Public credit rating report | Kenya Insurance | September 2022

East Africa Reinsurance Company Limited

Rated entity	Rating class	Rating scale	Rating	Outlook/Watch
East Africa Reinsurance Company Limited	Financial strength	International	B	Stable Outlook
		National	AA-(KE)	Stable Outlook

Rating rationale

East Africa Reinsurance Company Limited's ("EA Re") ratings balance a very strong financial profile and an intermediate business position. Financial profile strength is anchored by strong risk-adjusted capitalisation, solid liquidity and healthy earning capacity.

Risk-adjusted capitalisation represents a key rating strength, reflected by a strong capital base built on consistent profit generation and retention. In this respect, the reinsurer posted review year after-tax profit of KES137.4m, growing the capital base to KES5.4bn at FY21. This, coupled with moderately limited exposure to insurance and market sensitivities, sustained the assessment of the reinsurer's risk-adjusted capitalisation within a very strong range. Accordingly, the GCR capital adequacy ratio ("CAR") remained robust at 4.2x in FY21(FY20: 4.7x). Furthermore, statutory CARs for both short-term and long-term business units continued to measure within a rating adequate range, equating to 369% and 150% in FY21 (FY20: 387% and 207%), respectively. Going forward, risk-adjusted capitalisation is expected to remain above 4x sustaining a solid credit profile.

Despite a conservative asset allocation at FY21, reflected by low-risk assets (mostly government securities and term deposits) constituting 89% of invested assets (FY20: 89.3%), liquidity weakened under pressure from an increase in reserves. As such, cash and stressed assets coverage of net technical liabilities registered at 1.9x (FY20: 2.3x). However, a less material reduction was registered in the operational cash coverage, which stood at 18 months (FY20: 20 months). Liquidity metrics are expected to be sustained at similar levels, given management's decision to maintain the current asset allocation and contained net technical provisions.

Earnings remained moderately healthy over the review period, with slight deterioration noted on claims paid mainly due to the COVID-19 pandemic and additional reserves. In this respect, the entity recorded a 5-year rolling average underwriting margin of 2.6% (FY21: -0.6%; FY20: 3.0%). Nevertheless, investment income remained healthy, averaging KES674m over the past five years, supporting returns on revenue of 3.2% (FY20: 9.9%). A partial improvement in the claims experience on the back of remedial measures taken is anticipated for the current year and we project the improvement in the underwriting margin towards a 3% to 4% range over the medium term. On the other hand, returns on revenue are likely to continue within a solid range supporting a healthy earning profile.

The competitive position remained intermediate, with review year primary market and relative market shares of 4.8% and 0.7x (FY20: 5.7% and 0.8x), respectively. The reinsurer continues to review exposure to external markets in line with risk appetite, with strategies to exit from high-risk markets. Given our consideration of both scale and quality of premiums in assessing competitiveness, we expect a balance to be maintained over the medium term. Product diversification was sustained at similar levels, with three lines of business contributing significantly at both gross and net levels, with the largest and top five cedants accounting for 11% and 25% of gross written premiums in FY21, respectively. Premium diversification across multiple jurisdictions is evident, with c. 37.4% of FY21 GWP (FY20: 35%) sourced from outside Kenya.

Outlook statement

The Stable Outlook reflects the likelihood of sustained financial profile strength, coupled with the absence of material changes in the business profile. Consequently, very strong risk adjusted capitalisation will continue to anchor company specific assessment factors, with further support from liquidity and earnings. The GCR CAR is anticipated to register above 4x in the near-term. Cash and stressed assets coverage of net technical liabilities is likely to continue measuring within the same levels, while asset allocation remains weighted towards interest-earning financial assets. Earnings are forecast to be supported by investment income.

Rating triggers

Upward rating progression may follow a sustainable improvement in the operating environment and/ or improvement in liquidity. This may need to be accompanied by the restoration of earnings strength to historical levels. Conversely, an unfavourable earnings trend relative to expectations along with a material reduction in liquidity may warrant negative rating movement.

Analytical contacts

Primary analyst	John Kibebo	Analyst: Insurance
Nairobi, KE	JohnK@GCRratings.com	+254 724 846 700
Committee chair	Godfrey Chingono	Sector Head: Insurance Ratings
Johannesburg, ZA	GodfreyC@GCRratings.com	+27 11 784 1771

Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Insurance Companies, July 2022
GCR Ratings Scales, Symbols & Definitions, May 2022
GCR Country Risk Scores, August 2022
GCR Insurance Sector Risk Scores, August 2022

Ratings history

East Africa Reinsurance Company Limited

Rating class	Review	Rating scale	Rating	Outlook	Date
Claims paying ability	Initial	International	BB-	Stable	August 2007
		National	A+(KE)	Stable	August 2007
Financial strength	Last	International	B	Stable	June 2021
		National	AA-(KE)	Stable	June 2021

Analytical entity: East Africa Reinsurance Company Limited

Domiciled in Kenya, East Africa Reinsurance Company Limited commenced operations in October 1994 and has largely positioned itself as a regional reinsurer, with further footprints in select Asian markets. The reinsurer is licenced to conduct both short-term and long-term insurance business. The entity's shareholding structure remained unchanged with ICEA LION Life Assurance Company Limited and its ultimate parent company, First Chartered Securities, controlling a combined majority stake of 57%.

Operating environment

Country risk

Kenya's country risk score reflects the effects of the COVID-19 pandemic, which were more severe than forecasted, destroying many livelihoods and pushing an estimated two million Kenyans into poverty. The fiscal deficit has widened and the debt burden has increased on the back of lower tax revenues and lower government spending. For a detailed risk assessment of covered countries and peers, please visit: https://gcrratings.com/wp-content/uploads/2022/08/20220819-Country-Risk-publication.pdf

Sector risk

Kenya's insurance sector risk score reflects low insurance penetration and weaker industry growth potential, despite exhibiting some degree of resilience to COVID-19 pandemic risks. The rate of insurance penetration has reduced over the last five years, equating to 2.3% in 2019. Sustained compression in insurance penetration is largely due to high price competition, with industry gross premiums (5-year real average growth rate: 1.7%) underperforming a corresponding GDP growth rate of c. 5%. Nevertheless, the regulatory environment remains moderately strong, underpinned by a provisional risk-based solvency assessment regime and generally very high levels of transparency. The score also factors in the highly competitive market structure (with the top five companies accounting for c. 39% of total industry premiums), contributing to premium rates compression. For additional details on sector assessment, please visit: https://gcrratings.com/wp-content/uploads/2022/08/Insurance-Sector-Risk-publication-30-August-2022.pdf

Business profile

Competitive position

Intermediate competitive strength, supported by significant business outside the primary market

Table 1: Primary market position	FY19	FY20	FY21
EA Re GWP (USD'm)	45.7	37.6	40.6
EA Re total GWP (KES'm)	4 665.0	4 003.4	4 324.5
EA Re primary market GWP (KES'm)	2 924.6	2 612.4	2 706.9
Primary market cessions (KES'm)	46 841.4	45 995.3	54 593.6
Key metrics			
Share of domestic market cessions (%)	5.4	6.4	4.8

The underwriter's GWP premium base expanded by 8% to KES4.3bn in FY21, an improvement signifying recovery from the COVID-19-induced contraction experienced in the previous year. This was mainly supported by the implementation of the minimum premium rates and growth in the facultative business. EA Re's primary market and relative market shares of 4.8% and 0.7x (FY20: 5.7% and 0.8x), respectively. Albeit premium expansion was observed in both local short-term and long-term markets. As such, EA Re's competitive position assessment remains intermediate and is likely to be sustained at a similar level over the rating horizon. Current year GWP growth projection is set at 20%, supported by the enforcement of minimum rates and recovery of life business post-COVID-19.

Premium diversification

Healthy levels of premium spread across products and jurisdictions.

Table 2: LOB summary (%)	GWP		NWP		Retention	
	FY20	FY21	FY20	FY21	FY20	FY21
Fire/property	30.9	29.3	31.7	29.8	91.7	90.6
Transport	6.1	5.5	6.5	5.9	94.6	94.7
Motor	5.3	5.6	5.8	6.3	99.0	99.2
Accident	15.0	17.4	16.6	19.4	98.8	99.4
Liability	0.3	0.3	0.4	0.4	98.8	99.4
Engineering	6.2	5.4	6.4	5.6	93.0	90.9
Individual life	1.2	0.6	1.1	0.6	80.4	79.6
Group life	27.2	26.4	24.3	23.0	79.7	77.5
Miscellaneous	7.8	9.3	7.2	9.1	82.4	86.7
Total	**100.0**	**100.0**	**100.0**	**100.0**	**89.3**	**89.0**

Table 3: GWP spread by country	FY20		FY21	
	KES'm	(%)	KES'm	(%)
Kenya	2 612.4	65.3	2 706.9	62.6%
Tanzania	223.4	5.6	299.8	6.9%
India	209.5	5.2	158.1	3.7%
Nepal	205.8	5.1	180.5	4.2%
Bangladesh	148.8	3.7	2 706.9	0.0%
Others	603.4	15.1	979.2	22.6%
Total	**4 003.3**	**100.0**	**4 324.5**	**100.0**

Premium diversification is viewed to be intermediate, with three lines of business contributing materially to both gross and net premiums. Cedant concentration is present, with the single largest and top five cedants constituting 11% and 35% of GWP in FY21 (FY20: 12% and 37%), respectively. Treaty and facultative business comprised 95% and 5% respectively. In line with industry norms, about 76% (FY20: 83%) of the premiums are channelled through brokers and the rest through direct sales. Positively, premium diversification across multiple jurisdictions is evident, with c. 37% of FY21 GWP (FY20: 35%) sourced outside the primary market.

Management and governance

The board comprises 8 directors, an executive, 3 non-executive non-independent and 4 independent members. Board members have a diverse mix of experience from various industries. Supporting the board in discharging its responsibilities are the Finance, Investment and IT committee, Audit, Risk and Compliance ("ARC") committee and the Ethics, Nominations and Remuneration committee. A non-executive non-independent member chairs the main board while the ARC committee is chaired by an independent director. All directors have a fixed tenure of office and are required to retire at least every three years with a provision for re-election, subject to a favourable performance evaluation by the board. Each year the board undergoes a performance evaluation carried out by an independent consultant. The underwriter has an in-house actuarial function, tasked with evaluating and providing advice to the company regarding technical provisions and compliance with related statutory and regulatory requirements. The reinsurer has further contracted an "Appointed Actuary" in compliance with the Actuarial Function guidelines required by the regulator.

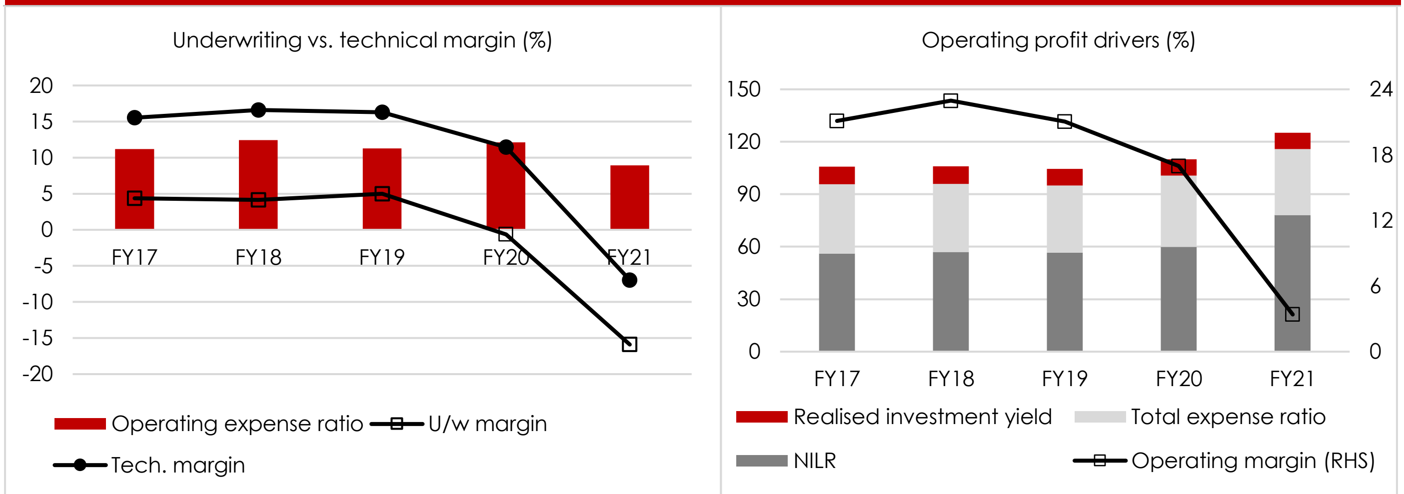
Financial profile

Earnings capacity

Moderately healthy earnings despite unfavourable claims experience, reinforced by increased investment income.

Table 4: Earnings progression (KES'm)	FY17	FY18	FY19	FY20	FY21
NEP	3 645.6	3 496.0	4 037.8	3 890.7	3,741.2
Claims	(2 044.3)	(1 994.0)	(2 285.1)	(2 330.4)	(2,919.4)
Net commission	(1 034.9)	(921.4)	(1 095.4)	(1 113.7)	(1,082.1)
Operating expenses	(407.7)	(435.1)	(455.7)	(471.0)	(334.5)
Underwriting result	158.7	145.5	201.7	(24.5)	(594.8)
Net investment income	658.6	676.5	633.3	631.5	697.2
Net profit after tax	601.6	615.5	589.3	410.4	137.4

Figure 1: Profit margin performance



The underwriter's cross-cycle earnings remained within moderately healthy despite elevated claims experience and some sensitivity to premium scale reductions due to COVID-19-related disturbances in the review year's performance. Accordingly, operating and technical expenses increased to KES4.3bn (FY20: KES3.9bn). As such, the entity registered negative underwriting performance with the underwriting margin falling to -15.9% (FY20: -0.6%; five-year average: -0.6%).

Positively, net investment income remains solid at KES697m (FY20: KES631m), mainly constituting interest from government securities, bolstering net profitability despite the underwriting margin pressure for the past two years. Looking ahead, claims pressure may ease given management decision to provide additional reserves in the review year with the underwriting margin projected to close the year within the -2% to 2% band.

Capitalisation

Healthy earnings and limited exposure to aggregate risks underpin solvency strength.

Table 5: Capital generation (KES'm)	FY17	FY18	FY19	FY20	FY21
Opening balance	**3 422.0**	**4 085.1**	**4 587.0**	**5 076.3**	**5 371.2**
Net profit for the year	601.6	615.5	589.3	410.4	137.4
Other comprehensive income	--	--	--	(15.5)	--
Dividends paid for the prior year	(60.0)	(100.0)	(100.0)	(100.0)	(100.0)
Other adjustments	--	(13.6)	--	--	--
Closing balance	**4 085.1**	**4 587.0**	**5 076.3**	**5 371.2**	**5 408.6**

Over the past five years, the underwriter's capacity to generate internal capital has expanded further underpinned by strong earnings performance and conservative dividend distribution. In the last five years, the entity recorded an accumulated net profit of KES2.4bn and distributed dividends of KES406m. As a result, the group's capital base expanded from KES 3.0bn in FY17 to KES 5.3bn in FY21.

This, combined with somewhat low exposure to insurance and market risks, kept the risk-adjusted capitalisation assessment within a very solid range. However, the growth in receivables moderated the GCR CAR to 4.1x (FY20: 4.7x). EA Re met the regulator's statutory capital requirements for both the short-term and long-term business, registering statutory CARs of 369% and 150% at FY21 (FY20: 387% and 207%), respectively.

Liquidity

Liquidity remains strong, supported by a conservative asset allocation.

Table 6: Liquidity	FY17	FY18	FY19	FY20	FY21
Liquidity ratio (RHS)	1.9	1.9	2.0	2.3	1.9
Operational cash coverage	17.4	19.5	18.8	20	18

Table 7: Investments	FY20		FY21	
	KES'm	%	KES'm	%
Cash on-hand	288.3	3.8	501.1	6.3
Short-term deposits	2,098.5	27.7	1,713.4	21.7
Short-term government securities (<1 year)	733.7	9.7	509.6	6.4
Cash and equivalents	**3,120.5**	**41.2**	**2,724.1**	**34.4**
Long-term government securities (>1 year)	3,323.1	43.9	4,216.6	53.3
Interest securities	269.4	3.6	59.1	0.7
Shares-Listed (ordinary)	51.3	0.7	141.7	1.8
Investment property	760.0	10.0	730.0	9.2
Loans/Mortgages	41.9	0.6	36.8	0.5
Non-cash investments	**4,445.6**	**58.8**	**5,184.2**	**65.6**
Total investments	**7,566.2**	**100.0**	**7,908.3**	**100.0**

EA Re's liquidity profile remained solid in FY21, underpinned by a very conservative allocation mix. However, it was slightly eroded by unearned premium reserve absorption and an increase in the claims reserve. This led to the liquidity ratio deteriorating to 1.9x at FY21 (FY20: 2.1x) while operational cash coverage closed the year at 19 months (FY20: 20 months). Low-risk assets (mostly government securities and term deposits) constituted 89% of invested assets in FY21 (FY20: 89.3%).

Comparative profile

The comparative profile is a neutral component for the ratings.

Peer analysis

The peer analysis is neutral to the ratings.

Group support

No group support has been applied to the ratings.

Rating adjustment factors

Structural adjustments

No structural adjustments have been made to the Anchor Credit Evaluator in arriving at the final ratings.

Instrument ratings

No adjustments for instrument ratings are applicable.

Risk score summary

Rating components & factors	Risk scores
Operating environment	**7.75**
Country risk score	4.00
Sector risk score	3.75
Business profile	**(0.75)**
Competitive position	(0.50)
Premium diversification	(0.25)
Management and governance	0.00
Financial profile	**3.25**
Earnings	0.25
Capitalisation	2.00
Liquidity	1.00
Comparative profile	**0.00**
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total score	**10.25**

East Africa Reinsurance Company Limited

(KES in millions except as noted)

Year ended: 31 December		2017	2018	2019	2020	2021
Income Statement						
Gross written premium (GWP)		4 202,5	4 006,0	4 665,0	4 003,4	4,324.5
Reinsurance cession		(294,9)	(308,0)	(346,9)	(428,5)	(475.5)
Net written premium (NWP)		**3 907,6**	**3 698,1**	**4 318,1**	**3 574,9**	**3,849.0**
Net UPR movement		(262,0)	(202,0)	(280,2)	315,8	(107.7)
Net earned premiums (NEP)		**3 645,6**	**3 496,0**	**4 037,8**	**3 890,7**	**3,741.2**
Net claims incurred		(2 044,3)	(1 994,0)	(2 285,1)	(2 330,4)	(2,919.4)
Net commission expenses		(1 034,9)	(921,4)	(1 095,4)	(1 113,7)	(1,082.1)
Operating expenses		(407,7)	(435,1)	(455,7)	(524,1)	(383.4)
Underwriting result		**158,7**	**145,5**	**201,7**	**(77,6)**	(643.7)
Realised investment income		610,8	657,4	648,6	738,8	770.9
Unrealised investment income		47,8	19,2	(15,3)	(55,2)	(24.8)
Other income / (expenses)		0,1	0,7	0,1	0,0	0.0
Taxation		(215,8)	(207,2)	(245,8)	(195,7)	34.9
Net income after tax		**601,6**	**615,5**	**589,3**	**410,4**	**137.4**
Other comprehensive income		121,4	0,0	0,0	(15,5)	0.0
Total comprehensive income		**723,0**	**615,5**	**589,3**	**394,9**	137.4
Dividends		(100,0)	(100,0)	(100,0)	(100,0)	(100.0)
Balance Sheet						
Shareholder's interest		**4 085,1**	**4 587,0**	**5 076,3**	**5 371,2**	**5,408.6**
Net UPR		1 436,0	1 595,4	1 811,2	1 469,1	1,577.8
Net OCR		1 426,7	1 446,6	1 456,0	1 566,3	2,109.8
Other liabilities		1 514,4	1 564,5	1 758,4	1 472,5	1,519.9
Total capital & liabilities		**8 462,2**	**9 193,5**	**10 101,9**	**9 879,1**	**10,616.1**
Fixed assets		546,7	520,7	489,6	446,6	414.7
Investments		4 176,8	3 913,2	3 740,4	4 445,6	5,184.2
Cash and equivalents		2 071,6	2 705,5	3 417,2	3 120,5	2,724.1
Other assets		1 667,1	2 054,0	2 454,7	1 866,4	2,293.2
Total assets		**8 462,2**	**9 193,5**	**10 101,9**	**9 879,1**	**10,616.1**
Key Ratios						
Solvency						
International solvency margin	%	104,5	124,0	117,6	150,2	140.5
Liquidity						
Liquidity ratio	mth	1,9	1,9	2,0	2,3	1,9
Operational cash coverage	mth	17,4	19,5	18,8	19,4	18,5
Average premium debtor days	days	65,4	99,6	110,5	124,9	112,0
Underwriting profitability						
GWP growth rate	%	26,3	(4,7)	16,4	(14,2)	8,0
Premium retention rate	%	93,0	92,3	92,6	89,3	89,0
Net incurred loss ratio	%	56,1	57,0	56,6	59,9	78,0
Net commission expense ratio	%	28,4	26,4	27,1	28,6	28,9
Operating expense ratio	%	11,2	12,4	11,3	12,1	8,1
Total expense ratio	%	39,6	38,8	38,4	40,7	37,9
Technical margin	%	15,5	16,6	16,3	11,5	(7,0)
Underwriting margin	%	4,4	4,2	5,0	(6,0)	(15.9)
Combined ratio	%	95,6	95,8	95,0	100,6	115,9
Net profitability						
Operating margin	%	21,1	23,0	21,1	17,0	3,4
Investment yield (excluding unrealised gains / losses)	%	10,2	10,2	9,4	9,3	9,3
Investment yield (including unrealised gains / losses)	%	13,1	10,5	9,2	8,4	9,0
ROaE (excluding unrealised gains / losses)	%	14,8	13,8	12,5	8,9	3,0
ROaE (including unrealised gains / losses)	%	16,0	14,2	12,2	7,9	2,5
RoR (excluding unrealised gains / losses)	%	14,2	16,1	14,0	13,0	4,2
RoR (including unrealised gains / losses)	%	16,5	17,6	14,6	10,5	3,7
Dividend cover	x	6,0	6,2	5,9	4,1	1,4
Reserving						
Net UPR / NWP	%	36,7	43,1	41,9	41,1	41,0
Net OCR & IBNR / NWP	%	36,5	39,1	33,7	43,8	54.8

Glossary

Premium	The price of insurance protection for a specified risk for a specified period of time.
Primary Market	The part of the capital markets that deals with the issuance of new securities.
Rating Horizon	The rating outlook period
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Recovery	The action or process of regaining possession or control of something lost. To recoup losses.
Reinsurance	The practice whereby one party, called the Reinsurer, in consideration of a premium paid to him agrees to indemnify another party, called the Reinsured, for part or all of the liability assumed by the latter party under a policy or policies of insurance, which it has issued. The reinsured may be referred to as the Original or Primary Insurer, or Direct Writing Company, or the Ceding Company.
Release	An agreement between the creditor and debtor, in terms of which the creditor release the debtor from its obligations.
Reserve	(1) An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders. (2) An amount allocated for a special purpose. Note that a reserve is usually a liability and not an extra fund. On occasion a reserve may be an asset, such as a reserve for taxes not yet due.
Retention	The net amount of risk the ceding company keeps for its own account.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Securities	Various instruments used in the capital market to raise funds.
Short Term	Current; ordinarily less than one year.
Spread	The interest rate that is paid in addition to the reference rate for debt securities.
Statutory	Required by or having to do with law or statute.
Term Deposit	A savings account held for a fixed term. Also called a time deposit. Generally, there are penalties for early withdrawal.
Underwriter	In a general sense, an underwriter is a person or company that assumes financial risk. In corporate analysis an underwriter refers to a financial institution closely involved in the pricing and distribution of a new issue of a security and who accepts the obligation to purchase all securities not sold to outside investors. In insurance, and underwriter evaluates risk and exposures of potential clients
Underwriting Margin	Measures efficiency of underwriting and expense management processes.
Underwriting	The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.
Unearned Premium Reserve	The amount shown in the insurance company's balance sheet which represents the approximate total of the premiums which have not yet been earned as of a specific point in time. Also known as insurance funds.

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Release	An agreement between the creditor and debtor, in terms of which the creditor release the debtor from its obligations.
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Securities	Various instruments used in the capital market to raise funds.
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Spread	The interest rate that is paid in addition to the reference rate for debt securities.
Statutory	Required by or having to do with law or statute.
Term Deposit	A savings account held for a fixed term. Also called a time deposit. Generally, there are penalties for early withdrawal.
Underwriter	In a general sense, an underwriter is a person or company that assumes financial risk. In corporate analysis an underwriter refers to a financial institution closely involved in the pricing and distribution of a new issue of a security and who accepts the obligation to purchase all securities not sold to outside investors. In insurance, and underwriter evaluates risk and exposures of potential clients
Underwriting Margin	Measures efficiency of underwriting and expense management processes.
Underwriting	The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.
Unearned Premium Reserve	The amount shown in the insurance company's balance sheet which represents the approximate total of the premiums which have not yet been earned as of a specific point in time. Also known as insurance funds.

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 ratings are based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings are an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to the rated entity. The ratings were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings. The rated entity participated in the rating process via virtual 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 the entity and other reliable third parties to accord credit ratings included:

- Audited financial results as at 31 December 2021;
- Five years of comparative audited financial statements to 31 December;
- Unaudited interim results to March 2022;
- Full year budgeted financial statements for 2022;
- Valuation Reports for 2021;
- Financial Condition Report for 2021;
- Retrocession cover notes for 2022; and
- Other relevant documents.