historically healthy levels of underwriting profitability. In this respect, the insurer's net incurred loss ratio registered at a peak of 134% in 2Q F20 (FY19: 78%; review period average: 75%). While management continued to take multiple loss limiting actions and had secured a more conservative reinsurance structure, earnings are expected to remain pressurised, with the insurer likely to register its first net loss over the review period, despite sound earnings support from healthy investment income. Earnings are expected to remain under pressure, given the protracted restrain from the pandemic, which is likely to flatten the credit cycle.

Risk adjusted capitalisation moderated from historically strong levels due to weakened earnings, with the Solvency Capital Requirement ("SCR") coverage registering at a lower 1.0x (FY19: 1.3x) at 2Q F20. Going forward, risk adjusted capitalisation remains susceptible to earnings pressure that may arise from uncertainty associated with the COVID-19 pandemic risks, albeit with the major shareholder expected to exercise the option of financial support should the SCR coverage ratio dip below regulatory compliance level. In this respect, GCR has factored in financial flexibility as a mitigant to regulatory solvency risk.

Liquidity has been maintained within a moderately strong range supported by conservative asset allocation. In this regard, the liquidity ratio registered at 2.0x at 1H F20 (FY19: 2.1x), while operational cash coverage measured at a lower 12 months (FY19: 23 months) due to increase in claims, albeit with potential reduction limited by increased reinsurer participation on technical reserves. Going forward, the insurer's claims experience is likely to remain elevated and volatile, although likely to moderate in 2H F20 due to easing lockdown restrictions, facilitating improved operating cash flows among buyers and aforesaid loss limiting measures. However, in GCR's opinion pressures in credit markets are likely to persist over the medium term, potentially suppressing the trend in liquidity metrics below projections.

CGIC's overall competitive positioning is viewed to be moderate. The insurer is the leading provider of trade credit insurance in the South African market, and its entrenched position, coupled with revenue scale, has supported sound through-the-cycle earnings, which is favourably viewed relative to peers. Furthermore, the insurer is viewed to be well positioned to withstand competitive pressures, with its specialised business model (including systems and technical expertise) considered to be difficult to successfully replicate. These strengths are, however, offset by low overall market share, with the single product focus limiting premium scale in the context of the South African short term insurance industry. The insurer is expected to remain the market leader in trade credit insurance, although strategic de-risking is likely to see subdued premium growth going forward.

Premium diversification is constrained by the mono-line trade credit offering and geographic concentration to the challenging South African economy. This is, however, partially offset by fairly diversified sector exposures, as the insurer is able to leverage off its market leading position to generate meaningful business from multiple sectors of the market, while also noting more granular exposure to underlying buyers.

The insurer's stand-alone credit profile derives upliftment from the group, underpinned by CGIC's success in achieving group objectives and integration in terms of capital and risk management frameworks and reinsurance arrangements.

Outlook statement

The Negative Outlook reflects GCR's expectation of persistent pressure on the insurer's credit profile emanating from elevated claims associated with the weak economic environment that is expected to impact credit insurers more severely, negatively impacting earnings capacity and liquidity.

Rating triggers

The rating is unlikely to be upgraded over the medium term; however, conversion to a Stable Outlook may follow a quicker than anticipated turnaround in earnings capacity and the management of the liquidity coverage above 2x, while retaining the same business profile strength. The rating could be downgraded should the insurer's net earnings average within a deeper than anticipated negative range over the next two years and/ or liquidity coverage reduces significantly below 2x over the same period. Furthermore, the rating could be lowered if the group fails to provide expected financial support and maintain the SCR coverage above 1.0x.

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019

GCR RATINGS

Criteria for Rating Insurance Companies, May 2019
GCR Ratings Scales, Symbols & Definitions, May 2019
GCR Country Risk Scores, May 2020
GCR Insurance Sector Risk Scores, July 2020

Ratings history

Credit Guarantee Insurance Corporation of Africa Limited

Rating class	Review	Rating scale	Rating class	Outlook/Watch	Date
Claims paying ability	Initial	National	$A+_{(ZA)}$	Stable Outlook	November 2000
Financial Strength	Last	National	$AA+_{(ZA)}$	Stable Outlook	November 2019

Risk score summary

Rating Components and Factors	Risk score
Operating environment	**15.00**
Country risk score	7.00
Sector risk score	8.00
Business profile	**(1.25)**
Competitive position	(0.25)
Premium diversification	(1.00)
Management and governance	0.00
Financial profile	**1.50**
Earnings	0.50
Capitalisation	0.00

Liquidity	1.00
Comparative profile	**1.00**
Group support	1.00
Government support	0.00
Peer analysis	0.00
Total Score	**16.25**

Glossary

Premium	The price of insurance protection for a specified risk for a specified period of time.
Primary Market	The part of the capital markets that deals with the issuance of new securities.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Technical Liabilities	The sum of Net UPR and Net OCR IBNR.
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.

SALIENT POINTS OF ACCORDED RATINGS

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

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

The rated entity participated in the rating process via virtual management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The information received from the rated entity and other reliable third parties to accord the credit rating included:

- Audited financial results as at 31 December 2019;
- Four years of comparative audited financial statements to 31 December
- Full year budgeted financial statements for 2020;
- Unaudited interim results to 30 June 2020;
- Reinsurance cover notes for 2020; and
- Other relevant documents.