MOODY'S INVESTORS SERVICE

CREDIT OPINION
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Update

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Guardrisk Group

Update following ratings affirmation and outlook change to stable

Summary

The Ba2 global scale Insurance Financial Strength (IFS) ratings, with stable outlook, assigned to entities in the Guardrisk group - as well as the Aaa.za national scale IFS ratings assigned to the South African entities - reflect its good market position as the largest cell captive insurer in the South African market, low underwriting risk due to its predominantly fee based model, diverse product mix across life insurance and short-tailed non-life insurance lines, and strong profitability. These strengths are partially offset by its investment portfolio's concentrated exposure to the South African economy and banking system with a significant majority of Guardrisk group's invested assets comprising South African bank deposits, debt securities and investments in money market funds. Also, Guardrisk group has a lower regulatory capital buffer above the new South African Solvency Assessment and Management framework (SAM) capital requirements due to non-recognition of surplus capital in cells for regulatory capital purposes, and is exposed to corporate credit risk through its reliance on cell-owners to recapitalise cells in the event needed. Deterioration in the local economy, exacerbated by the economic effects of coronavirus, will lead to rising corporate credit risk.

On 5 April 2022, Guardrisk's ratings were affirmed and the outlook changed to stable from negative following Moody's affirmation of South Africa government's Ba2 issuer rating and change of outlook to stable from negative on 1 April 2022.

The rated entities included in the Guardrisk group, collectively referred to as Guardrisk, include Guardrisk Insurance Company Limited (Guardrisk Insurance), Guardrisk Life Limited (Guardrisk Life) and Guardrisk International Limited PCC (Guardrisk International), incorporated in Mauritius (Government of Mauritius, Baa2 negative). Guardrisk Insurance and Guardrisk Life are rated both Ba2 on the global scale, and Aaa.za on the national scale, while Guardrisk International is rated Ba2 on the global scale only. Additionally, while Guardrisk is comprised of various regulated entities, we consider Guardrisk's various entities to be a single analytic unit, and, as such rate them at the same level, including Guardrisk International, which although it is regulated and capitalised separately from the broader Guardrisk group, remains an integral part of the group and therefore the analytic unit.

For FY21, the Guardrisk group reported gross premium income of R27.1 billion (2020: R26.8 billion) and net revenue of R1,082 million (2020: R929 million), with Guardrisk Insurance (70%) and Guardrisk Life (22%) contributing the majority of net revenue for the year. Total assets under management grew to R41.9 billion (2020: R37.2 billion) and shareholders' funds increased to R8 billion (2020: R7.4 billion).

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Guardrisk's ratings are constrained by the sovereign credit environment - (Government of South Africa Ba2, stable) - due to linkages as a result of (i) invested assets (government, banking or other securities) and (ii) correlation of operating performance to the local economy.

Credit strengths

» Solid market position with a dominant position in the cell captive sector

» Significant fee based income that is inherently less volatile than traditional underwriting income

» Contractual control over risk management and capitalisation of individual cells, including recourse to cell owners for recapitalisation of cells

Credit challenges

» Onerous regulatory capital requirements under SAM standard formula, which does not fully take into account specific characteristics of the cell-captive business model

» White-label nature of the business and limited end customer interaction weakens the market position relative to some retail insurers with a stronger link to actual policyholders

» Significant exposure of its asset base and income stream to South Africa, and the country's economic performance

Outlook

The outlook for Guardrisk's global scale ratings are stable, in line with the rating of South Africa (Ba2, stable).

Factors that could lead to an upgrade of Guardrisk's Global Scale Rating

The following factors could lead to upward pressure on the ratings:

(i) positive rating action on the South African sovereign or banking sector;

(ii) explicit support from a higher rated entity within the Momentum Metropolitan group; and

(iii) diversification of the group's geographic footprint as concerns its invested assets and earnings that meaningfully reduces is exposure to South Africa, or other highly correlated regions.

Factors that could lead to a downgrade of Guardrisk's Global Scale Rating

The following factors could lead to downward pressure on the ratings:

(i) negative rating action on the South African sovereign or banking sector;

(ii) failure to maintain regulatory capital levels comfortably above management's minimum target; and

(iii) material weakening in the Guardrisk's franchise, including regulatory or market changes that limit the appeal of the cell captive insurance model in South Africa.

Profile

Guardrisk is the largest provider of cell captive insurance in South Africa and manages cells that insure both life and non-life risks in South Africa and internationally, predominantly in other African countries. Based on premiums written -- both at the cell and promoter levels -- Guardrisk is the third largest non-life insurer in South Africa. Guardrisk is a subsidiary of Momentum Metropolitan Holdings Limited, a leading insurance group in South Africa.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

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Guardrisk was awarded a microinsurance license in April 2021. Through its microinsurance licence, Guardrisk is able to sell individual life, group life, credit life and funeral insurance, as well as products that provide cover for motor, property, legal expenses, and accident and health.

A new development for Guardrisk has been the establishment of a Specialist Liability Underwriting team.

Detailed credit considerations

Guardrisk's credit profile has a meaningful link to the South African sovereign (Government of South Africa, Ba2 stable) and banking system, which acts as a constraint to Guardrisk's ratings. The primary reasons for this link include (i) the significant majority of the company's invested assets being held in domestic securities, including deposits with domestic banks, and (ii) sensitivity of the group's operating performance to the South African economy and financial markets. While Guardrisk International Limited is based in Mauritius (Government of Mauritius, Baa2 negative), Moody's currently considers its credit profile to be linked to the broader Guardrisk group, and its parent, Guardrisk Insurance, that is based in South Africa.

Guardrisk's Ba2 IFS rating is three notches below the Baa2 adjusted scorecard-indicated outcome as shown in Moody's scorecard (Exhibit 2) reflecting the constraint of the sovereign rating.

Insurance Financial Strength Rating

Market Position and Distribution – Solid franchise with dominant position in cell captive industry

Guardrisk is the largest cell captive insurer in South Africa and has a dominant position in the cell captive industry, focused on both non-life and life insurance and most recently microinsurance. Guardrisk Insurance, the non-life insurer, is the third largest insurer in the sector. Gross premium income for fiscal year 2021 increased to R27.1 billion (2020: R26.8 billion) including premiums of all cells and the promoter. While Guardrisk Life has a significantly smaller share of the life insurance market in South Africa, it is a key complement to Guardrisk's business and is licensed to write assistance, disability, fund, health, life policies and endowment policies, primarily as a cell captive insurer.

However, while Guardrisk handles significant premium volumes, the majority of these are on behalf of the individually owned cells, with Guardrisk's primary source of revenue being the fees it earns for managing the cells and invested assets belonging to cell owners. Similarly, its expenses are substantially related to operational expenses, and it is not exposed to significant underwriting gains and losses. This fee based model limits volatility in earnings, and reduces the level of underwriting risk Guardrisk is exposed to.

That said, as part of its growth strategy, Guardrisk has been increasing the amount of business it underwrites on its own balance sheet, including through reinsuring a portion of business written by specific cells. The group plans a gradual and targeted increase in risk taking, focused on niche corporate, commercial and specialist lines, using appropriate reinsurance structures to moderate net retentions. In line with this strategy, in March 2019, Guardrisk launched its newest offering Guardrisk General Insurance (GGI) and in November 2017, Guardrisk acquired Marine Underwriting Managers (Pty) Ltd.

As a result of the increase in the its risk taking activities, the group's contribution from underwriting profit has increased to 26% (albeit reduced from 27% in 2020) in 2021 from 17% in 2018. The remaining share of Guardrisk's total net revenue was comprised of 57% management fees, 10% investment income and 7% investment fees. At H1 FY22, the contribution from underwriting profit increased to 29%.

The group's business is primarily conducted through brokers, although Guardrisk maintains very strong relationships with its cell captive clients, and individual cells distribute to end customers through a variety of channels. Guardrisk's partnership with Insuretech startup, Root Insurance, will provide it with a more direct distribution platform, although on a very small scale initially. Guardrisk will provide insurance capacity and infrastructure to Root, which functions as a white-label insurance distribution platform in the South African market. With this partnership, Guardrisk is positioning itself for the technology-led modernisation of the insurance sector.

Product Focus and Diversification – Good diversification across short-tailed lines offset by geographic concentration and business model complexity

Guardrisk writes a diverse mix of business across both personal and commercial lines, with property, motor, accident and health and Marine being the predominant non-life lines. The vast majority of its business is written in South Africa, although Guardrisk International writes life and non-life business internationally, predominantly in other African countries and Latin America. The

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majority of Guardrisk's life and non-life business relates to either first or third-party cells, where underwriting risk resides with the cell. Guardrisk's main exposure in the cell business is to third-party cells, however exposure is limited to credit risk insofar as the cell owner is not able to recapitalise a cell that is insufficiently capitalised. In addition to its cell business, Guardrisk does earn a moderate, and growing, amount of its premium through assuming insurance risk on its own balance sheet, either through reinsurance of business written in particular cells, or insurance it has written directly.

While Guardrisk's insurance exposure is modest relative to the premium volume it handles, its cell captive business is inherently complex due to the many individually managed cells with bespoke insurance products and pricing frameworks. This complexity requires intricate systems and meaningful management attention to ensure that individual cells are in compliance with Guardrisk's risk management policies and regulatory requirements. Somewhat mitigating the operating risks associated with complexity are the fairly wide-ranging contractual rights that Guardrisk has over individual cells, that provide it with control over many aspects of the cells, including product design and pricing, underwriting, capitalisation, and the ability to cause individual cells to purchase reinsurance protection. In addition, Guardrisk benefits from the contractual ability to pursue certain third parties in the event of a cell owner not appropriately recapitalising an undercapitalised cell.

Asset Quality – Heavy concentration in domestic assets including securities that correlate closely to the sovereign

Guardrisk maintains a very conservative investment strategy, in line with its objectives of capital preservation and liquidity. As such, a significant majority of Guardrisks's invested assets comprise high-quality, liquid domestic securities, including bank deposits, government debt and investments in money market funds. While these securities are high-quality in the South African context, they tend to be correlated with the credit profile of the sovereign, and therefore we consider Guardrisk's credit profile to be linked to that of the South African government and banking sector, as reflected in the Ba score for Asset Quality.

Guardrisk makes extensive use of reinsurance as a risk management tool, both at the individual cell level, and on certain insurance risks that Guardrisk retains. Reinsurance is placed with well established, high-quality reinsurers that are able to provide underwriting expertise on cell exposures in addition to capital relief. As the group increases the amount of risk its takes on its own balance sheet, it expects prudent use of reinsurance to be a key tool in limiting earnings volatility, and potential stress on capital.

Capital Adequacy – Economic capitalisation is good, but SAM regulations place regulatory capitalisation under pressure

At 30 June 2021, Guardrisk Insurance's and Guardrisk Life's capital cover, under the SAM requirements, were at 1.15x and 1.12x the solvency capital requirements respectively. While the solvency position for Guardrisk Insurance has improved from 1.11x, the SCR cover for Guardrisk Life has remained at the same level as at 30 June 2020. For the six months ended December 2021, the solvency positions of Guardrisk Insurance and Guardrisk Life improved 1.28x and 1.16 respectively and in both entities, the solvency position remains above the risk appetite thresholds of 1.05x SCR. The group's capital coverage levels are meaningfully lower than under the previous regulatory capital requirements, where at year-end 2018, Guardrisk Insurance's and Guardrisk Life's solvency ratios were at 1.6x and 2.6x respectively.

While the group is compliant with SAM capital requirements, its buffer above the minimum regulatory capital requirement is lower under SAM than in the previous dispensation. This is because excess capital in individual cells is not recognised as solvency capital at the Guardrisk license level. However, this excess capital is available to absorb losses, and therefore we expect the SAM SCR coverage ratio to be very resilient to downside, and not particularly volatile, mitigating the risk of a lower regulatory capital buffer.

A unique feature of the cell captive business, which is not reflected in regulatory capital requirements, is the fact that while Guardrisk is the ultimate backstop for all insurance written by the cells it manages, it is the cell owners' contractual obligation to recapitalise a cell in the event of the solvency ratio of the cell falling below the ratio required by the regulator or if the shareholder's funds reflect a deficit. Therefore, we consider Guardrisk's primary risk to be the credit risk related to the individual cell owners. That said, weakening in the South African macro environment, and the impact it has on local corporate entities, raises the credit risk that Guardrisk is exposed to.

Profitability – Strong profitability driven by fee income

We consider Guardrisk's profitability to be strong, benefiting from meaningful operational leverage given the extent of premium volume handled by its cells relative to its own capital (excluding capital attributable to cell owners). In addition the majority of Guardrisk's income is fee-based, including an insurance contract management fee and an investment fee, which is less volatile than

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traditional underwriting income. Guardrisk group reported operating income before interest and tax (trading result) of R513 million in fiscal year 2021, an increase of 12% over R457 million for 2020. The group's performance was supported by strong growth in new business, as well as an increase in underwriting profits compared to the previous year. Core earnings for FY21 are reported before an impairment as a result of the continued prudent approach to the treatment of cells in deficit. In FY 2021, no material risk has been identified in any of the cells and the provision for impairment amounted to only R600 thousand (FY 2020: R100 million).

For the six months ended 31 December 2021, Guardrisk's normalised headline earnings increased by 73% to R295 million with operating profit supported by growth in management fees in the mining rehabilitation and life divisions, and growth of 53% in underwriting profits.

In December 2020, the Supreme Court of South Africa concluded on the scope of coverage for pandemic-related business interruption (BI) claims. Already before the final outcome of the legal process, Guardrisk has been providing relief to policyholders in the South African hospitality industry as a result of the impact of the coronavirus by offering a settlement in terms of the policy to affected policyholders. The settlement offer triggers cover under quota share and non-proportional (excess-of-loss) reinsurance agreements. By 31 December 2021, Guardrisk had settled most of its business interruption claims, with 52 claims outstanding that have an estimated gross value of R152 million. The Group has stated that the remaining provision against business interruption claims is seen as sufficient to absorb the impact of the outstanding claims in Guardrisk.

Going forward, the group aims to increase underwriting profit to be within the 25% to 30% range. However, as the company expands its risk-based premium income, return on capital might decrease slightly, even as absolute profits increase.

Reserve Adequacy – Short-tailed product focus limits reserve risk

Guardrisk's predominantly short-tail focused non-life insurance book allows the majority of claims to be settled within two years of policy underwriting, reducing the risk of unexpected losses emerging from older accident or underwriting years. While the nature of Guardrisk's exposures do not present the type of reserve risks typically associated with longer-tailed business, individual cells have, at times, experienced meaningfully higher than expected claims leading to adverse reserve development. As Guardrisk increases the extent of its own underwriting exposure, potentially to more complex specialty risks and an increased amount of liability business, we expect reserve risk to rise moderately.

Financial Flexibility – Moderate leverage and solid coverage metrics despite deterioration due to coronavirus

Moody's assesses the financial flexibility of Guardrisk and other rated entities in the group at the Momentum Metropolitan Holdings Limited (MMH) level.

Moody's assesses the financial flexibility of MML and other rated entities in the group at the MMH level. MMH's leverage remains moderate, although slighly increased, with Moody's adjusted financial leverage of 25.8% for FY 2021 (FY 2020: 23.6%). Approximately R0.4 billion of debt related to property development loans is not included in the financial leverage metric, because the debt is secured on the related real estate without recourse to MMH. Also, approximately R0.4 billion of preference shares via a consolidated special purpose vehicle are excluded from the metric. R1,252 million of financial liabilities, classified as "other" in the financial accounts, with no additional public disclosure, is included in the financial and total leverage metrics. However, we understand that this debt, which is held by MMH property assets SPVs and Isabelo employee ownership shares SPVs, is ring-fenced with no recourse to MMH.

Earnings cover improved in 2021 to 6.6x, from 5.3x in 2020, which was driven by both the increase in MMH's earnings for FY 2021 and the lower interest expense. While MMH's financial flexibility is relatively strong, on an unconstrained basis, in line with its peers, MMH's financial flexibility is constrained at the Ba level in line with the rating of the South African sovereign.

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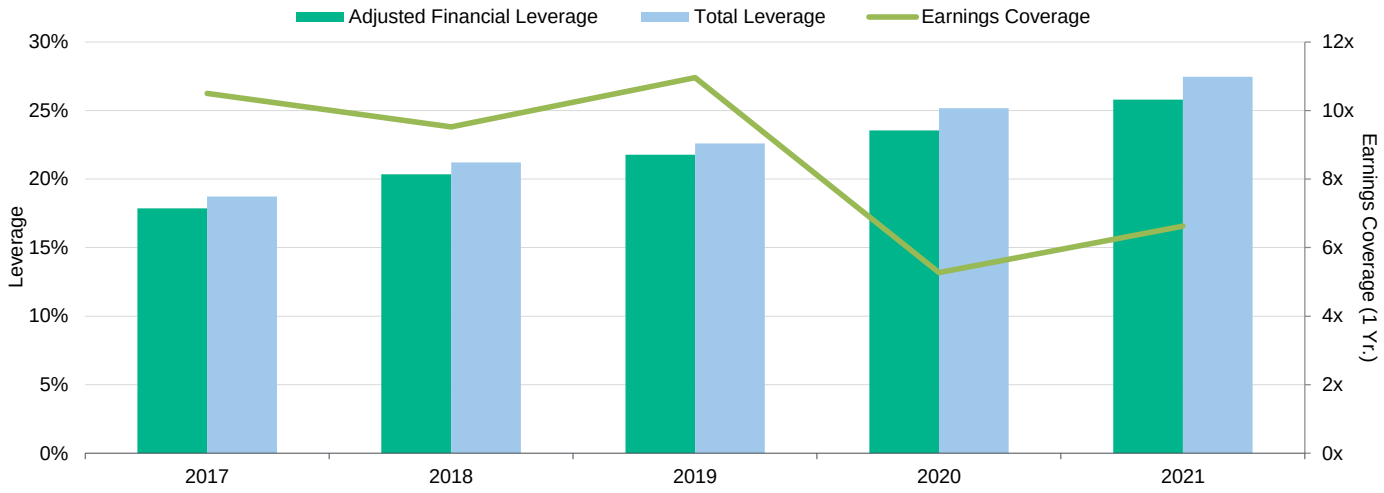
Exhibit 1

Declining financial flexibility as leverage edges up



Financial Flexibility metrics for Guardrisk parent, Momentum Metropolitan Holdings Limited
Source: Company reports, Moody's Investors Service

MMH's capital structure primarily includes common equity, preference shares and subordinated debt. The subordinated debt, amounting to R4.4 billion at 30 June 2021 with maturities well spread out, is issued by MML and qualifies as Tier 2 capital for regulatory capital purposes. In February 2021, MML issued two new subordinated debt instruments with the combined value of R750 million. The issuances have refinanced R750 million of MML's subordinated debt which matured in March 2021, and therefore do not impact MMH's adjusted financial leverage. However, the coupon on the notes is lower than the 10.07% of the matured notes which benefits MMH's earnings coverage.

National Scale Rating

Moody's National Scale Credit Ratings (NSRs) are opinions of the relative creditworthiness of issuers and financial obligations within a particular country. NSRs are not designed to be compared among countries. Rather, they address relative credit risks within a given country. Moody's assigns NSRs in certain local capital markets in which investors have found that the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country. The last two characters of the national scale rating indicate the country in which the issuer is located or the market of issuance.

While NSRs have no inherent absolute meaning in terms of default risk or expected loss, a historical probability of default consistent with a given NSR can be inferred from the GSR to which it maps back at that particular point in time. For information on the historical default rates associated with different global scale rating categories over different investment horizons, please see https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1216309 .

Guardrisk's Aaa.za national scale IFS rating is based on the application of Moody's mapping criteria for a Ba2 global scale IFS rating to the South African national scale. At the Ba2 global scale rating level, Guardrisk's Aaa.za rating is at the upper of three possible outcomes on the South African national scale, reflecting our view of Guardrisk's dominant position in the cell captive sector and fee-based nature of revenues.

Overview of Key Guardrisk Subsidiaries

Guardrisk Insurance is the largest non-life insurer in the Guardrisk group primarily focused on providing cell captive insurance for the South African market. It writes a wide range of corporate, personal and commercial lines that are mostly short-tailed.

Guardrisk Life is a life insurer primarily focused on providing cell captive insurance for the South African market. It offers a diverse range of long-term insurance lines including funeral benefits, health and employee benefits.

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Guardrisk International is domiciled in Mauritius and is licensed to write both short-term and long-term reinsurance, although its business is predominately short-term focused. It offers a diverse set of products to Guardrisk's clients with operations outside of South Africa, predominantly in Africa.

Environmental, Social and Governance (ESG) Considerations

Environmental

Like its non-life insurance peers, Guardrisk is exposed to the economic consequences of climate change, primarily through the unpredictable effect of climate change on the frequency and severity of weather-related catastrophic events, such as floods, convective storms, drought and wildfires. Because of its geographic focus on South Africa, Guardrisk is less exposed to certain weather-related events, such as hurricanes, than some other insurers, and is able to manage its exposure to changing weather-related events through extensive reinsurance protection, and annual repricing and adjustment of its insurance exposures.

Social

Like its peers with life insurance exposures, Guardrisk faces a range of social risks that are potentially material to its business. It operates in a sector which is highly regulated and provides the majority of its products through diverse distribution channels. Customer relations are important because of the sector's reliance on handling customer data and privacy. Human capital risks are potentially significant, primarily in respect of recruiting and retaining key employees. Demographic and societal trends, including longer lifespans and aging populations, will affect retirement and estate planning products, as well as the pricing of life and health risks as the group manages mortality, longevity and morbidity risks. Societal trends could also limit the group's ability to share adverse experience through higher premiums for holders of life and long-term care insurance policies. Digital innovations are disrupting distribution patterns for life insurers. Effects range from the underwriting process itself to how life insurance and retirement products are purchased.

Governance

Like all other corporate credits, the credit quality of Guardrisk is influenced by a wide range of governance-related issues, relating to financial, managerial, ownership or other factors, all of which can be exacerbated by regulatory oversight and intervention. While Guardrisk's risk exposures are complex, the group has strong risk management processes and internal controls that mitigate various governance risks. Under the oversight of its Board of Directors, the group's management team has a strong track record and experience. Guardrisk and the broader MMH group operates within a strong regulatory environment, being overseen by the South African Reserve Bank's Prudential Authority, and various national regulators in other jurisdictions.

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Rating methodology and scorecard factors

Exhibit 2

Guardrisk Insurance Company Limited

Financial Strength Rating Scorecard [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adj Score
Business Profile								A	Baa
Market Position, Brand and Distribution (25%)								A	Baa
-Relative Market Share Ratio	X								
-Underwriting Expenses % Net Premiums Written							X		
Product Focus and Diversification (10%)								A	Baa
-Product Risk		X							
-P&C Insurance Product Diversification			X						
-Geographic Diversification						X			
Financial Profile								Ba	Baa
Asset Quality (10%)								B	Ba
-High Risk Assets % Shareholders' Equity							X		
-Reinsurance Recoverable % Shareholders' Equity							X		
-Goodwill & Intangibles % Shareholders' Equity[3]				44.8%					
Capital Adequacy (15%)								Caa	Baa
-Gross Underwriting Leverage							X		
Profitability (15%)								Aa	A
-Return on Capital (5 yr. avg.)	X								
-Sharpe Ratio of ROC (5 yr.)			X						
Reserve Adequacy (10%)									A
-Adv. (Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd. avg.)									
Financial Flexibility (15%)								Ba	Ba
-Adjusted Financial Leverage[3]		25.8%							
-Total Leverage[3]		27.5%							
-Earnings Coverage (5 yr. avg.)[3]		8.6x							
-Cash Flow Coverage (5 yr. avg.)[3]									
Operating Environment								Baa	Baa
Preliminary Standalone Outcome								Baa3	Baa2

[1] Information based on IFRS financial statements as of fiscal year ended June 30, 2021. [2] The Scorecard rating is an important component of the company's published rating, reflecting the standalone financial strength before other considerations (discussed above) are incorporated into the analysis. [3] Information based on IFRS financial statements of Momentum Metropolitan Holdings Limited as of fiscal year ended June 30, 2021.

Source: Moody's Investors Service

Ratings

Exhibit 3

Category	Moody's Rating
GUARDRISK INSURANCE COMPANY LIMITED	
Rating Outlook	STA
Insurance Financial Strength	Ba2
Insurance Financial Strength--National Scale	Aaa.za
GUARDRISK LIFE LIMITED	
Rating Outlook	STA
Insurance Financial Strength	Ba2
Insurance Financial Strength--National Scale	Aaa.za
GUARDRISK INTERNATIONAL LIMITED PCC	
Rating Outlook	STA
Insurance Financial Strength	Ba2

Source: Moody's Investors Service

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