



## Credit Rating Announcement

GCR upgrades Compass Insure's national scale financial strength rating to AA<sub>(ZA)</sub> from AA<sub>-(ZA)</sub> ; Outlook Stable

## Rating Action

Johannesburg, 11 March 2020 - GCR Ratings ("GCR") has upgraded Compass Insurance Company Limited's ("Compass Insure") national scale financial strength rating to AA<sub>(ZA)</sub>, with the outlook accorded as Stable.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook/Watch
Compass Insurance Company Limited	Financial strength	National	AA <sub>(ZA)</sub>	Stable Outlook

## Rating Rationale

The rating action reflects Compass Insure's sustained healthy earnings over the bulk of the review period, coupled with the maintenance of a large portion of captive revenue, as well as a diversified spread of risk premiums across UMAs.

Compass Insure has evidenced a healthy level of earnings over the bulk of the review period. This was a result of cancellation of underperforming books of business and the effective implementation of operational systems and processes. In this regard, the gross underwriting profit margin was 12% in FY19 (FY18:19%; review period average: 7%), while the operating margin was 58% in FY19 (FY18: 74%; review period average 57%). Despite elevated exposure to high severity risks, GCR expects cross cycle net profitability to be sustained, supported by a consistent stream of investment income and high reinsurance protection.

Compass Insure's liquidity is very strong, as evidenced by stressed financial asset coverage of net technical liabilities of 8.9x (FY18: 10.0x) and operational cash coverage of 57 months at FY19 (FY18: 86 months). Note is taken of the inherent concentration risk within the South African banking sector among the four big banks. Going forward, liquidity metrics are expected to remain very strong over the rating horizon, given the conservative investment strategy and capacity for strong internal cash flow generation.

Capitalisation is viewed to be strong with well contained underwriting and market risk supporting healthy risk adjusted capitalisation. Although note is taken of increased dividend extraction, risk adjusted capitalisation is expected to be maintained at rating adequate levels going forward, based on management's targeted Regulatory Solvency Capital Requirement coverage (between 1.2x and 1.5x).

The rating is constrained by the entity's limited business profile, reflecting a gross premium market share of approximately 1.1% and limited revenue on a net basis as well as high product concentration to the property line of business. However, strong growth in ancillary lines of business recorded over the review period, together with the launch of new technology driven products has positively impacted Compass Insure's competitive position. Furthermore, the insurer's competitive

position is viewed in light of the large portion of captive revenue, as well as the well diversified spread of risk premiums across UMAs.

Compass Insure's rating derives upliftment from implied parental support from Hannover Reinsurance Group Africa (Pty) Limited, given its strategic integration and alignment with group risk and capital management frameworks.

## Outlook Statement

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The stable outlook reflects expectations of premium growth to range between 10% and 15%, potentially increasing underwriting profitability. Investment income is expected to moderate slightly (due to constraints in the economic environment), thereby balancing stable earnings. As a result, capitalisation is likely to be maintained within a similar range, with steady earnings balancing dividend extraction, and SCR coverage maintained above 1.3x. On the other hand, the business profile is expected to remain restricted over the outlook horizon owing to limited geographic and net premium diversification.

## Rating triggers

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Positive rating action may stem from a strengthening in capitalisation while all other credit protection metrics remain within strong ranges. Conversely, downward rating pressure may arise from a weakening in liquidity below expectations and/or prolonged earnings strain.

## Analytical Contacts

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## Related Criteria and Research

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

## Ratings History

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### Compass Insurance Company Limited

Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Financial Strength	Initial	National	A(ZA)	Stable	September 2004
	Last	National	AA-(ZA)	Stable	December 2019

## Risk Score Summary

### Risk scores

<b>Operating environment</b>	<b>16.25</b>
Country risk score	7.50
Sector risk score	8.75
<b>Business profile</b>	<b>(2.75)</b>
Competitive position	(1.75)
Premium diversification	(1.00)
Management and governance	0.00
<b>Financial profile</b>	<b>2.50</b>
Earnings	0.50
Capitalisation	0.50
Liquidity	1.50
<b>Comparative profile</b>	<b>1.00</b>
Group support	1.00
Government support	0.00
Peer analysis	0.00
<b>Total Score</b>	<b>17.00</b>

## Glossary

Accident	An unplanned event, unexpected and undesigned, which occurs suddenly and at a definite place.
Accounting	A process of recording, summarising, and allocating all items of income and expense of the company and analysing, verifying and reporting the results.
Agency	An insurance sales office which is directed by an agent, manager, independent agent, or company manager.
Assets	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Budget	Financial plan that serves as an estimate of future cost, revenues or both.
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.
Captive Insurance Company	A company owned solely or in large part by one or more non- insurance entities for the primary purpose of providing insurance coverage to the owner or owners.
Cash	Funds that can be readily spent or used to meet current obligations.
Catastrophe	An event, which causes a loss of extraordinary magnitude.
Claim	A request for payment of a loss, which may come under the terms of an insurance contract.
Commission	A certain percentage of premiums produced that is received or paid out as compensation by an insurer.
Contract	An agreement by which an insurer agrees, for a consideration, to provide benefits, reimburse losses or provide services for an insured. A 'policy' is the written statement of the terms of the 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.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Diversification	Spreading risk by constructing a portfolio that contains different investments, 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.
Equity	Equity is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Experience	A term used to describe the relationship, usually expressed as a percent or ratio, of premiums to claims for a plan, coverage, or benefits for a stated time period.
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.
Income Statement	A summary of all the expenditure and income of a company over a set period.
Interest	Money paid for the use of money.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Investment Income	The income generated by a company's portfolio of investments.
Investment Portfolio	A collection of investments held by an individual investor or financial institution.
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. 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.
Loss	The happening of the event for which insurance pays.
Market Risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
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.
Net Retention	The amount of insurance that a ceding company keeps for its own account and does not reinsure.
Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people or systems or from external events. This includes legal risk, but excludes strategic risk and reputational risk.
Personal Lines	Types of insurance, such as auto or home insurance, for individuals or families rather than for businesses or organisations.

## 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 entities, 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 Compass Insurance Company Limited. 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.

Compass Insurance Company Limited participated in the rating process via face-to-face 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 Compass Insurance Company Limited and other reliable third parties to accord the credit rating included:

- Draft financial statements to 31 December 2019;
- Four years of comparative audited financial statements to 31 December;
- Budgeted financial results to 31 December 2020;
- Statutory returns to 31 December 2019;
- The current year reinsurance cover notes; and
- Other relevant information

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