

Composite

## **AFRICAN REINSURANCE CORPORATION**

### **BEST'S RATING**

Based on our opinion of the company's Financial Strength, it is assigned a Best's Rating of A- (Excellent). The company's Financial Size Category is Class VIII.

**Best's Rating: A-**

**Outlook: Stable**

### **BUSINESS REVIEW**

African Reinsurance Corporation (Africa Re) is an established regional reinsurer with its head office in Nigeria and six other regional offices/subsidiaries in major African countries. The company's shareholders include five development finance institutions, 41 member governments and 110 African insurance and reinsurance companies. In A.M. Best's opinion, Africa Re has a recognised business profile in the African reinsurance market, where it continues to lead many reinsurance treaties (particularly in fire and engineering) and benefits from the close proximity of its branch offices to its cedants.

At year-end 2007, the Establishment Agreement provided that 5% of all treaty business in member states must be offered to Africa Re, with a refusal option on the part of Africa Re if particular risks are undesirable in terms of the company's portfolio mix. Compulsory cessions as a percentage of business written decreased to 10.3% in 2007, from 11.5% in the previous year, though this figure was significantly lower than in 2002 when approximately 27% of business was ceded in this form. Going forward, A.M. Best expects compulsory cessions to account for approximately 10% of the total portfolio over the next two years.

In 2007, gross written premium was split between motor (25%), property (24%), accident business (15%), energy (11%), marine and aviation (9%), engineering (9%), and life (3%). A.M. Best does not expect significant changes to the composition of the business portfolio. The company's business mainly emanates from Africa (94%), while the remaining 6% comes from the Middle East and South Asia. The majority of international business is accounted for by fire risks. In 2007, gross written premiums increased by 30% to USD 370 million, from USD 272 million in the previous year, with net written premiums increasing 35% to USD 318 million. This was as a result of increased premiums from its South Africa business. Africa Re obtained a one-off quota share treaty with one of its major clients that amounted to USD 30 million in premium, though with Africa Re's share expecting to reduce year on year. The company also benefited from exchange rate gains from the stronger South African rand compared to the United States dollar, along with additional new business from Nigeria due to uncertainty among existing insurers with respect to re-capitalisation requirements. It is expected that gross premiums will grow by 7.5% in both 2007 and 2008, mainly emanating from the company's energy (oil) business, which is anticipated to account for 13-15% of Africa Re's portfolio.

A.M. Best expects the company's life business to grow materially, due to the currently underdeveloped life market in Africa (except for South Africa, where the company has ceased to write life policies). Africa Re's life portfolio is dominated by group life, which accounts for 95% of the portfolio.

Despite writing business in most African countries, approximately 43% of gross premium income emanates from South Africa as this country's insurance industry provides approximately 80% of total premium income in Africa. Growth rates for South Africa are likely to be 7.5% over the next two years, with Angola targeted as Africa Re's main area for expansion due to its oil and mineral deposits. In A.M. Best's opinion, Africa Re's expectations are in line with economic growth in its major markets of between 5-10% per annum. Africa Re's business is either broker driven (65%) or direct (35%). The majority (88%) of broker driven business arises from South Africa, where brokers are prevalent. Otherwise business is written directly through the company's regional offices.

## FINANCIAL PERFORMANCE

**Overall Earnings:** A.M. Best believes that Africa Re's financial performance is likely to remain marginal, with pre-tax profits expected to be approximately USD 30 million in 2008 and 2009. In A.M. Best's opinion, Africa Re's overall earnings are expected to remain mainly dependent on investment income as underwriting performance has been modest with a combined ratio of 97.9% in 2007. Tougher market conditions in 2008 and 2009 are likely to result in the softening of rates, particularly with regard to energy risks, consequently placing added pressure on Africa Re's underwriting performance. A.M. Best forecasts that the company's investment returns (including realised and unrealised gains and losses) will decline over the next two years, with investment yields of 5%.

In A.M. Best's opinion, Africa Re's return on equity (ROE) in 2008 and 2009 is likely to be lower at 11%, compared to 16% in 2007.

**Underwriting Income:** A.M. Best believes that Africa Re's underwriting performance is likely to remain modest, with a combined ratio of 97.9% in 2007, down marginally from 98.4% in 2006. Africa Re's expense ratio decreased in 2007 to 32.7%, from 34.9%, with the increase offset by marginally higher claims experience translating into an increasing loss ratio to 65.2%. Expenses are expected to remain at this level going forward. In A.M. Best's opinion, it is essential that the company controls its underwriting risks to ensure its combined ratio remains below 100%.

For Africa Re's life business (which represented 4% of overall net written premium in 2007), A.M. Best anticipates technical profits will improve to USD 585,000 in 2008, following the reduction of unprofitable life business written in South Africa (which contributed to the underwriting loss in 2006).

**Investment Income:** A.M. Best forecasts that Africa Re's net investment returns, including realised and unrealised gains and losses are likely to decline to approximately 5% in 2008 and 2009. This is due to the company's exposure to assets denominated in United States dollars, where the company has significant investments and returns are expected to be lower. Africa Re has a conservative investment strategy, which is geared towards cash and short-term deposits (approximately 68% of total investments in 2007). Approximately 75% of these deposits are invested in US and European banks, with the remainder held in regional banks. In A.M. Best's opinion, this reduces somewhat the investment risk. The company aims to revise its investment strategy to accommodate higher proportions of investment in fixed income securities and less in fixed term cash deposits. The company uses internationally recognised investment companies to manage its investment portfolio.

## CAPITALIZATION

**Overall Capitalization:** In A.M. Best's opinion, Africa Re's prospective risk-adjusted capitalisation is expected to remain solid over the next two years, provided growth in net premiums is limited to 10% per annum. A significant increase in net written premiums may put pressure on the company's risk-adjusted capitalisation going forward. In A.M. Best's opinion, the company's risk-adjusted capitalisation benefits from the company's requirement to transfer 50% of net profit to general reserves (which A.M. Best regards as equity). Furthermore, Africa Re's risk-adjusted capitalisation also benefits from the company's continuing increase in overall retained earnings. In A.M. Best's opinion, Africa Re's ability to attract "AAA" rated supranational investors indicates the strong level of international support for the company. It is essential that the company has sufficient retained earnings invested back into the business to support its projected growth aspirations.

Furthermore, Africa Re has increased authorised share capital to USD 500 million during 2007. It is anticipated that the company will increase its capital base to this level by 2015. The company receives excellent support from its main shareholders and exhibits improved enterprise risk management, which should ensure that the company's capital position remains strong over the long term.

**Reserve Quality:** In A.M. Best's opinion, reserves are adequate and set in accordance with regulatory requirements. The company performs two methods for calculating reserves; firstly, with the use of case estimates with incurred but not reported (IBNR) provisions, and secondly, actuarial methods. The company adopts the higher reserve of the two methods. Reserves are reviewed independently by external actuaries, and are considered more than sufficient to meet the company's liabilities with surplus estimated to be approximately USD 40 million in 2007.

## LIQUIDITY

**Overall Liquidity:** In A.M. Best's opinion, Africa Re's liquidity ratio is solid and expected to remain at the 2007 level of 100% during the next two years as the majority of total investments (68% in 2007) are held in cash and short-term deposits. The remaining investments are split between bonds (20%), listed shares (7%) real estate (4%) and unlisted shares (1%). A.M. Best does not expect any material changes to the composition of the investment portfolio. The average maturity of the bond portfolio is two to five years, and this, in A.M. Best's opinion, is in line with the average duration of the company's corresponding liabilities.

## MANAGEMENT

In A.M. Best's opinion, Africa Re benefits from an experienced management team with longstanding and wide-ranging knowledge of global (and in particular, African) insurance and reinsurance markets. The company's corporate governance is extensive, using very good management information systems to maintain control over the regional office network throughout the African continent.

A.M. Best regards the company's move from a three year accounting basis to an annual accounting basis in accordance with International Financial Reporting Standards (IFRS) as a

progression towards compliance with international regulations. Although unregulated outside of South Africa, Africa Re benefits from a supervisory board of independent directors, a significant number of which are heads of their national insurance regulatory bodies. In addition, the African Development Bank, International Financial Corporation and Deutsche Investitions und Entwicklungsgesellschaft each hold a permanent board position and the company is subject to regular internal audits which are submitted to the audit and risks committee of the board of directors at Africa Re.

Furthermore, the company has improved its risk control procedures by setting up an independent risk management unit within the company. The company uses Remetrica to assess its risk profile and capital requirements. Currently, Africa Re has implemented the system into two regional offices, including South Africa, and is expected to apply the methods for all other regional offices by year-end 2009. Additionally, Africa Re has used independent third parties to conduct a Risk Identification and Assessment procedure, whereby all risks, including potential organisation failure and probable maximum loss are assessed with regard to the impact on the company. The company's management will continue these risk control measures going forward.

## **REINSURANCE**

A.M. Best believes that Africa Re's retrocession programme is very good, both in its structure and in the security of the companies used. Africa Re purchases retrocession cover through a comprehensive excess of loss programme. Excess of loss cover is bought separately for property, casualty, marine and aviation accounts from reinsurers who generally have a rating in the "A" range.

Africa Re is exposed to earthquake risks in South Africa, Kenya and Algeria. Additionally, the company is exposed to cyclone risks in Mauritius. The retrocession programmes enable the company to restrict its net retention to USD 10 million with the option of reinstatements at each layer. The company's largest exposure is more than adequately covered by the company's extensive retrocession cover.