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Research Update:

South African Insurer Santam Ltd. Downgraded To 'BBB+' On Sovereign Downgrade; Outlook Stable

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Overview

- On June 13, 2014, we lowered our long-term foreign currency sovereign credit rating on the Republic of South Africa to 'BBB-' from 'BBB' and our long-term local currency rating to 'BBB+' from 'A-'.
- We consider Santam to have a material exposure to South Africa. We are therefore lowering our ratings on Santam to 'BBB+'. We affirmed our national scale rating at 'zaAA+'.
- We have also revised to strong our assessment of Santam's enterprise risk management and raised the company's indicative stand-alone credit profile to 'a' from 'a-', two notches above the foreign currency rating on South Africa.
- The stable outlook reflects that on the ratings on South Africa and our expectation that management actions will not increase Santam's exposure to sovereign risk.

Rating Action

On June 24, 2014, Standard & Poor's Ratings Services lowered its long-term counterparty credit and insurer financial strength ratings on South Africa-based non-life insurer Santam Ltd. to 'BBB+' from 'A-'. The outlook is stable.

At the same time, we affirmed the 'zaAA+' South Africa national scale rating on Santam.

Rationale

On June 13, 2014, we lowered our long-term local currency sovereign credit rating on South Africa by one notch to 'BBB+' and our foreign currency sovereign credit rating to 'BBB-'. The downgrade reflects our expectation of lackluster GDP growth in South Africa, against a backdrop of relatively high current account deficits, rising general government debt, and the potential volatility and cost of external financing (see "South Africa Long-Term FC Rating Lowered To 'BBB-'; LC Rating Lowered To 'BBB+' On Ongoing Weak Growth; Outlook Stable," published on June 13 2014).

We consider Santam to have a material exposure to South Africa. We generally view country exposure as material when investments in a country's assets (including sovereign bonds and other assets) reach about 25% of its total investments. Under our ratings criteria, sovereign risk is a key factor influencing the financial strength of insurers.

The ratings on Santam are two notches higher than the foreign currency sovereign credit ratings on South Africa. This reflects several factors.

- The indicative stand-alone credit profile--our view of the company's creditworthiness before our assessment of its exposure to sovereign risk--is 'a'. We have revised this upward by one notch because we revised our assessment of Santam's enterprise risk management (ERM) to strong from adequate with strong risk controls. We now have a positive view of Santam's strategic risk management, which supports its capital management, asset allocation, recent pricing initiatives, and catastrophe risk modeling.
- That said, the rating on Santam is capped at the local currency sovereign rating on South Africa because of Santam's exposure to South African assets and its liability profile, offset by its ability to pass our foreign currency sovereign default stress test. As a result, the stand-alone credit profile is two notches above the foreign currency rating on South Africa (see "South African Insurer Santam 'A-' Ratings Affirmed Based On Criteria For Rating Above The Sovereign; Outlook Negative," published on Feb. 20, 2014).
- Santam benefits from positive regulatory capital and a liquidity ratio that exceeds 100%, even in the stress scenario associated with a hypothetical South African foreign currency default. However, that depends on it executing material, board-approved mitigation actions in a timely manner.
- As a non-life insurer, Santam is less sensitive to country risk. However, the potential rating differential is constrained at two notches by the local currency sovereign credit rating. We do not consider that Santam passes the local currency stress test, owing to its material exposure to asset risk stemming from South Africa.
- Santam is insulated from its parent, Sanlam Ltd. This reflects Santam's independence from its majority owner, as well as the benefits that stem from the oversight of the South African regulatory framework, Santam's independent board of directors, and its sizable minority shareholders.

We expect Santam to post premium growth of around 7%-8% per year over the next 24 months and maintain its underwriting performance. It should have a combined ratio of 94%-96%, combined with lower expenses than its peers. We anticipate that operating profits will be at least South African rand (ZAR) 1.5 billion a year over the same period and investment yield will be about 4%. Capital is likely to remain a relative weakness to the overall rating, although we expect capital adequacy will remain within the 'BBB' range. We expect the sovereign downgrade may lead to a weaker exchange rate, placing increased pressure on claims costs and increasing investment portfolio volatility. This could lead to realized losses. However, we anticipate that these exposures will continue to be managed in line with Santam's existing appetite and tolerances.

Outlook

The stable outlook on Santam mirrors that on the long-term local currency ratings on South Africa, reflecting our view that the ratings on Santam are constrained at the level of the long-term local currency rating on South Africa.

Downside scenario

We could lower the ratings on Santam if management actions increased Santam's exposure to sovereign risk. This could result from a weakening in capital, a greater weighting to longer-duration domestic fixed-income assets, or failure to execute its investment policy in a scenario of rising sovereign risk. Similarly, we could lower the ratings if we considered that Santam's independence from its controlling shareholder is compromised to such an extent that we no longer consider it an insulated subsidiary, according to our criteria.

Upside scenario

A positive rating action is unlikely in the next 12 months, given the recent downgrade of South Africa, which constrains the rating on Santam.

Ratings Score Snapshot

	To	From
Financial Strength Rating	BBB+/Stable	A-/Negative
Indicative SACP	a	a-
SACP	bbb+	a-
Anchor	a-	a-
Business Risk Profile	Strong	Strong
IICRA	Intermediate Risk	Intermediate Risk
Competitive Position	Strong	Strong
Financial Risk Profile	Upper Adequate	Upper Adequate
Capital & Earnings	Lower Adequate	Lower Adequate
Risk Position	Intermediate Risk	Intermediate Risk
Financial Flexibility	Strong	Strong
Modifiers	+1	0
ERM and Management	+1	0
Enterprise Risk Management	Strong	Adequate with strong risk controls
Management & Governance	Satisfactory	Satisfactory
Holistic Analysis	0	0
Liquidity	Strong	Strong
Sovereign Risk	-2	0

Support	0	0
Group Support	0	0
Government Support	0	0

SACP--Stand-alone credit profile.
IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria And Research

Related Criteria

- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Enterprise Risk Management, May 7, 2013
- Insurers: Rating Methodology, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- South Africa Long-Term FC Rating Lowered To 'BBB-'; LC Rating Lowered To 'BBB+' On Ongoing Weak Growth; Outlook Stable, June 13, 2014
- South Africa Life Insurance Sector Carries Intermediate Insurance Industry And Country Risk Assessment, April 22, 2014

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Santam Ltd.		
Counterparty Credit Rating	BBB+/Stable/--	A-/Negative/--
Financial Strength Rating	BBB+/Stable/--	A-/Negative/--

Ratings Affirmed

Santam Ltd.	
Counterparty Credit Rating	
South Africa National Scale	zaAA+/--/--

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