

Renasa Insurance Company Limited

South Africa Insurance Analysis

November 2009

Security class	Rating scale	Currency	Rating	Rating outlook	Expiry date
Claims paying ability	National	Rand	BBB+	Positive	11/2010

Financial data:

(US\$'m Comparative)

	30/06/08	30/06/09
R/US\$ (avg)	7.31	9.05
R/US\$ (close)	7.96	7.88
Total assets	7.2	12.5
Total capital	2.6	4.3
Cash & equiv.	4.7	6.7
GPI	35.9	51.8
U/w result	(0.1)	1.0
NPAT	0.3	1.4
Op. cash flow	0.7	2.0
Market cap	n.a.	
Market share*	0.5%	

*Estimated share of industry GPI in 2008.

Fundamentals:

Renasa Insurance Company Limited ("Renasa") was established in 1998. In 2002, a consortium of local investors acquired Renasa. Since the acquisition, new management and other key personnel have been appointed and the company has undergone vast reconstruction.

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Rating rationale

The rating is based on the following key factors:

- Renasa has made good progress with its turnaround strategy, having surpassed critical mass and reporting its first underwriting profit in F09. Furthermore, the capital base has been strengthened by two years of net profits.
- Large commission recoveries are expected to lend stability to underwriting profitability in the medium term, although low retention will continue to limit the efficiency benefits of top line growth.
- The insurer has maintained a conservative investment stance, and strong liquidity ratios.
- Solvency measures remain comfortable, supported by reinsurance. Furthermore, note is taken of the demonstrated financial backing of the shareholder.
- The insurer's ability to sustain volume efficiencies will be tested by fierce competition in the personal lines arena, exacerbated by the difficult economic environment. In this regard, cognisance was taken of the large exposure to the challenging personal lines motor portfolio.

Solvency & liquidity

Over the past two years, the insurer has generated capital internally. Retained income amounted to R13m in F09 (F08: R2m), raising shareholders funds to R34m. Capital growth was outpaced by the 98% rise in risk premiums for the year, to R55m. As such, international solvency contracted to 61%, from 76% previously. XOL cover limits the maximum net retention per event to around 4% of year-end capital. The statutory funding ratio was posted at a stable 51% in F09, although declined marginally to 49% as at 1Q F10. Strong volume growth and improved underwriting profitability resulted in an operating cash flow of R18m in F09 (F08: R5m), raising liquid holdings to R53m (F08: R38m). However, claims incurred more than doubled for the year, reducing claims cash coverage to 13 months (F08: 20 months).



Industry overview

The year 2008 proved challenging for the industry, beginning with electricity shortages that constrained productive capacity and culminating in the global downturn that saw insurers realise outright investment losses. Given the soft market and deterioration in the economic climate, GPI growth is estimated to have declined to 9% from 13% in 2007, with growth emanating from sum insured adjustments and a degree of re-pricing, rather than increased volumes. The industry underwriting margin has narrowed significantly since 2004 (industry average of 12%) and registered at approximately 7% in 2007 and 5% in 2008. This has been a function of competitive pricing and rising claims volumes, particularly in the motor and property portfolios. Adverse weather conditions and a higher incidence of industrial accidents and fires (partly ascribed to weaker risk management) have exerted upward pressure on property claims. Furthermore, the motor book has been impacted by higher claims frequency and the impact of increasing replacement costs. The overall loss ratio increased to approximately 66% in 2008 (2007: 64%), representing the highest level in more than four years.

It is expected that the deterioration in industry loss ratios will continue until rates are adjusted in line with the systemic changes to the claims environment. In this regard, the capital erosion experienced by insurers with large listed equity exposures could provide impetus to re-pricing, as company's attempt to compensate for investment losses. However, the deterioration in economic growth, increasing unemployment and a reduction in disposable income levels are expected to place pressure on volume growth and lead to higher policyholder churn in the near term. Accordingly, pricing adjustments will need to be implemented selectively and will be more successfully realised by insurers with strong brand affinity, and those that have captive distribution channels.

Fundamentals

Renasa entered a period of run off following the discontinuation of operations by then-parent Reliance National Insurance Company (Europe) Limited. A consortium of shareholders acquired the company in January 2002, and underwriting activity recommenced in September 2002. At the beginning of 2005, a new management team was appointed, and the reconstruction of Renasa began. However, this coincided with a downward turn in the industry cycle, which was compounded by the poor quality of the inherited portfolio, as well as systems deficiencies in core capabilities such as underwriting and claims controls. As such, initial emphasis was placed on more stringent risk selection, with the insurer shedding a large portion of business. Following the

cleaning out of the book, management began to focus on the attainment of critical mass. The primary focus is on commercial lines. However, this implies a natural progression into the personal lines segment, given the business mix of its independent brokers. Accordingly, a key focus has been on volume efficiencies and accurate pricing of business, thereby adapting the benefits of the direct business model to suit its intermediary driven distribution channels. In this regard, management has focused on four elements:

1. *Growth.* The expansionary phase took place between F06 and F09, and saw the insurer register a 3-year CAGR of 53%. GPI grew by 79% in F09 (F08: 35%) to R468m, surpassing the R300m mark that had been earmarked by management as critical mass. The insurer has used proportional reinsurance to limit the impact of growth on solvency as it gradually builds underwriting capacity.
2. *Scientific underwriting methodology.* Renasa has moved to an underwriting-centric operation, while applying actuarial rating on a per risk basis, which allows for more accurate premium setting. The improved assessment, admission and pricing of risk has run in tandem with increased volumes.
3. *Claims controls.* Average claims costs are addressed on two levels. (1) The web-based IT system provides a facility for online claims administration, including policyholder intimation, which allows for timeous reporting of claims and access to information. (2) The group's vertical integration of downstream operations (assessment centres, salvage yards, para-legal entities, etc) extends its operational reach to mitigate the arm's length challenges relating to these functions.
4. *Integrated IT platform.* Running parallel to these areas of attention has been the insurer's development of an integrated web-based IT platform, which facilitates the real-time transfer of information between the insurer, its distribution intermediaries, and policyholders. This enables the insurer to monitor the risk that it carries, and adjust rates on an ongoing basis using feedback on claims experience. Regular audits are carried out to ensure that brokers comply with rates setting and do not go beyond predetermined discounting limits.

Management continues to build on existing capabilities and refine parameters for rate setting, which is viewed as an ongoing process. Further improved benefits are expected to be realised, as the system gains acceptance by intermediaries and more new business/renewals have been subject to the refined rating model.

Competitive positioning

Table 1 compares Renasa to multiline and total industry averages. Renasa reported growth of 79% in F09, having secured several new personal lines portfolios. In contrast to the short term industry as a whole, the insurer improved its motor loss ratio for the year, using enhanced underwriting and claims controls. This notwithstanding, Renasa's earned loss ratio remained high in F09, strained by property and motor claims that were well above industry norms. Management's strategy going forward includes a reduction in high exposures on property risks. The volumes written in F09 afforded the insurer greater cost efficiencies. This notwithstanding, management expenses relative to EPI remained well above industry averages, with underwriting profitability supported by commission recoveries. Management expenses as a proportion of GPI (4%), however, compared favourably to the industry average (17%). As a result, Renasa's underwriting performance compared favourably with competitors. Credit protection measures also registered above the industry average, supported by reinsurance and Renasa's conservative investment approach.

	Renasa	Multiline industry	Total industry
GPI growth	78.9	6.1	12.7
Retention	11.7	88.9	74.1
Earned loss ratio	87.0	70.8	63.7
Mgmt. expense ratio	37.5	16.6	18.2
Commission ratio	(40.8)	12.0	10.9
U/w margin	16.3	5.8	7.2
Cash coverage (months)	13.4	4.9	7.3
International solvency	61.4	43.6	48.2
Statutory solvency	51.4	27.9	37.6

Risk diversification

Over half of the insurer's F09 growth was generated by motor personal lines, which accounted for 42% of GPI for the year (F08: 36%). Inclusive of commercial business, motor as a proportion of gross premiums increased to 67%, from 62% previously, reflecting a high degree of concentration. Personal property premiums more than doubled to R66m in F09 (F08: R30m), although subdued commercial fire growth resulted in a slightly lower share of the overall gross book, at 21% in F09. The risk premium spread remained relatively stable in F09, with the higher proportion of motor business resulting in a slightly higher retention ratio of 12% (F08: 11%).

Premium by class (%)	GPI		NPI		Retention	
	F08	F09	F08	F09	F08	F09
Property	21.8	20.9	14.6	17.2	7.1	9.7
Motor	62.1	67.4	70.2	72.3	11.9	12.6
Guarantee	3.8	1.5	3.1	1.2	8.6	9.2
Liability	0.3	0.2	0.0	0.0	0.0	0.0
Miscellaneous	12.0	10.1	12.1	9.3	10.6	10.8
Total	100.0	100.0	100.0	100.0	10.6	11.7

Source: ST 2009.

The more appropriate pricing of personal lines business enabled Renasa to register improvements in the claims experience across its accounts in F09, barring property. Motor registered a significantly improved performance, with the gross loss ratio of 78% comparing favourably with both the prior year's figure (90%) as well as management's expectations (83%). This was accompanied by lower guarantee and miscellaneous earned loss ratios. This notwithstanding, three large fire claims in F09, the largest of which amounted to R43m gross of reinsurance, caused the property gross loss ratio to increase to 108%. Despite cash recoveries from reinsurers (net ratio: 63%), the disproportionate reinsurers' share of reserving pushed the earned loss ratio to 107%. As such, the overall earned loss ratio increased to 87%, from 81% previously.

Loss ratios (%)	Gross ratio		Net ratio		Earned ratio		Contrib. to Δ in F09 earned loss ratio
	F08	F09	F08	F09	F08	F09	
Property	56.4	107.5	102.6	63.0	8.5	107.1	17.0
Motor	89.5	78.0	110.8	85.2	102.6	88.8	(7.7)
Guarantee	4.5	46.0	5.2	50.1	39.9	17.8	(1.0)
Liability	0.0	497.7	n.a.	n.a.	n.a.	n.a.	n.a.
Misc.	47.5	42.5	61.2	43.2	53.1	43.7	(2.4)
Total	73.8	80.8	100.2	84.2	80.6	87.0	6.4

Source: ST 2009.

Management expenses rose by 27% to R21m in F09, following significant outlay related to enhancements of the IT infrastructure. However, the onset of scale efficiencies lowered management expense relative to EPI to 38% (F08: 58%). As a proportion of GPI, management expenses measured an improved 4% in F09 (F08: 6%). Commission recoveries from motor increased by 120% in F09, to R53m, on the back of higher volumes, coupled with improved loss experience (profit share). Commission recovered from the guarantee and miscellaneous books (which displayed very favourable gross loss ratios) exceeded associated costs in F09, resulting in a negative delivery cost ratio of 3% (F08: +23%). This allowed for the first underwriting surplus of the review period, which translated into an underwriting margin of 16% (F08: -3%).

Performance by class (R'm)	Mgmt expense		Net comm income		Underwriting result	
	F08	F09	F08	F09	F08	F09
Property	(3.3)	(4.3)	2.9	4.0	3.4	(0.9)
Motor	(10.7)	(13.8)	3.6	13.6	(7.6)	4.2
Guarantee	(0.6)	(0.3)	1.5	1.1	1.4	1.4
Liability	0.0	(0.0)	0.0	0.1	0.1	(0.1)
Miscellaneous	(1.7)	(2.1)	1.9	3.5	1.8	4.3
Total	(16.2)	(20.5)	9.9	22.3	(0.9)	8.9

Source: ST 2009.

Reinsurance

The current reinsurance programme is in the final year of the three-year treaty arrangement, and runs to 31 June 2010. Lead reinsurers on the programme are

Munich Re, Africa Re and Swiss Re. The insurer does not plan to increase retention levels significantly in the short to medium term. Renasa derives technical expertise regarding the structuring of its reinsurance programme through its partnership with Aon Re. Following adverse property claims, the insurer stopped writing to EML in F10, with treaties established purely on a sum insured basis. This has been supported by a reduction in high value exposures.

	Retention	Capacity
Surplus		
Fire and Engineering	R5m	R45m
Quota share		
Motor	60%	R1.3m
Fire and Engineering	60%	R5m
Marine	25%	R20m
Bonds and Guarantees	10%	R12m
Accident	60%	R6m
Attritional net	20%	R4.5m
Excess of loss		
General account XOL – risk/occurrence	R1.2m	R175m
Marine	R0.5m	R100m

Premiums ceded to reinsurers grew by 77% in F09, to R414m. Claims recoveries more than doubled to R332m (80% of reinsurance premiums, vs 71% in F08), following significant recoveries pertaining to large property claims. Accordingly, despite stable commission recoveries in proportional terms, the reinsurance underwriting account registered a cash gain for Renasa of R10m (F08: R19m loss). On an earned basis, the R9m surplus corresponds to a quarter of year-end capital. This is in contrast to the high deficits accruing to Renasa in the two prior years, equating to an average of 46% of capital.

	F07	F08	F09
Premium ceded	(157.7)	(234.1)	(413.5)
Commission recovered	29.2	49.6	91.4
Claims recovered	104.0	165.4	332.3
Cash profit / (loss)	(24.6)	(19.1)	10.2
Earned profit/(loss)	(8.0)	(6.6)	8.8
Expenses recovered	(2.1)	(1.5)	0.0
Net profit / (loss)	(10.1)	(8.1)	8.8
Net profit/(loss) : Capital	(53.4%)	(38.7%)	26.1%

Source: ST 2009.

Asset management

Strong volume growth and improved underwriting profitability resulted in an operating cash flow of R18m in F09 (F08: R5m). Despite expenditure relating to IT back-up systems, cash and equivalents rose to R53m, from R38m in F08. However, claims incurred more than doubled for the year, reducing claims cash coverage to 13 months (F08: 20 months), albeit remaining on par with the review period average. The dip in interest rates (450 basis point decline in the prime overdraft rate during Renasa's financial year) led to a slight reduction in the average

investment yield, to 8.1% (F08: 8.5%). Renasa invested R0.3m in a single listed counter in F09, although the holding generated no returns, and management is considering a return to a pure-cash portfolio in the short term.

Solvency and reserving

Significant retained losses, totaling R20m between F05 and F07, resulted in capital erosion and necessitated a number of capital injections over this period. However, over the past two years, the insurer has generated capital internally. Retained income amounted to R13m in F09 (F08: R2m), raising shareholders funds to R34m. Capital growth was outpaced by the 98% rise in risk premiums for the year, to R55m. As such, international solvency contracted to 61%, from 76% previously. Although no formalised capital injection policy is in place, note is taken of the demonstrated financial backing of the shareholder.

Statutory solvency remained stable at 51% in F09. As of 30 September 2009, Renasa's statutory solvency margin had reduced slightly, to 49%, while note is taken of a subsequent R2.8m dividend distribution. Management aims to maintain statutory solvency above 40% in the medium term. In terms of financial condition reporting ("FCR"), Renasa has purchased a capital modeling software licence from UK-based EMB Actuaries and Consultants. The reduction in exposure to high value property risks and improved operating controls are expected to have a favourable impact on the risk based capital model.

Financial performance

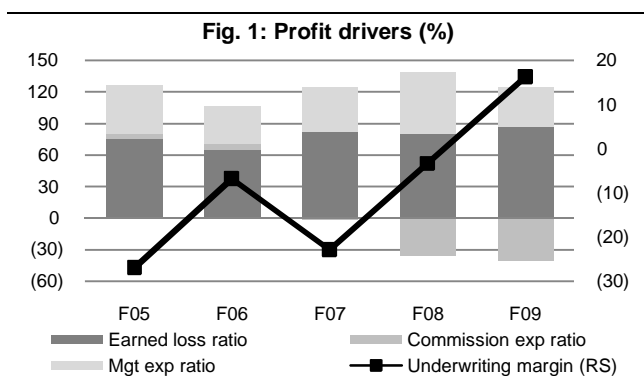
A five year synopsis of Renasa's results is reflected at the end of the report and brief comment follows.

	F09		% of budget
	Actual	Budget	
GPI	468.3	520.0	90.1
NPI	54.8	60.9	90.0
EPI	54.7	53.5	102.4
Claims	(47.6)	(43.7)	108.9
Commission	22.3	25.5	87.5
Management expenses	(20.5)	(24.7)	83.0
U/w result	8.9	10.6	85.2
Ratio (%)			
GPI growth	78.9	98.7	-
Retention	11.7	11.7	-
Loss ratio	87.0	81.7	-
Commission ratio	(40.8)	(47.7)	-
Mgmt. expense ratio	37.5	46.2	-
U/w margin	16.3	19.8	-
Trade ratio	83.7	80.2	-
International solvency	61.4	40.0	-

GPI growth amounted to 79% in F09 (3-year CAGR: 53%), raising total gross premiums to R468m. EPI exceeded budget, owing to the higher weighting of

monthly premiums. The large property losses caused the loss ratio to exceed the anticipated measure by 5 percentage points. This resulted in the underwriting margin registering below the expected level of 20%.

Increased volumes resulted in a contraction in the management expense ratio, to 38%, from 58% previously. Management expenses relative to GPI reduced to 4% in F09 (F08: 6%). Claims rose by a pronounced 112% to R48m in F09, with the overall loss ratio deteriorating to a review period high of 87% (F08: 81%). However, this rise was more than offset by the escalation in commission income (including profit share).



Accordingly, Renasa generated its first underwriting surplus of the review period of R9m, translating into an underwriting margin of 16% (F08: -3%). This is in sharp contrast to the period between F04 and F08, during which the insurer registered an average negative underwriting margin of 17%. Combined with investment income of R3.7m, this bolstered NPAT to R13m in F09, 5x higher than the previous year.

Future prospects

Table 8: Income statement (R'm)	F10		% of budget
	Actual YTD*	Budget	
GPI	135.6	546.5	24.8
NPI	16.3	55.3	29.5
EPI	16.4	55.3	29.7
Claims	(12.9)	(43.1)	29.9
Commission	3.9	23.9	16.4
Management expenses	(6.0)	(26.2)	23.0
U/w result	1.4	9.8	14.4
Investment income	0.7	3.3	20.1
Ratio (%)			
GPI growth**	15.8	16.7	-
Retention	12.0	10.1	-
Loss ratio	78.4	78.0	-
Commission ratio	(23.8)	(43.2)	-
Mgt. expense ratio	36.8	47.5	-
U/w ratio	8.6	17.7	-
Trade ratio	91.4	82.3	-
International solvency**	54.7	72.3	-

*3 months to September 2009.

**YTD annualised. Budgeted solvency ratio assumes effective tax rate of 229% and a total dividend payment of R2.8m

Management's strategy for F10 is not on growth, with emphasis on consolidation and enhanced risk selection. The R79m rise in GPI is projected based on a new book of business accepted in October F10, while additional new policies are expected to be garnered from an existing administrator later in the year. Continued focus on per risk rate increases and a reduction in high value exposures is expected to lower the earned loss ratio to 78% in F10 (F09: 81%). However, further outlays pertaining to data recovery system upgrades are expected to raise management expenses relative to earned premiums, to 48% (F09: 38%). Accordingly, underwriting profitability will continue to be supported by commission inflows.

Year to date figures for the first three months of F10 display premium levels relatively in line with budgeted figures. Additionally, the earned loss ratio and management expense ratio compare favourably with both the budget and F09 measures. However, owing to the cyclical nature of net commission income, stemming from higher (motor) earned loss ratios at the beginning of the year, the underwriting result is behind budget. Management expects that the implementation of corrective measures such as rate increases, excess adjustments and reductions in high claims exposures will allow for the attainment of the targeted commission income. The retained profit supported an increase in capital, with the international solvency margin amounting to an annualised 55% for the period (F09: 61%).

Renasa Insurance Company Limited

(R in millions except as noted)

Year ended : 30 June

	2005*	2006	2007	2008	2009	
Income Statement						
Gross premium income (GPI)	210.3	102.0	193.5	261.7	468.3	
Reinsurance premiums	(155.7)	(67.4)	(157.7)	(234.1)	(413.5)	
Net premium income (NPI)	54.6	34.6	35.7	27.7	54.8	
(Increase) / Decrease in insurance funds	(0.1)	(0.4)	(0.1)	0.2	(0.1)	
Net premiums earned	54.5	34.3	35.6	27.8	54.7	
Claims incurred	(41.6)	(22.4)	(29.4)	(22.4)	(47.6)	
Commission	(2.5)	(1.8)	0.7	9.9	22.3	
Management expenses	(25.1)	(12.4)	(15.1)	(16.2)	(20.5)	
Underwriting profit / (loss)	(14.7)	(2.3)	(8.2)	(0.9)	8.9	
Investment income (incl. realised gains)	2.2	0.9	1.9	3.0	3.7	
Other income / (expenses)	0.0	0.0	0.0	0.0	0.0	
Taxation	0.0	0.0	0.0	0.0	0.0	
Net income after tax	(12.5)	(1.5)	(6.3)	2.1	12.6	
Unrealised investment gains / (losses)	0.0	0.0	0.0	0.0	0.0	
Cash Flow Statement						
Cash generated by operations	(13.2)	(1.4)	(7.8)	(0.6)	9.6	
Cash flow from investment income	2.2	0.9	1.9	3.0	3.7	
Working capital decrease / (increase)	(16.4)	(2.0)	4.4	3.0	4.4	
Cash available from operating activities	(27.5)	(2.5)	(1.6)	5.4	17.7	
Tax paid	0.0	0.0	0.0	0.0	0.0	
Cash flow from operating activities before dividends	(27.5)	(2.5)	(1.6)	5.4	17.7	
Dividends paid	0.0	0.0	0.0	0.0	0.0	
Cash flow from operating activities	(27.5)	(2.5)	(1.6)	5.4	17.7	
Purchases of investments	(0.7)	(0.2)	(0.5)	(0.5)	(2.4)	
Proceeds on disposal of investments	0.0	0.0	0.0	0.0	0.0	
Other investing activities	0.0	0.0	0.0	0.0	0.0	
Cash flow from investing activities	(0.7)	(0.2)	(0.5)	(0.5)	(2.4)	
Cash flow from financing activities	5.5	8.0	7.0	0.0	0.0	
Net cash inflow / (outflow)	(22.6)	5.4	4.9	4.9	15.2	
Balance Sheet						
Shareholders interest	11.7	18.3	18.9	21.1	33.6	
Insurance funds	0.4	0.8	0.9	0.7	0.9	
Outstanding claims provision	14.5	16.4	14.4	9.2	10.6	
Other liabilities	8.4	6.9	20.6	26.4	53.7	
Total capital & liabilities	35.1	42.3	54.9	57.3	98.7	
Fixed assets	0.5	0.4	0.7	0.9	2.8	
Investments	0.0	0.0	0.0	0.0	0.3	
Cash and short term deposits	22.5	27.9	32.8	37.8	53.0	
Other current assets	12.1	14.0	21.3	18.7	42.7	
Total assets	35.1	42.3	54.9	57.3	98.7	
Key Ratios						
Solvency / Liquidity						
Shareholders funds / NPI	%	21.5	79.1	53.0	76.2	61.4
Solvency margin (Act)	%	19.8	42.7	43.0	51.3	51.4
Financial base	%	22.3	82.5	55.6	78.8	63.0
Outstanding claims / NPI	%	26.6	70.9	40.4	33.1	19.3
Insurance funds / NPI	%	0.8	3.5	2.6	2.7	1.6
Claims cash coverage	mth	6.5	22.4	13.4	20.2	13.4
Avg. premium debtors days	days	21.1	15.5	15.9	16.1	14.9
Profitability						
ROaE (before unrealised gains / losses)	%	(82.0)	(6.6)	(33.9)	10.5	46.0
ROaE (after unrealised gains / losses)	%	(82.0)	(6.6)	(33.9)	10.5	46.0
Investment yield (including unrealised gains / losses)	%	6.5	2.3	6.2	8.5	8.1
Cash investment yield (average)	%	6.5	2.3	6.2	8.5	8.1
Efficiency / Growth						
GPI Growth	%	39.3	(27.0)	89.6	35.3	78.9
Premiums reinsured / GPI	%	74.0	66.0	81.5	89.4	88.3
Earned loss ratio	%	76.3	65.3	82.7	80.6	87.0
Commissions / Earned premiums	%	4.6	5.3	(2.1)	(35.5)	(40.8)
Management expenses / Earned premiums	%	46.1	36.3	42.4	58.2	37.5
Underwriting result / Earned premium	%	(27.0)	(6.8)	(23.0)	(3.3)	16.3
Trade ratio	%	127.0	106.8	123.0	103.3	83.7
Operating ratio	%	122.9	104.3	117.7	92.4	77.0
Operating						
Effective tax rate	%	0.0	0.0	0.0	0.0	0.0
Dividend cover	X	n.a.	n.a.	n.a.	n.a.	n.a.

* 18 months ended 30 June, prior to which 31 December year end - relevant ratios annualised.