Analysis of major South African insurers' results for the year ended 31 December 2012

March 2013

Fortune favours the brave

Insurance industry analysis

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About this publication

We are pleased to present the second edition of PwC's analysis of major insurers' results. This publication comments on the financial results of South Africa's major insurers for the year ended 31 December 2012. The results are a positive reflection of the health of the industry in a tough global operating environment.

The results of the following insurance groups were considered in this publication, with a focus on their South African insurance operations:

Long-term insurers

- Discovery Holdings Ltd (Discovery)
- Liberty Holdings Ltd (Liberty)
- MMI Holdings Ltd (MMI)
- Old Mutual plc (Old Mutual)
- Sanlam Ltd (Sanlam)

Short-term insurers

- Absa Insurance Company Ltd (Absa)
- Mutual & Federal Ltd (Mutual & Federal)
- Outsurance Holdings Ltd (Outsurance)
- Santam Ltd (Santam)
- Zurich Insurance Company South Africa Ltd (Zurich)

Due to differences in reporting periods, availability of information and changes in, for example, accounting policies, comparable information is not always available for all periods. We have highlighted areas where there are differences in the information presented for the insurers in Section 8 of this publication.

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1. Overview of insurance industry results

1.1 Long-term insurance

Key indicators – on an aggregated basis

Group IFRS earnings increase by 2%

Group return on average equity of 19%

Group embedded value profits up by 53%

Value of new business written up by 27%

Margin on new business improves to 3.2%

Despite continued market uncertainty and economic turmoil during 2012, the local equity market closed at almost record highs. Although global investment markets remained volatile, local performance was strong, with the JSE All Share Index closing 23% higher than in 2011. The all bond index yielded a strong total return of 16% which was beneficial for long-term insurers.

A significant proportion of the business written by long-term insurers provide for a contractual link between the investment return generated on assets which are passed on to policyholders. Much of the investment gains of 2012 are therefore offset by a corresponding increase in policyholder benefits. Over the past couple of years, insurers have also adopted a more conservative investment strategy with regard to shareholder asset allocations. This is partly due to the impact that riskier asset classes have on their solvency capital requirements.

The long-term insurers included in this publication increased group IFRS earnings by 2%. Different insurers achieved varying levels of success and the aggregate result has been impacted by Old Mutual's Emerging Market IFRS earnings which decreased by 32%. The extent to which shareholder assets were invested in the equity, bond and money markets as well as differences in hedging strategies impacted on the individual insurers' performance.

It is important to note that South African long-term interest rates reduced significantly in 2012, with the 10 year government bond yield decreasing by more than 100 bps. This had an unfavourable impact on the valuation of investment guarantees for those groups that historically offered significant investment guarantees in some of their products.

Although CEOs focused less in their result presentations on the impact that factors in the external environment had on their businesses in 2012, these cannot be ignored:

- Continued high volatility in global equity markets;
- European Sovereign dept crisis;
- Subdued GDP growth;
- Strong local equity market performance in 2012;
- Significant reduction in long-term interest rates – to the lowest level in many years;
- Sovereign debt downgrade;
- An increase in the trade deficit;
- Rand weakness;
- Pressure on consumer disposable income;
- Inflationary pressures on the economy;
- High levels of unemployment; and
- Regulatory changes which continue to affect all insurance businesses.

Despite the above, there were some positive developments. The long-term insurers reported stronger new business growth in the last quarter of the year. In the aggregate, they increased the embedded value of South African new business written by 27%, to R4.7 billion. They were also able to increase volumes of new business on a present value of new business premium basis by 7.4%, marginally above inflation. Margin on new business written increased from 2.7% in 2011 to 3.2% in 2012, supported by the lower risk discount rate used to discount the value of future profits.

The majority of companies included in this publication had positive results with regard to their lapses/ persistency experience relative to assumptions set in 2011. All companies reported gains from positive mortality and morbidity experience. Despite the growing inflationary pressure on the economy, fuelled by high oil and energy prices and Rand depreciation, most companies put through relatively small increases in their expense assumptions for 2013. Going forward, insurers are likely to focus on achieving efficiencies through tight budgetary controls.

Old Mutual reported that in 2000, Africa's GDP was $587 billion; in 2012 it is estimated to be just under $2 trillion and it is expected to grow in excess of $2.5 trillion in 2016. The GDP growth is fuelled by a growing youthful population that are becoming increasingly urbanised and have more discretionary income.

Given these exceptional growth prospects and the fact that this population is underserviced by the insurance industry, it is no surprise that long-term insurers are prioritising their strategic business initiatives to include their expansion into Africa. Liberty, Old Mutual and Sanlam have confirmed their preference to deliver growth in existing African partnerships. Liberty plans to expand through focussing on rolling out new products, affinities and enhancing distribution channels. MMI has a footprint in 12 African countries, excluding South Africa and have set aside R500 million to invest in expansion through organic growth or acquisition of businesses in Africa.

Old Mutual's focus, with its existing partnerships, is to sell funeral cover products, but is considering the possibility of expanding its product range as consumers are now able to pay for these products using their mobile phones. Sanlam has a presence in 10 African countries outside of South Africa. Old Mutual is exploring expansion opportunities into West and East Africa and has earmarked R5 billion for this. However, the chief executives cautioned that businesses in Africa are often expensive to acquire and organic growth might be an alternative option in some of these countries.

1.2 Short-term insurance

Key indicators – on an aggregated basis

Gross written premiums up 10%

Claims ratios deteriorated to 66%

Underwriting margin reduced to 4.6%

Investment returns increased by 37%

International solvency margin of 43%

2012 has once again shown the importance of insurance in a world that is economically challenged and where natural catastrophes have become regular headline news, both locally and internationally. South Africa followed, almost exactly, the global underwriting trend in 2012. In the first three quarters of 2012 the industry's underwriting performance was good. However, the fourth quarter was significantly impacted by the multi-million Rand Gauteng hailstorms and the St Francis Bay fires. These significant catastrophes adversely affected the underwriting margins of the local insurers. Internationally, following a benign first three quarters, Hurricane Sandy significantly impacted the reinsurance market in the fourth quarter. Swiss Re predicted a combined ratio of between 103% and 105% for the reinsurance industry in 2012.

It is not surprising that a number of the local players have indicated that they will be re-pricing some of their business on a selective basis in 2013. If one were to compare the underwriting margin achieved in 2011 of 9.3% to the 4.6% achieved in 2012, this would support the hardening of the market. Motor lines remain by far the most significant line of business. A significant component of the overall repair costs of vehicles relate to imported parts and Rand weakness is pushing up these costs.

Not everything is doom and gloom though. The reinsurance market at present has excess capacity globally. In fact, Aon Benfield reported in January of this year that the reinsurance capacity growth continues to outpace demand. Reinsurance capital reached $500 billion in 2012 for the first time. This is good news for local consumers. The new record level of reinsurance capital creates what is likely the widest gap between reinsurance supply and demand. Although reinsurance premiums have, after some years of stagnation, started to increase again, reflecting possibly the end of the soft market underwriting cycle, the current level of supply over demand could postpone the turn in the cycle in the near-term. Reinsurance rates should therefore remain competitive to the benefit of the end consumer.

The South African personal lines market remains very competitive, especially for motor business. This was confirmed in our June 2012 survey of insurance companies where 95% of respondents rated the level of competition for motor business as intensive. More than half of them have made significant changes to strategy and positioning over the last year. With new direct writer market entrants such as MiWay (part of Santam) which hit the R1 billion premium written level in 2012, competition is fierce. Against this backdrop, the short-term insurers grew gross written premiums by 10%, outpacing CPI for 2012.

The underwriting margin achieved in 2011 of 9.3% was nearly halved to 4.6% in 2012. This has, to a large extent, been attributed to the significant catastrophe losses suffered in 2012. Following the adverse weather experience, panel beaters had to be imported to cope with the increased volume of motor vehicle repairs. However, it is important to note that most insurers also reported an increase in their 'business-as-usual' claims. The increased prevalence of out of the ordinary events has forced insurers to relook at, and better understand, the risks they are underwriting.

The industry's overall claims ratio increased to 66% (2011: 62%). This compares to loss ratios last seen in 2009. In addition to the large catastrophe losses, insurers have attributed this to the weaker Rand in the second half of the year and a pickup in the crime-related claims. In the current economic environment, firms, including insurers themselves, are therefore shifting their focus to cost savings. Insurers should be aware of cost cutting activities at customers. This might increase their exposure to risk where insureds reduce some of their risk management activities. Insurers themselves should therefore step up their underwriting practices. Proper underwriting will be the differentiator between insurers who maintain good margins compared to those who do not.

The trend of a gradual decline in the acquisition cost ratio over the previous three years with a corresponding increase in the administrative expense ratio has continued in 2012. The change in ratios indicates a continued increase in business from direct marketing channels. The combined acquisition and administrative cost ratio has again slightly increased from 28.8% in 2011 to around 29% of net earned premium in 2012, which may be indicative of start-up costs incurred in getting new direct businesses off the ground, as well as costs incurred by insurers in dealing with regulatory and reporting changes facing their business.

The industry was positively impacted by the buoyant equity market investment performance during 2012, with investment income up by almost a third compared to 2011. This was primarily due to the JSE All Share Index closing 23% higher than in 2011. Although the long-term interest rates in 2012 were lower, the All Bond Index returned 16%. The average short-term rate was stable during 2012.

As a result of stronger investment performance, some short-term insurers were able to absorb some of the effect of the weakened underwriting performance in 2012. Despite the tough trading conditions in 2012, some industry players still boasted impressive weighted average returns on equity for 2012. Santam posted 18% and Outsurance 43% return on average equity.

The industry's capital adequacy position, calculated on the international solvency margin basis, reduced from 49% in 2011 to 43% in 2012. No insurer included in this publication had a solvency margin of below 40%.

1.3 Looking forward

2012 was a year of opposites for the long-term and short-term insurance industries. Long-term insurers benefited from strong investment markets but the same level of performance may not be expected to repeat itself in 2013, despite strong performances continuing in the first couple of months in 2013. While short-term insurers suffered from catastrophe losses, the market have priced their shares to exclude a recurrence of catastrophes of the same magnitude in 2013.

Premium growth in 2013 will be under pressure due to the inflationary pressures on the economy, the continuing competitiveness in the insurance market as well as slow economic recovery. Consumers have to contend with inflationary pressures including increased fuel price, imminent urban tolls, electricity and other utilities increases which impact adversely on their spending power.

Regulation remains top of mind for insurance executives. The industry will be impacted by the cost of implementing proposed Social Security reforms, Treating Customers Fairly (TCF) and Solvency Assessment and Management (SAM) with the third and compulsory Quantitative Impact Study planned for later this year.

The current economic environment will be challenging for annuity writers. The increase in longevity as a result of medical advances, inflationary pressure in managing these policies and the reduction in yields when bonds have to be reinvested, are all impacting negatively on annuity business. The long-term insurers will have to adapt to the low-interest environment and can learn from the UK experience.

Although long-term insurers may benefit to some extent from a weaker Rand on offshore investments, they will have to contend with the low interest rate environment for some time. Insurers have responded to this, with Old Mutual implementing an interest rate hedge and Liberty managing its market risk through the Libfin business unit. The long-term insurers should however benefit from increased fees generated off higher asset levels in 2013, following the strong market performance in 2012.

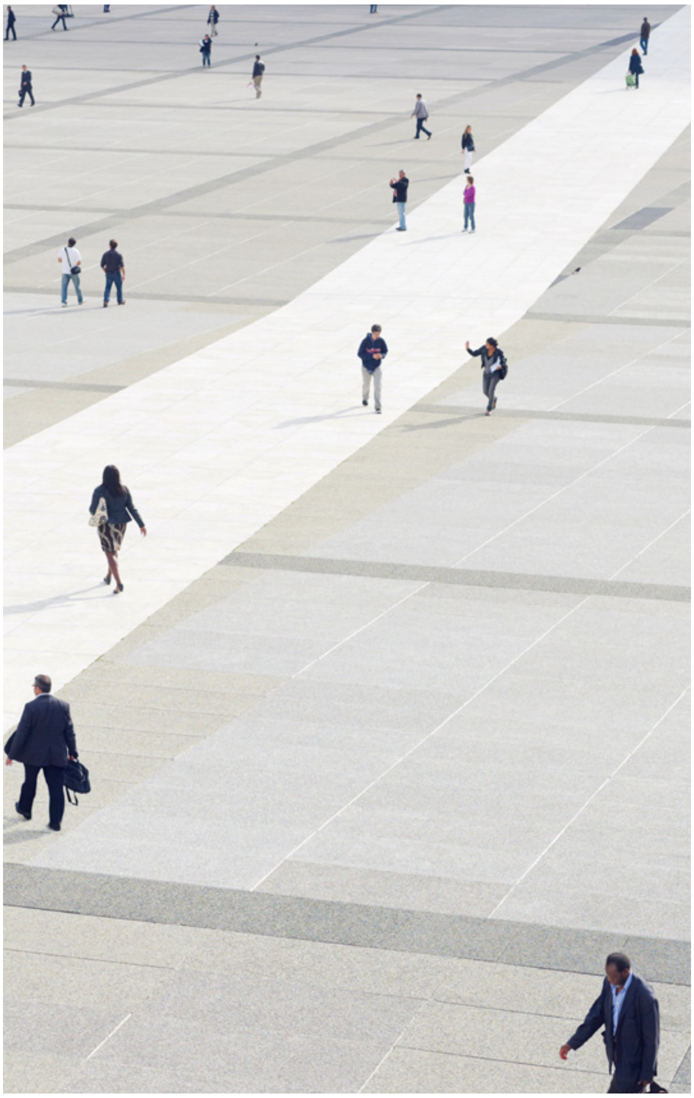
The Rand weakened to its weakest levels against the dollar in a number of years as investor concerns increased over the labour unrest. Unresolved labour relation issues and the widening of the trade deficit will keep the Rand on the back foot. Falling mining production also does not help the widening current-account deficit. Labour costs will also contine to increase due to the emerging pressures in the industry.

The fact that the Rand has been the worst performing emerging market currency is also bad news for short-term insurers, given the significant proportion of imported vehicle parts and the effect this will have on claims inflation. Inevitably, these costs will have to be passed on to consumers.

The sovereign debt downgrade in 2012 also impacted negatively on the insurers, with many of them having their ratings downgraded as well. This impacts negatively on their ability to raise debt at reasonable prices in the capital markets. For a company like Santam, which is bedding down and growing its reinsurance business, a strong credit rating would be vital in order to compete with global reinsurance players.

South Africa has a very competitive insurance market, with a number of direct writers having entered the market in recent years. A potential growth area to keep an eye on is technology and the use of big data and cloud. Insurers with modern information systems are potentially well-placed to make use of technology for sending, receiving or storing any information via telecommunication devices, which can be used to evaluate risk proactively, for example gathering information on vehicle location and driving style for use in dynamic pricing decisions. This can be used to make risk management more effective, by communicating potential catastrophes effectively to consumers.

With a number of countries with some of the highest economic growth rates on our doorstep, insurers will continue to expand on the African continent. For example Mutal & Federal indicated that they are in the process of acquiring Oceanic's Nigerian short-term insurance business. Together with other emerging markets, Africa will remain the area where global insurers look to grow their businesses in the foreseeable future. As these markets are not yet as competitive as the traditional local market, they offer an opportunity to earn profits at attractive levels. Given the competitive nature of the South African insurance industry, innovation has been a key driver for continued success. Taking these and new innovative solutions to African countries should help insurers get a competitive advantage in those new markets.



2. Long-term insurance

2.1 Group IFRS earnings

IFRS earnings

	Combined results			
	2012 Rm	2011 Rm	2010 Rm	2012 vs. 2011
Total comprehensive income	20 390	19 962	15 644	2%
Return on average equity[1]	19%	20%	20%	-5%

[1] Excludes MMI in 2010 as this information was not available for the newly formed group.

The long-term insurers included in this analysis recorded combined group IFRS earnings of R20.4 billion, up 2% on 2011. This is a steady performance in a period where the JSE all share index closed 23% higher than at the start of the year. The all bond index yielded a strong total return of 16% which was beneficial for long-term insurers. However, its yield reduced by approximately 75bps to an average of 7.5%. The repurchase rate (repo rate) was also reduced from 5.5% to 5.0% in July. Despite the positive equity and bond market performance, there were large variations in IFRS earnings achieved by the respective insurers. For example, one insurer's IFRS earnings more than doubled in 2012 while another saw earnings reduced by almost a third.

South African equities ended the year near record highs at the end of 2012, after a 23% surge that marks the best annual return since 2009, lifted by a strong performance from the retail industry. Equities in Africa's biggest economy have surprised most investors in 2012, as shares largely shrugged off sluggish economic growth and three months of industrial action in the crucial mining sector that sparked credit downgrades.

As a result of the 8% higher average shareholders' equity that the insurers held, the combined group return on average equity reduced to 19%, compared to the 20% achieved in 2010 and 2011. This is reflective of a cautious approach followed in investing shareholders' capital, hedging against exposure to the volatile equity markets and holding slightly higher levels of capital.

Liberty posted a 26% (2011: 22%) return on average equity, followed by Discovery at 23% (2011: 27%), Old Mutual at 21% (2011: 33%), Sanlam at 16% (2011: 17%) and MMI at 14% (2011: 6%).

2.2 Group embedded value

Embedded value

	Combined results			
	2012 Rm	2011 Rm	2010 Rm	2012 vs. 2011
Embedded value	220 344	191 165	172 641	15%
Embedded value earnings[1]	38 941	25 389	21 881	53%
Return on embedded value[1]	19%	14%	16%	36%

[1] Excludes MMI in 2010 as this information was not available for the newly formed group.

The long-term insurers recorded strong group embedded value earnings in 2012. The main contributors to this performance were the significant earnings from investment markets, as well as the effect of lower market interest rates on valuations. This result also reflects steady operating performances by the South African businesses in 2012. This is highlighted in the overview of insurance industry results as well as in the new business statistics, analysed in more detail below.

2.3 Embedded value of South African new business

Value of new business

	Combined results			
	2012 Rm	2011 Rm	2010 Rm	2012 vs. 2011
Present value of new business premiums (PVNBP)	148 178	137 915	129 322	7%
Embedded value of new business (VNB)	4 694	3 699	2 983	27%
Value of new business margin	3.2%	2.7%	2.3%	19%
Average payback period	6.3 years	6.3 years	6.3 years	0%

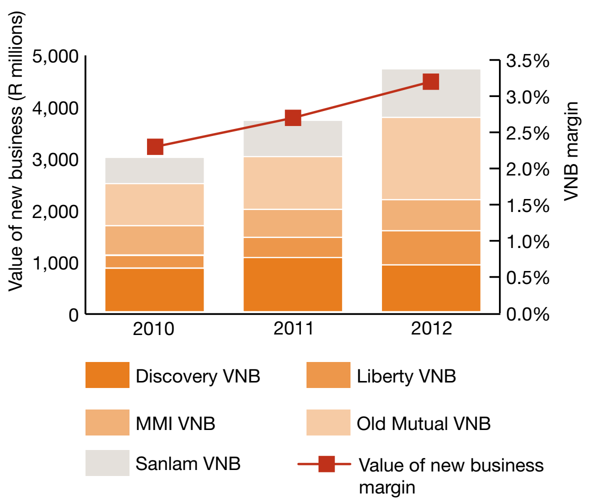
The PVNBP written by the long-term insurers in 2012 reflects a steady increase. The year-on-year increase of 7.4% (2011: 6.6%) reflects an increase in demand for life insurance products when compared to CPI of 5.6%. The value of the increase was however also helped by lower market interest rates. Consumers continue to struggle in tough economic conditions and the increase in volume of business is therefore a good result under the circumstances.

Not only were the insurers able to increase their PVNBP, but were also able to do so with a margin on new business that at 3.2% was 19% higher than in 2011 at 2.7%. This was the second consecutive year where insurers were able to increase the margin achieved on new business written. Insurers were therefore able to achieve a good balance between increasing new business volumes and thereby benefiting from economies of scale and focusing on the quality of the business written by their sales forces and achieving good profit margins. As a result of both the positive growth in PVNBP as well as the margins locked into this new business, the long-term insurers were able to grow the VNB by 27% (2011: 24%).

The average payback period remained constant at 6.3 years. This is a crude measure to indicate the average period over which the majority of the VNB will be earned (PVNBP divided by annual premium equivalent).

Figure 2.1

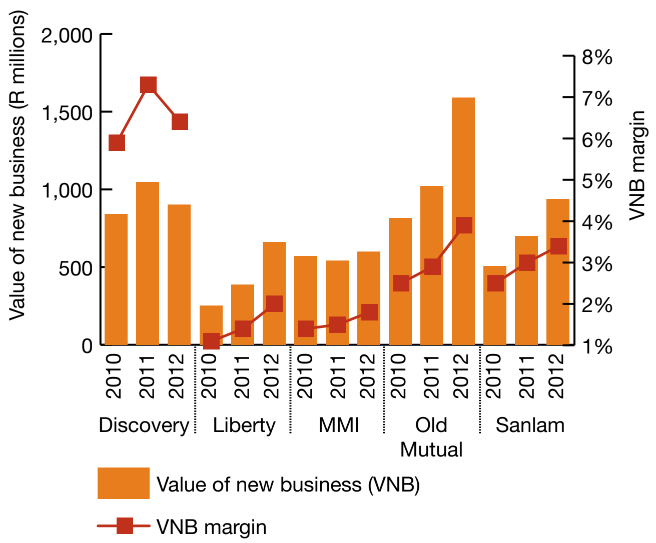
Industry value of new business (VNB) and value on new business margin



Source: PwC analysis

Figure 2.2

Value of new business (VNB) and value on new business margin



Source: PwC analysis

Discovery

Discovery achieved PVNBP of R14.0 billion in 2012, which was at similar levels to both 2011 and 2010. However, the company was not able to maintain the value of new business margin at the same levels as in 2011, which decreased from 7.3% to 6.4%. As a result of the reduced margin and a slight reduction in volume, the value of new business decreased by 14% to R904 million. Although Discovery was able to increase the value of new business margin on its risk business, the change in business mix (more towards investment business that attracts lower margins) resulted in an overall reduction in the value of new business margin. Discovery noted the continued positive impact that policyholder engagement with Vitality has on the company's persistency levels.

Liberty

Liberty's VNB of R660 million increased by 70% in 2012 and benefited from the continuation of the group's improved persistency levels and the successes of its financial advisor value propositions with increased headcount across all distribution channels. The group also profited from the increased size of the in-force book of policies – for the first time since the Capital Alliance acquisition in 2005 – which impacted positively on the cost per policy assumption. The company wrote PVNBP amounting to R33.5 billionn, an increase of 18% in 2012. This represents 23% of the total PVNBP for the insurers in this publication and has an expected payback period of 5.7 years, which is better than the average of the other long-term insurers considered in this publication. Liberty grew its share of the large insurers' market share while at the same time improving the margin on new business to 2.0%.

MMI

MMI's value of new business grew by 11% to R601 million in 2012. Although the group's PVNBP reduced by 9% to R32.6 billion, the value of new business margin improved from 1.5% to 1.8% in 2012. The group's business volumes reduced but MMI was able to achieve a better overall value of new business margin. In the last six months of 2012 the group achieved strong growth compared to the corresponding period in 2011, except for the Metropolitan Retail business that yields high margins where the new business volumes were flat. MMI's average payback period remained steady at 7.3 years in 2012.

Old Mutual

Old Mutual's insurance business increased its PVNBP in 2012 by 14% to R40.7 billion. The company increased its value of new business margin from 2.9% to 3.9%. The result of both a strong increase in the PVNBP and the uplift in expected margin achieved on this business is that the VNB increased by 56% to R1.6 billion in 2012. The group benefited from growth in sales in its Mass Foundation Cluster by increasing the adviser force by 12% as well as investing heavily in their customer relationship management capability. The value of new business written was also boosted by improved product mix across the business. Old Mutual's payback period lengthened marginally to 6.7 years in 2012.

Sanlam

Sanlam increased its PVNBP by 17% to R27.3 billion in 2012. The company also increased its value of new business margin from 3.0% to 3.4% in 2012, which resulted in an increase in its VNB by 34% to R939 million. The group focuses on writing good quality business at an appropriate margin. As a result of the selective targeting of customers, the group achieved their best persistency levels since 2007. Sanlam also benefited from a strong improvement in the margin achieved on the entry-level business. Sanlam's payback period increased marginally from 5 years to 5.2 years in 2012.

2.4 Cost management

Costs

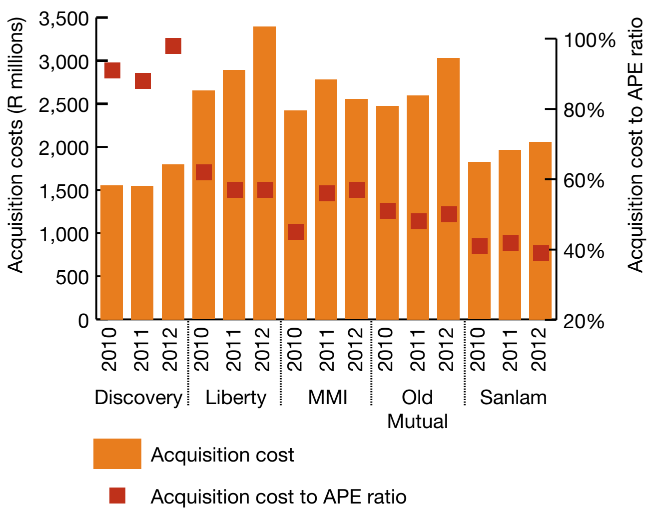
	Combined results			
	2012 Rm	2011 Rm	2010 Rm	2012 vs. 2011
Acquisition costs	12 835	11 785	10 929	9%
General marketing and administration costs	27 068	24 958	20 411	8%
Annual premium equivalent	23 579	21 896	20 616	8%

Acquisition costs incurred by the South African businesses (Emerging Markets segment for Old Mutual) of the long-term insurers increased by 8.9% to R12.8 billion in 2012. This is lower than the increase in APE growth of 7.7% over the same period. Acquisition costs have therefore not increased to the same extent as new business premiums. This could be indicative of a changing product mix, with more investment products being sold, which attract relatively lower commissions than risk products.

Figure 2.3 reflects both the monetary value of acquisition costs paid by the long-term insurers for the years 2010 to 2012 and the ratio of acquisition costs incurred relative to the annual premium equivalent (a measure of new business written by taking 10% of single premiums and 12 months worth of recurring premiums) of new business written for the respective years:

Figure 2.3

Acquisition cost and ratio to annual premium equivalent (APE)



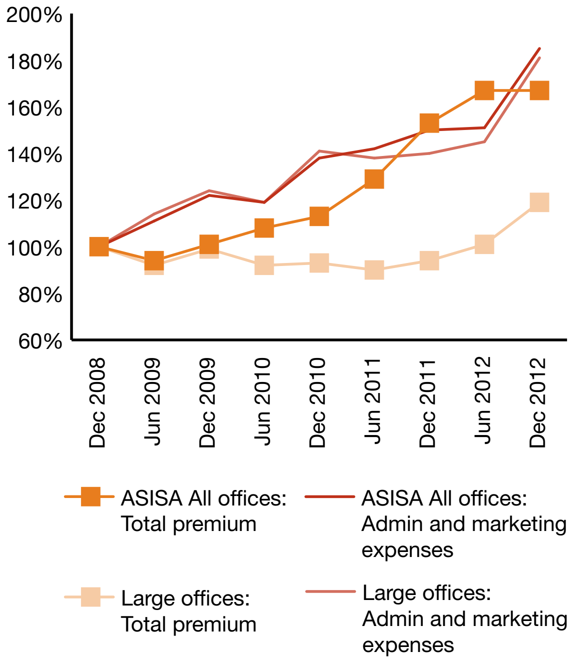
Source: PwC analysis

In the previous year we noted the decreasing trend in acquisition costs relative to the APE ratio. Acquisition costs as a percentage of new business APE had been reducing over the last three years to 2011 for most companies. One of the reasons for this trend was the change in commission regulations that came into effect in 2009 whereby long-term insurers were no longer allowed to remunerate intermediaries for certain types of the investment/savings contracts through upfront commissions. The commission structure on these products was changed to a 'pay-as-you-go' basis, i.e. commission is only paid if the policyholder pays the premium. In 2012, acquisition costs as a percentage of new business APE flattened out for some companies.

It is clear from the graph above that Discovery's product mix may still be heavily weighted towards pure risk products, which attract significantly higher commissions and, as such, acquisition costs would be a significant proportion of first-year premium income. Discovery has also increased the proportion of its new business written by agents, which could account for the increase in this ratio of acquisition cost to new business APE in the current year.

Figure 2.4

Premiums vs expenses



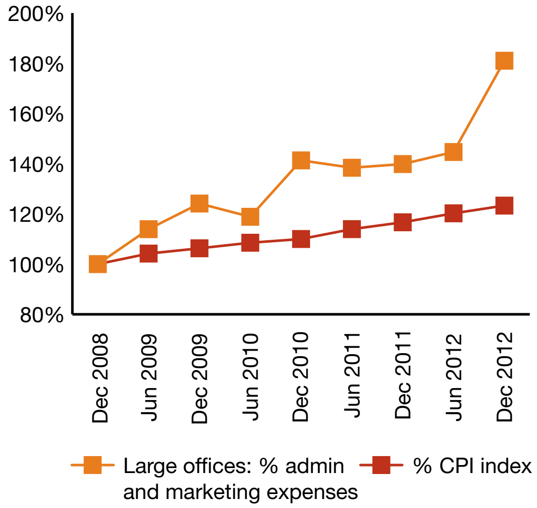
Source: Obtained from statistics published by the Association for Savings and Investment SA (ASISA).

The level of expenses for 'large' offices and 'all' offices are closely correlated for all periods presented. From 2010 to 2011 the large offices seem to have lost market share to smaller, but faster-growing players in the market. The large offices' premium levels for 2010 and 2011 were depressed compared to levels seen from 2008 to 2009, in nominal terms. In 2012 things started to change. The large offices' premium income grew strongly, especially in the second half of the year. Contrary to the large offices whose premiums grew by 18% in the second half of the year, the level of premiums for all life offices was flat. It would seem that the large offices have regained some of the market share lost to some of the smaller players over the last couple of years.

Although premium levels were stagnant over the past couple of years, expenses have continued to increase and were more than 80% up in 2012 compared to 2008 levels.

Figure 2.5

Large offices: Expenses vs CPI



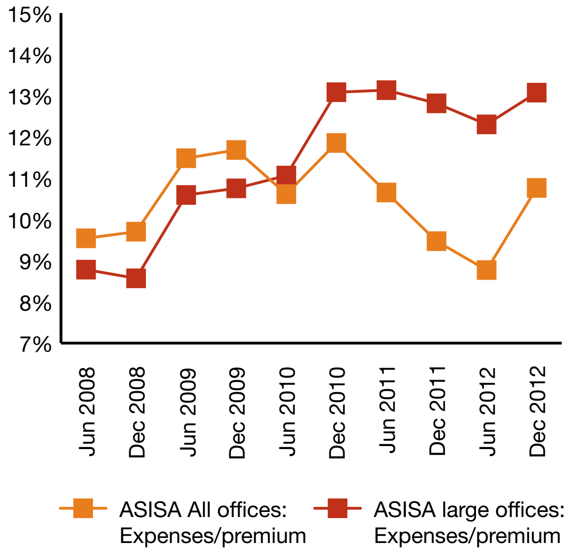
Source: Large offices expenses obtained from statistics published by the Association for Savings and Investment SA (ASISA) and CPI from Statistics SA.

For the period 2008 through to June 2010, the expenses incurred by large insurance offices tracked the CPI index. However, from June 2010 and again in the second half of 2012 there was a stepped change. The expenses incurred by long-term insurers grew significantly faster than CPI. This is reflective of the cost of doing business in a highly regulated industry and is not surprising when one considers the cost of all the changes to the regulatory environment, not to mention all the other inflationary pressures within the economy.

SAM places a higher demand on scarce and skilled resources, for example actuarial resources. In our June 2012 survey of insurers, a lack of skilled resources and specialist talent was highlighted as an emerging trend. This will negatively impact the cost for these resources. Legacy information systems were also highlighted as a weakness. Insurers will also have to get to grips with the SAM Pillar III reporting requirements. The quantitative as well as the qualitative disclosure could have a significant impact on how insurers are judged by policyholders, investors and supervisors.

Figure 2.6

Expenses as a percentage of premiums



Source: Association for Savings and Investment SA (ASISA).

Figure 2.6 is interesting. It reflects that up to the end of 2009, the larger offices were able to use their economies of scale in efficiently managing their insurance businesses compared to all offices. When one considers that all offices also include the large offices, the gap in the ratio of expenses compared to premium income between large offices and the smaller offices is far more pronounced. However, in June 2010 the position changed completely. It might be that the large offices have been more responsive to the regulatory, compliance and customer demand changes compared to the smaller players in the market. Again, the gap between the large offices and all offices in the expense ratio is significant from January 2010 to June 2012. In the second half of 2012 this however narrowed significantly.

Liberty

Liberty indicated that it would continue to manage the business within their assumption set. In the period it integrated regulatory change initiatives for SAM, PoPI (Protection of Personal Information Act) and TCF. It also strengthened its risk management capabilities and improved its financial, risk and capital forecasting capabilities.

MMI

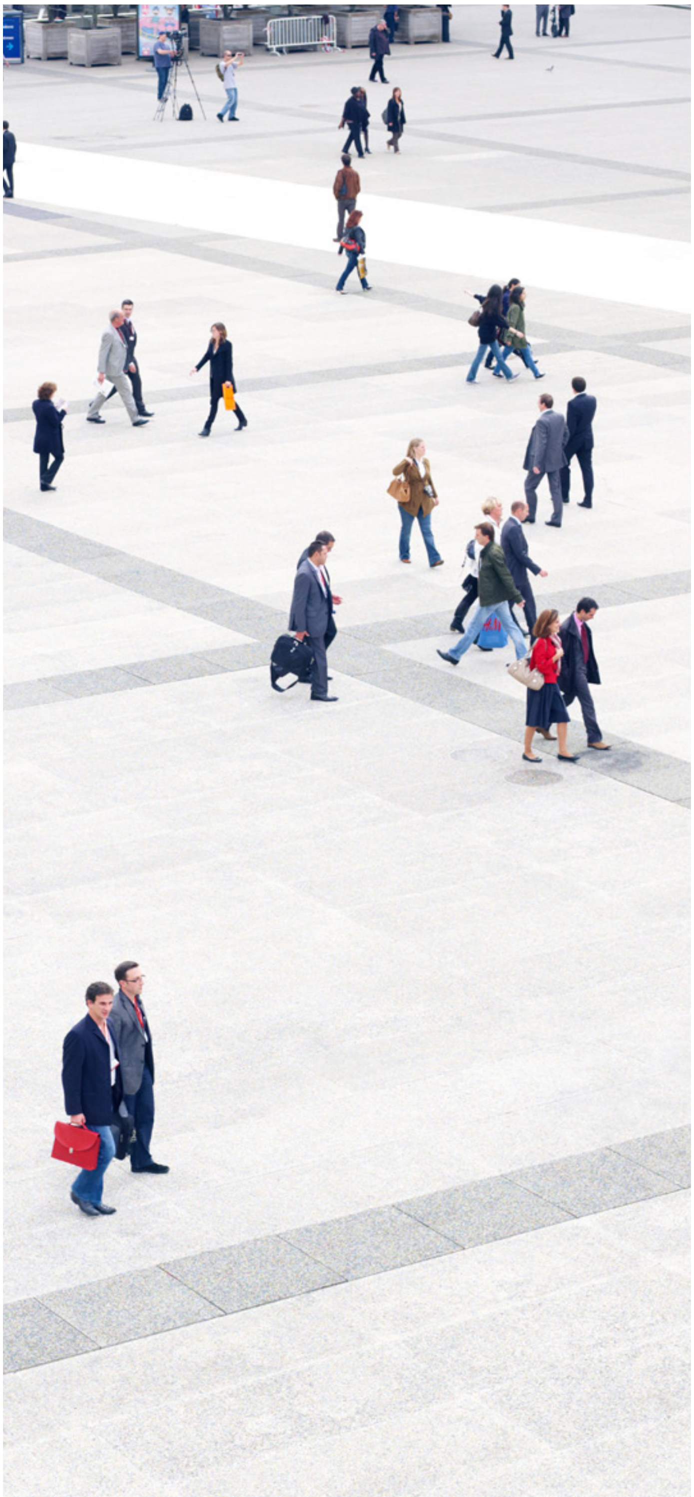
The MMI merger resulted in the group having in excess of 300 under-utilised staff members (who could not be retrenched for the two years following the merger). The group indicated that half of these individuals had been redeployed in the business and the remainder voluntarily left the group. Following the merger, the group targeted an annual cost saving amounting to R500 million to be achieved over three years, of which R256 million has been achieved to date.

Old Mutual

Old Mutual indicated that they were successful in their maintenance expense management and also benefited from some positive assumption changes in this regard.

Sanlam

As one of its priorities for 2013, Sanlam noted the need to improve operational efficiency. During the year the group completed the implementation of new IT systems at a cost of some R400 million, which will enable Sanlam Personal Finance to improve efficiencies and design more innovative and competitive products. The group acknowledged the imperative of a digital strategy to remain relevant into the future and have intensified their focus on digital strategy.



3. Short-term insurance

3.1 Gross written premiums

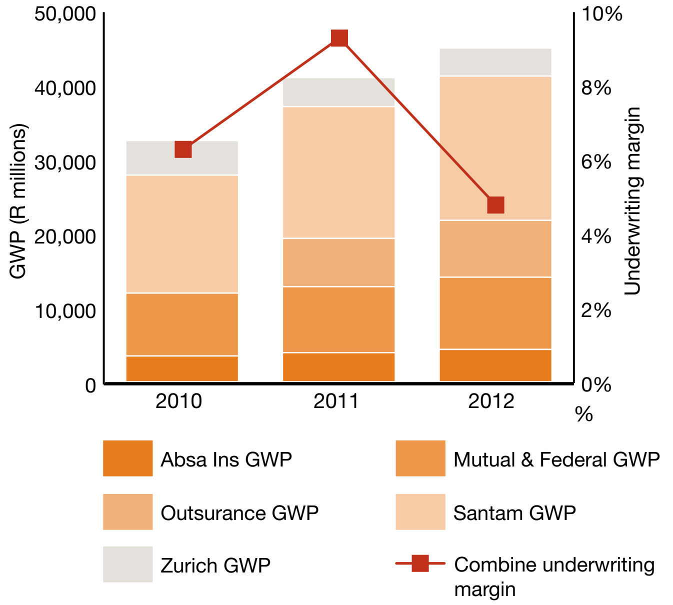
Gross written premiums

	Combined results			
	2012 Rm	2011 Rm	2010 [1] Rm	2012 vs. 2011
Gross written premiums	44 826	40 852	32 395	10%
Net earned premiums	36 039	33 653	26 799	7%

[1] The 2010 numbers exclude Outsurance as detailed comparative information is not publicly available.

Figure 3.1

Industry gross written premiums (GWP) vs underwriting margin



Source: PwC Analysis
The 2010 information excludes the GWP and underwriting margin of Outsurance as detailed comparative information is not publicly available.

Gross written premiums (GWP) increased by 10% during 2012 to R44.8 billion for the year. The growth is ahead of the CPI index of 5.6% for 2012. This represents an improvement over 2011 when the insurers included in this publication were unable to achieve any real growth. The 2012 industry result also benefited from strong growth achieved in Outsurance's Australian business. This business doubled in size during 2012 and if this impact is eliminated the industry still grew GWP by a credible 7.6%.

Absa

Absa's GWP increased by 11% to R4.3 billion in 2012. This was slightly subdued compared to the growth of 13% achieved in 2011.

Mutual & Federal

Mutal & Federal's GWP increased by 9% to R9.7 billion in 2012. This result was supported by the strong premium growth achieved in iWyze, with policy count growing by 33% to now exceed the 50,000 mark. iWyze is Mutal & Federal's direct joint venture with Old Mutual's mass foundation business.

Outsurance

Outsurance posted 18% growth in GWP to R7.6 billion. This result includes Youi, Outsurance's Australian start-up business. Youi doubled its GWP in 2012 to R1.8 billion. Eliminating the impact that this business has on Outsurance's consolidated results, Outsurance grew its GWP locally by 4%.

Santam

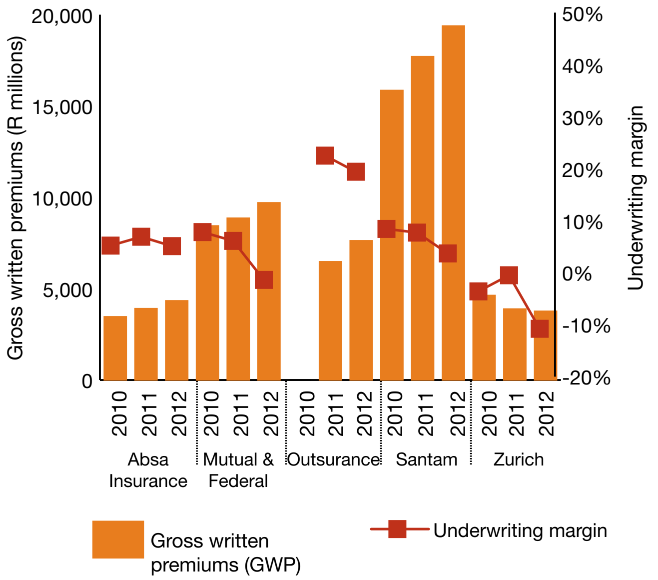
Santam posted a 9% increase in GWP to R19.4 billion, gaining some market share with industry premiums reflecting marginal growth. Santam grew the GWP on its motor book by 10%, assisted by strong growth achieved in the Miway business. Although the property book only grew by 6%, strong growth in the albeit smaller specialist lines such as crop and engineering made up for this.

Zurich

Zurich's business volumes declined by 3% to below R3.8 billion in 2012. The company's business has been in remission for three consecutive years. The group's cell captive business is in run-off which impact on the GWP numbers.

Figure 3.2

Gross written premiums (GWP) vs underwriting margin



Source: PwC analysis. The 2010 information excludes the GWP and underwriting margin of Outsurance as detailed comparative information is not publicly available.

3.2 Key ratios

Key ratios

	Combined results		
	2012 %	2011 %	2010 [1] %
Claims ratio	66.3	61.9	65.3
Acquisition cost ratio	11.3	11.6	15.0
Expense ratio	17.8	17.2	13.4
Combined ratio	95.4	90.7	93.7
Underwriting margin	4.6	9.3	6.3
Total	100.0	100.0	100.0

[1] The 2010 numbers exclude Outsurance as detailed comparative information is not publicly available.

2012 was a tough year for South African short-term insurers. Most insurers experienced a significant uplift in claims experience compared to 2011. This was the result, not only from an increase in business as usual claims, but also from catastrophe losses approaching R2 billion for the industry namely:

- Mpumalanga floods in January;
- Gauteng hailstorms in October and November; and
- St Francis Bay fires in November.

The impact of these catastrophes on the insurers included in this publication varies significantly. The extent of the adverse effect on claims ratios depends firstly on exposure to these catastrophes and secondly on the extent and method in which these exposures were ceded to reinsurers.

- Santam indicated that they had incurred R475 million gross catastrophe losses. This consisted of R280 million for hail, R140 million for flood and R55 million for fire. At the analysts presentation, Santam indicated that the catastrophes impacted its underwriting margin by approximately 2.5%. This amounts to R390 million of net earned premium. This indicates that Santam's catastrophe reinsurance cover kicks in at higher catastrophe loss levels as the group had retained the majority of the losses.
- Mutual & Federal incurred hail and fire claims amounting to R144 million and R201 million respectively. In addition to the St Francis Bay fire claims (amounting to R24 million of the R201 million) the group also experienced a marked increase in commercial fire claims.
- Outsurance experienced its most severe weather-related catastrophes in its history and incurred total claims of R180 million. Due to the group's conservative reinsurance strategy only R40 million of this amount was retained within the group. However, it incurred R19 million additional premiums to reinstate the reinsurance cover.
- Absa indicated that it incurred high fire-related claims in its commercial portfolio as well as an increase in fire- and weather-related personal lines claims during the last quarter of 2012.

The extent of losses suffered above highlights the importance of robust underwriting practices for insurers. Without the required understanding from appropriate analysis of concentration risk and accumulation of exposures, insurers could incur far greater losses than anticipated. Predictive technology could possibly be used in future to reduce potential catastrophe claims.

Across the board, the claims ratios in 2012 deteriorated when compared to 2011. Absa and Outsurance were able to keep their increase to a minimum with the loss ratios only increasing marginally. Mutual and Federal and Zurich were most affected as their claims ratios increased by 12% and 14% respectively. Santam's claims ratio increased by 6%.

The acquisition cost ratio continued to decline. The ratio has been steadily declining from 2009 through 2012 to 11.3% (2009: 15.6%). It is clear that the direct marketing insurers are increasing their market share. The move to direct marketing distribution channels is reflected in the administrative expense ratio, which further increased from 13.2% in 2009 to 17.8% in 2012.

The reduction in acquisition costs and corresponding increase in administrative expenses is a result of the growth of the Miway and iWyze business. Miway wrote R1 billion in premiums in 2012. iWyze is roughly a third the size of Miway judged by the number of policies on the books. When one considers the combined acquisition and expense ratios, this has increased from 28.8% in 2011 to 29.0% in 2012. This is despite growth in GWP in excess of CPI. The challenge for fast-growing start-up businesses is to manage adverse selection and to achieve economies of scale coupled with tight cost control. Miway indicated that they target R2 billion of premium to achieve the required economies of scale.

The MiWay business incurred an underwriting loss R37 million which, if it wasn't for the catastrophe losses, might potentially have operated at a break-even level. iWyze, on the other hand, increased its start-up losses to R161 million (2011: R119 million).

Most traditional short-term insurance business written in South Africa relates to policies that can be re-priced on a monthly basis. The business is also typically short-tail in nature, i.e. the period between the date at which a claim is incurred and it being reported to the insurance company is fairly short. As a result, there is not a significant amount of uncertainty inherent in the measurement of liabilities of short-term insurers in South Africa. The direct insurers are more responsive and flexible when it comes to market forces and can adjust premiums rates quickly and also have better underwriting data at their fingertips.

4. Investment performance

4.1 Market performance

After reporting the 2011 financial year results, insurers anticipated an upturn in the market for 2012 following the lacklustre performance in 2011. When analysing the market's performance for a period, it is important to understand the underlying factors that drive performance. To put the insurers' 2012 performance into perspective, a closer look at the JSE All Share Index and bond market is required.

In 2012, the JSE All Share Index delivered a phenomenal performance, closing 22.7% higher than at the start of the year. This performance was achieved despite the tough economic and social environment experienced in South Africa in 2012. When taking a more in-depth look at the Figure 4.1, 16% of the 22.7% increase was achieved in the second half of 2012. The JSE increased on average by 9.5% in 2012. This assisted insurers in generating higher asset-based fee income.

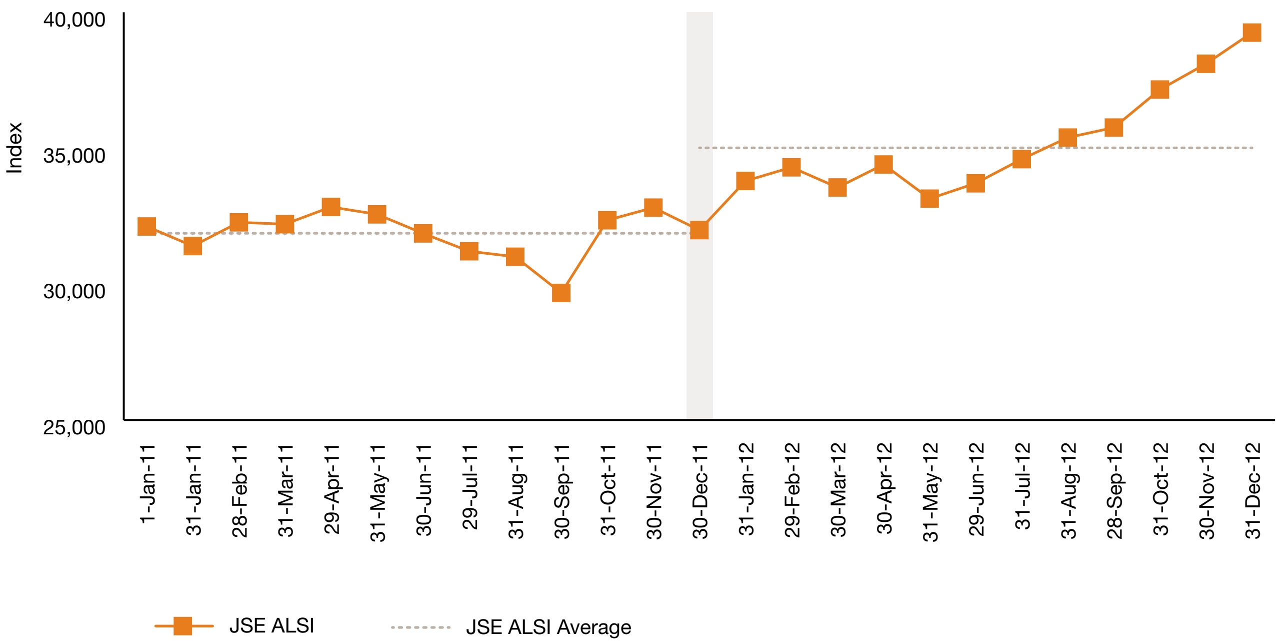
The yield on the All Bond Index decreased to close at 7.05% after opening at 8.12%. The yield decreased by more than 100 bps despite the downgrade of South Africa's credit outlook, which would have caused the credit spreads to widen. The index however still delivered a 16% total return, which is considered good given the downgrade of South Africa's sovereign credit outlook.

The decrease in the yield impacted insurers positively who had invested in fixed rate instruments as they benefited from a fair value uplift in these instruments. However, insurers were exposed to lower yielding assets where they had reinvested in 2012, especially after July 2012 when the South African Reserve Bank (SARB) lowered the repo rate. This had an unfavourable impact on discounting liabilities at a lower rate, especially considering the increase of value of guaranteed products. The effect of the decrease in the repo rate on the All Bond Index is reflected in figure 4.2 on the next page.

The SARB lowered the repo rate from 5.5% to 5.0% in July 2012 to help alleviate some of the economic pressures faced by a number of sectors in an attempt to support economic recovery. The SARB further stated that, given the prevailing conditions at that time and their concerns going forward, they thought it important to be proactive. Although the lowering of the repo rate could assist to stimulate the economy, it results in lower investment inflows as returns are lower.

Figure 4.1

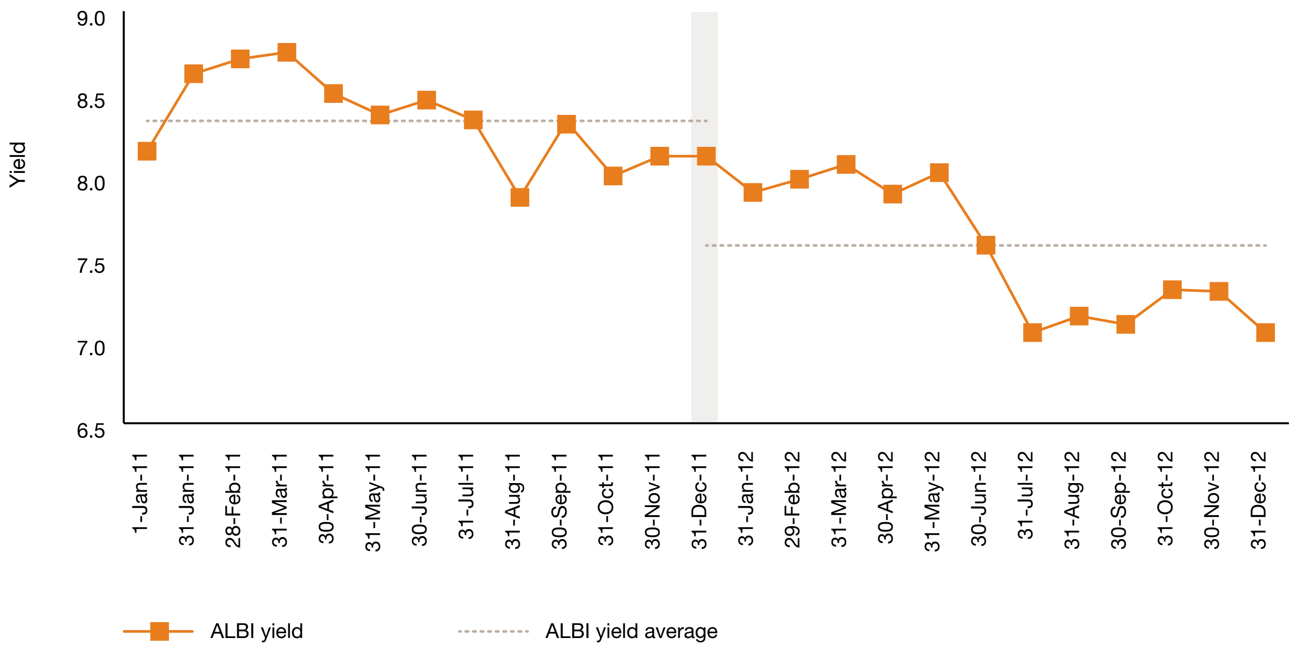
JSE All Share Index



Source: McGregor BFA

Figure 4.2

All Bond Index yield



Source: McGregor BFA

4.2 *Industry investment performance*

Long-term insurers

	Combined results			
	2012 Rm	2011 Rm	2010 Rm	2012 vs. 2011
Total invested assets[1]	1 492 930	1 283 491	1 220 588	16%
Income on invested assets	211 612	88 094	137 610	140%
Return on average invested assets[3]	15.2%	7.0%		
Adjusted net worth per embedded value report[2]	72 497	53 483	47 388	36%
Income on adjusted net worth[2]	6 730	2 550	3 868	164%
Return on average adjusted net worth[2]	10.7%	5.1%	8.4%	

Short-term insurers

	Combined results			
	2012 Rm	2011 Rm	2010 Rm	2012 vs. 2011
Total consolidated invested assets[1]	29 001	28 630	27 709	1%
Income on invested assets[3]	2 431	1 741		40%
Return on average invested assets[3]	8.4%	6.2%		

[1] Invested assets comprise the group financial assets, investment properties as well as the cash and cash equivalents of the insurers (for Old Mutual the Emerging Market segment information has been used). This includes all policyholder and shareholder assets.

[2] This information has been taken from the group-embedded value reports of the long-term insurers, but excludes MMI for 2011 and 2010 as insufficient information was available to calculate the return on average adjusted net worth for the newly formed group.

[3] The combined return on average invested assets for 2010 could not be calculated as there is insufficient information available for MMI and Outsurance.

The combined invested assets of the long-term insurers grew by 16% from R1.28 trillion in 2011 to R1.49 trillion in 2012. The total investment income earned in 2012 amounted to R211.6 billion, representing a return of 15.2%. The combined adjusted net worth (ANW) grew by 36% from R53.5 billion in 2011 to R72.5 billion in 2012. The average income on ANW totalled R6.7 billion in 2012. This represents a return of 10.7% which has doubled from 5.1% in 2011. When one considers the more than doubling of return on net worth in 2012, the long-term insurers still have exposure to the equity market as part of their shareholder assets as is reflected in the improved returns.

Over the last few years we have seen an increased focus on balance sheet management, both by local and international insurers. The focus on balance sheets has been in the form of de-risking and de-leveraging as we see insurers returning to their core activities and pursuing revenue and earnings growth with increased stability. This is reflected in the consistency achieved on the return on equity. As part of their preliminary results announcement, Old Mutual reported that while the economic environment remains uncertain, they have significantly restructured and de-risked their business to focus on the markets where they want to be and where they see long-term, structural growth. Liberty, through LibFin Investments, increased its portfolio diversification and benefited from favourable investment market movements.

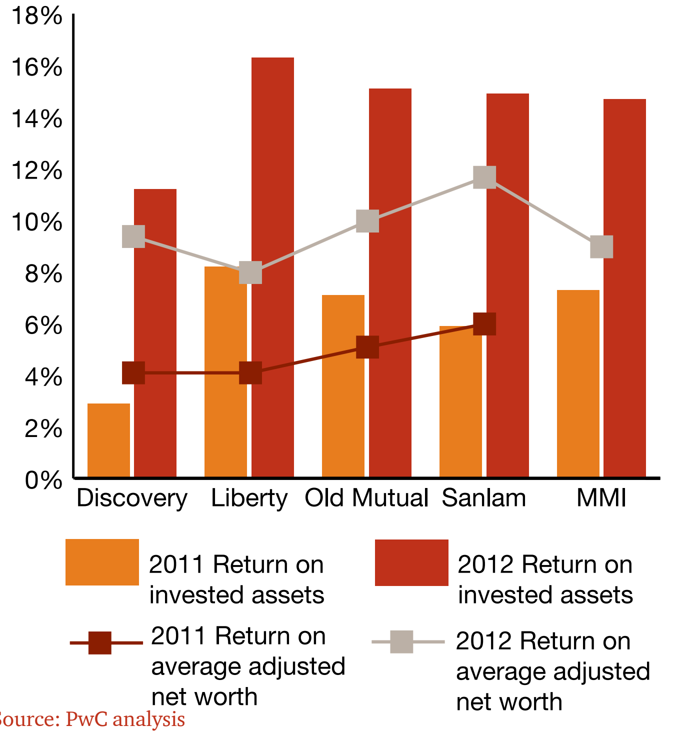
For some insurers, the de-risking of balance sheets will continue in the short term only, whereas it may be a longer term effort for others. The introduction of SAM and the consequent increase in balance sheet volatility will clearly influence balance sheet management activities over the next five years.

The second quantitative impact study (QIS2) exercise conducted by the FSB showed that there is very little difference in the overall free surplus under SA QIS2, compared to that under the current position for long-term insurers.

Market risk (and in particular equity risk) still remains a key component of the capital requirements under SA QIS2 – in the region of 40-45% of the basic standard capital requirement for both long- and short-term insurers. This will increase the focus on equities in the board room, and in particular, on how they contribute to both the cost of maintaining a healthy balance sheet and contribution to increasing return on equity.

Figure 4.3

Return on invested assets and return on average adjusted net worth: long-term insurers



Source: PwC analysis

Discovery grew its invested assets by 46.2% from R19.4 billion in 2011 to R28.3 billion in 2012. Invested assets have increased by R5.4 billion due to the sale of Discovery Invest products as well as the significant returns on these investments. Discovery's ANW grew by 17.5% from R3.1 billion in 2011 to R3.6 billion in 2012.

Liberty's investments grew by 15.9% from R243.6 billion in 2011 to R282.4 billion in 2012. Liberty's ANW grew by 15.1% from R13.6 billion in 2011 to R15.7 billion in 2012, which LibFin manages under a low risk balanced mandate.

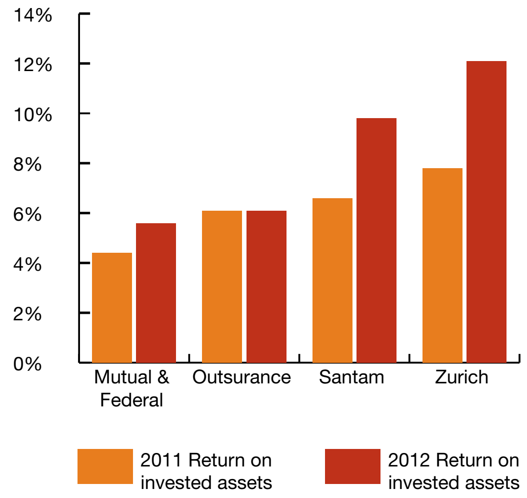
MMI grew its invested assets by 16.9% from R269.7 billion in 2011 to R315.3 billion in 2012. MMI's ANW grew by 1.6% from R13.0 billion in 2011 to R13.2 billion in 2012.

The invested assets included in Old Mutual's Emerging Markets segment grew by 15.2% from R410.3 billion in 2011 to R472.5 billion in 2012. Old Mutual's ANW grew by 12.7% from R22.2 billion in 2011 to R25.0 billion in 2012. This is most likely a result of Old Mutual restructuring and de-risking its business.

Sanlam's invested assets grew by 15.8% from R340.6 billion in 2011 to R394.4 billion in 2012. Sanlam's ANW grew by 2.7% from R14.6 billion in 2011 to R14.9 billion in 2012.

Figure 4.4

Return on invested assets: short-term insurers



Source: PwC analysis

Most short-term insurers experienced significant catastrophe losses during the last quarter of 2012, which adversely affected the underwriting margin. However, short-term insurers benefited from the strong market performance. Zurich posted a 12.1% (2011: 7.8%) return on average invested assets, followed by Santam at 9.8% (2011: 6.6%), Outsurance at 6.1% (2011: 6.5%) and Mutual & Federal at 5.9% (2011: 4.4%). Short-term insurers typically invest in debt securities and cash.

When predicting what the market will do in 2013, all insurers had a similar message for investors. Notwithstanding the positive economic indications experienced in 2012, a repeat performance in 2013 is unlikely. A low interest rate environment is seen as the 'new norm' for insurers and the effects thereof should be considered. This makes designing attractive investment products challenging for long-term insurers. Investor confidence remained fragile, local operating conditions and unemployment levels remain challenging and are expected to continue into 2013. Uncertainty over the Eurozone debt crisis remains high and continues to influence the world economy. South Africa is not insulated from this.

5. Capital and solvency

5.1 Long-term insurance

Capital adequacy requirement cover

	Combined results			
	2012	2011	2010	2012 vs. 2011
Discovery	3.9	4.4	3.9	-11%
Liberty	2.7	2.9	2.7	-6%
MMI	2.4	2.3	2.5	4%
Old Mutual South Africa	3.9	4.0	3.9	-3%
Sanlam	4.3	3.7	3.4	16%

Discovery

Discovery is in a growth phase. The company has indicated that it will continue to invest profits made on the long-term insurance business back into the business. The group will continue to invest approximately 5-7% of operating profits towards the development of new businesses and aims to achieve a return on capital at the risk-free rate plus 10%. The group indicated that with its growth, it will continue to reinvest in the business. Discovery Life Limited's capital adequacy requirement (CAR) decreased from 4.4 times in 2011 to 3.9 times in 2012.

Liberty

Liberty Group Limited's CAR cover decreased from 2.9 times in 2011 to 2.7 times in 2012. The decrease is due to funding the share buy-backs of R415 million. Liberty is in the process of preparing for the proposed new long-term insurance solvency regime and has reported that the group is appropriately positioned from a capital perspective. Liberty declared a special dividend of 130 cents per share given the increase in earnings in 2012 and after taking into account the additional capital required for the new business flows. The group also indicated that they are planning for the rationalisation of their life licences with the SAM implementation. It is expected that this will result in a reduction of the CAR ratio due to differences in the base level of the capital held in the various life licences.

MMI

MMI continued to remain close to the regulator's Solvency Assessment and Management (SAM) project. MMI reported a capital buffer of R3.8 billion after allowing for strategic growth initiatives and an interim dividend. MMI will continue to assess the impact of SAM on the capital buffer, but believe that the present level of capital is appropriate given the current environment.

Old Mutual

The Old Mutual plc group has applied £1.52 billion of cash to the repayment of debt since January 2010. The group believes it is well positioned to make the transition to Solvency II in the UK (when effective) and SAM in South Africa, which will become effective on 1 January 2015 with parallel reporting runs in 2014. Old Mutual South Africa remained well capitalised with a CAR cover of 3.9 times at 31 December 2012.

Sanlam

Sanlam confirmed the group's preference of investing discretionary capital in growth opportunities. During 2012, Sanlam utilised discretionary capital of R3.3 billion for this purpose and has continued to expand the group's footprint in Africa, India and Malaysia. Sanlam is currently considering future opportunities which, if successful, will utilise an additional R3 billion discretionary capital. Sanlam announced the distribution of R1 billion of discretionary capital to shareholders by way of a special dividend which, in line with the group's capital management strategy, is distributed to shareholders where it is not likely to be applied within the business. The life insurance business remained sufficiently capitalised with an increase in CAR cover from 3.7 times in 2011 to 4.3 times in 2012.

5.2 Short-term insurance

International solvency margin

		Combined results		
		2012	2011	2010 [1]
Combined solvency margin		43%	49%	47%
Individual companies	Mutual & Federal	Outsurance	Santam	Zurich
2012	47%	47%	41%	69%
2011	52%	47%	48%	68%
2010	61%	-	45%	52%

[1] The 2010 numbers exclude Outsurance as 2010 information is not publicly available.

Mutual & Federal

Mutual & Federal's solvency margin decreased from 52% in 2011 to 47% in 2012. The ratio is expected to improve in 2013 as Mutual & Federal's outlook for 2013 includes the implementation of selective rate increases.

Outsurance

Outsurance has maintained their conservative approach in managing capital resources. Outsurance's solvency margin remained constant at 47% in 2012. Outsurance reported that their strategic focus is to generate underwriting returns which corresponds with the risk assumed in running an insurance operation.

Santam

Santam's solvency margin, which has been calculated including its subordinated debt amounting to R1 billion, has decreased to 41%. This is due to the payment of a special dividend in March 2012. The solvency ratio is within the company's target solvency range of 35% and 45%.

Zurich

The 1% increase in Zurich's solvency margin is mainly the result of the reduced levels of premiums written in 2012.

5.3 *What is the potential impact of SAM?*

The Financial Services Board's process of developing a new risk-based solvency regime for South African insurers based on the developments in Europe around Solvency II is gathering pace. Solvency Assessment and Management (SAM) is being adapted for South African-specific circumstances. Interim measures for the calculation of liabilities and capital requirements for short-term insurers, as provided for in Board Notice 169 (BN169) of 2011 has already been put into place to assist the transition to SAM.

The second South African Quantitative Impact Study (SA QIS2) marks an important milestone in the development of the SAM framework. This is the last voluntary quantitative impact study, with the third Quantitative Impact Study (SA QIS3) planned for 2013 being compulsory. The approach taken to SA QIS2 is to collect information, with a quantitative focus, to assist in the decision-making required to determine the final measures under the SAM framework.

There has been an increase in participation from 95 insurers in SA QIS1 to 121 insurers in SA QIS2. This represents 98.5% of the South African insurance industry by volume of premium. The FSB has also received 26 insurance group submissions.

The impact of SA QIS2 for long-term insurers indicated that the results of SA QIS2 have remained largely consistent with SA QIS 1. The increase in their available capital is the result of the removal of prudential margins from the valuation of liabilities leading to lower liabilities and therefore an increase in available capital. Although the higher available capital is partially offset by an increase in the capital requirement, the net effect is positive for the majority of long-term insurers. Life insurers were most impacted by the onerous capital requirements for the mortality catastrophe risk and mortality risk components.

Aggregate impact of SA QIS2 on long-term insurers

R billion	Current position	SA QIS2
Available Capital	122.5	200.5
Capital Requirement	35.6	116.5
Free Surplus	86.9	84.0
Capital Coverage Ratio (times covered)	3.4	1.7

Source: Financial Services Board SAM SA QIS2 report

From the table below it is apparent that the capital requirement for short-term insurers has increased from post-BN169 levels to the SA QIS2 capital requirement. Reasons for the large movement in the capital requirement include: market risk components, less diversification benefit allowed under SA QIS2, and a risk charge for participations included under SA QIS2. Most short-term insurers have a lower free surplus under SA QIS2 compared to that under the post-BN169 position. Overall, the results for non-life insurers in SA QIS2 have remained consistent with SA QIS1.

Aggregate impact of SA QIS2 on short-term insurers

R billion	Current position	SA QIS2
Available Capital	42.8	49.5
Capital Requirement	17.9	33.2
Free Surplus	24.9	16.3
Capital Coverage Ratio	2.4	1.5

Source: Financial Services Board SAM SA QIS2 report

SA QIS 1 only studied the impact of SAM proposals on solo entities. SA QIS2 also evaluated the impact of the SAM framework on the solvency position of insurance groups. As with solo entities, groups generally had higher group capital available under the SA QIS2 calculations compared to the current capital position. The higher capital available was generally offset by a higher group capital requirement.

6. Insurance financial reporting in 'no man's land'

The term 'no man's land' is most commonly associated with the First World War to describe the area of land between two enemy trench systems to which neither side wished to move openly or to seize due to fear of being attacked by the enemy in the process. The current state of insurance reporting, not only internationally but also in South Africa, is in a similar state.

In this section we explore the implications of SAM on the future of insurance financial reporting. In the first section we assess the issues that insurers are likely to grapple with as they think through the implications of SAM on external reporting. In the second section we explore how this fits with other developments, in terms of investor focus and in relation to IFRS 4 Phase II, which will collectively lead to a wider re-evaluation of how to judge and assess value and risk in the next five years.

With no 'one size fits all' view, how insurers should address these challenges will vary considerably. Considering the focus by most insurers on Pillar I and II, compared to Pillar 3 to date, it is often possible to misjudge or underestimate some of the key strategic and implementation challenges. As the timeline for the implementation of SAM draws closer, attention is increasingly being placed on the reporting requirements. The quantitative reporting requirements and design of the regulatory turn under SAM are currently in progress. And while the exact timing of implementation of IFRS 4 Phase II is uncertain, the breathing space provided by delays to IFRS 4 Phase II provides insurers with a valuable opportunity to plan ahead, and to put the foundations in place for a finance function which is capable of meeting these new demands and providing the insights that will give your business an edge in the new commercial landscape.

6.1 Judging the business through the lens of Pillar III reporting

SAM will fundamentally reshape how insurers think about their business. For many, it will change how they evaluate and communicate in relation to performance, risk and capital. But using regulatory driven data for performance analysis brings with it many challenges for which proposed Pillar III reporting as currently proposed in Solvency II is poorly prepared. Furthermore, for quite a few insurers, particularly in the life insurance industry, SAM data may not be viewed as the right basis for allocating capital or judging the performance of the business as some insurers are using their own economic capital model. This is because SAM is design to value the balance sheet of the insurer on an economic basis. These insurers may look to augment SAM data with additional metrics, both internally and externally, but this introduces a new set of issues. And whether management think SAM is a good approach or not, this regime will introduce greater variability into capital metrics and possibly changes to the amount of cash available to pay dividends, key areas of analyst and investor focus.

Given the well documented problems with the existing insurance regulatory framework in many countries, introducing greater harmonisation and better alignment of capital requirements and risk should be a big step forward for the global insurance sector. In this respect, Solvency II and SAM may help iron out some of the inconsistencies that impact current solvency reporting, and the outputs should be more useful as a tool to help evaluate the business than is the case with current regulatory information.

Pillar III is also going to put new and potentially more detailed information about insurers' risk profiles and the way it is managed into the public domain. Even countries such as the UK, where regulatory returns are already made public, will see new disclosures that the markets will be keen to scrutinise.

In an industry that currently lacks a consistent approach to calculating an 'economic' view of the business, some insurers believe that a new regulatory regime could help to fill the void, and for the first time enabling companies to be able to link performance, capital and risk metrics. These companies tend to look to SAM Pillar III reporting to bring market disclosure closer into line with the measures they use to run their businesses and possibly even providing a new basis for how they judge performance. This is more likely to be the case for short-term insurers as the ways risk and capital are evaluated under SAM are conceptually not far away from how most internal models work. Although few short-term insurers are using internal models in South Africa, they may thus want to focus analyst and investor attention on these numbers and use them as one of the bases for steering the business.

Making sense of the numbers

While easy to say, this will often be very difficult to achieve in practice. In this respect, a particular challenge will be trying to use a framework designed for regulatory reporting to provide information that is useful to management (let alone investors).

In Europe, there have been various attempts to ensure that insurers can explain the movements in solvency capital in a Solvency II world, be this in the form of 'variation analysis' or a 'P&L attribution analysis'. However, this may not generate the type of information that is actually needed – essentially, a clear view of operating and non-operating elements, and an ability to determine what is really driving movements in capital available at a group level.

In particular, 'variation analysis' may not prove particularly useful – this will be prepared on a solo basis only, it will not be mandatory for several years after the implementation of Solvency II, and the degree of detail around the results is hardly at the granular level of insight that will be needed to understand what is actually happening in the business.

And while 'P&L attribution analysis' could be much more valuable, the main aim of this information is to act as a cross check against whether internal models are focusing on the key risks, not on providing insight into profit drivers to management or investors. With a lack of clarity as to how this information should be presented combined with considerable flexibility as to the approach adopted (for example, whether in fact to use a SAM or alternative basis for defining required capital), it is by no means certain that this will necessarily be a step forward for the industry.

Those insurers that might be considering to use SAM to help bridge the information void both internally and with investors, will need to be able to build from solo level to group-level analysis and to help provide clarity on the different sources of earnings that drive results on a SAM basis, as well as how group capital structures work in practice.

A further consideration is to reflect the views of investors – and in particular, the very clear view in a global survey of analysts PwC conducted in March 2012 that they need to be able to 'join the dots' with measures that are comparable to other industries. Given the 'economic' starting point for Solvency II/ SAM reporting, this will create new challenges – in particular, simply providing analysts with a new raft of data on a basis that is unique to insurers is unlikely to be a successful strategy.

What this means is that insurers will need to be able to reconcile Pillar III disclosures with other aspects of financial reporting andexplain the main differences, whether they relate to contract boundaries, the basis for discounting or the myriad of other differences. From a practical perspective it will be important to prepare the qualitative disclosure requirements in parallel with annual reports to allow the business to identify any divergence and be able to explain the reasons to analysts. Insurers that fail to do this will find themselves sending out mixed messages and incompatible numbers, which can only undermine their market credibility.

When SAM may not be the right answer

So far we have assumed that insurers are likely to welcome the SAM approach. Yet for large and complex insurance groups with significant operations outside the remit of SAM and equivalent regimes, SAM may not be fully consistent with what management views as the main drivers of value and risk.

First, regulatory capital calculations for many African operations would be based on the existing local rules and not on the prescribed SAM basis. This is likely to be particularly significant for insurers with large African operations, given the conceptual differences between the local statutory and SAM frameworks. While not relevant to solo level reporting, the consolidated data that is likely to emerge from the SAM reports would feature what would in effect be both 'apples and pears', rendering it far less useful internally or externally as a means with which to judge performance or to allocate capital. In this context, it is hard to see how SAM information for insurers operating outside of South Africa could be viewed as a substitute for existing KPIs, for example.

Secondly, SAM is built on a market consistent economic approach that does not have universal appeal. While it is true that some insurers may view this as the most appropriate benchmark of economic value in an insurance business, there are many who believe that market consistent information can portray an overly generous view of some business (for example, mortality and other risks within protection business, as well as unit-linked business), while taking a highly punitive view of the risks within certain guaranteed savings business. A market-consistent approach also introduces much greater volatility into both capital available and capital requirements, which even with 'dampeners' in place may exacerbate pro-cyclical pressures.

How companies adapt to these challenges will require careful thought. On the one hand, management teams will need to demonstrate that SAM data is put at the heart of the business if they are to pass the use test, especially for those insurers who are in the process of applying for internal model approval. On the other, companies will not want to adopt bases for internal or external reporting that do not reflect their own view of risk and value. Insurers could look to adopt a consistent group-wide 'SAM' view, but this may not be easy to do, and would be resisted by those who believe that a market-consistent economic based approach is inappropriate for their business. For this group of insurers, one option is to focus group-wide capital allocation decisions and external markets on the outputs from existing capital models, and to use SAM data at a local solo level, and as a means of testing compliance with binding regulatory constraints.

The advantage of this approach is that it can be applied on a consistent basis across the business and may better reflect management's own perspectives and objectives, as well as what is viewed as most important in creating value in the business.

However, this approach also brings numerous challenges. A key one is ensuring that this does not jeopardise internal model approval. In addition, experience shows that embedding an approach for group-wide decision-making that is not fully aligned with local regulatory approaches, or with how local competitors set capital requirements or price products, is far from straightforward.

In this respect, companies can't simply dismiss SAM and other approaches. They will still need to find ways to tie these binding regulatory constraints to group level economic capital evaluations, along with those used in IFRS and rating agency capital models. In Figure 6.1 we set out some of the considerations that companies will need to address.

Figure 6.1

Two polar positions – or a hybrid view?

You develop an alternative capital and risk framework	You use local regulatory approaches to assessing capital and risk
• What metrics will you use to judge capital and performance? • What will be the challenges in fully embedding this within the business? • Will SAM data be a 'binding constraint', alongside other regulatory/rating views? • How will you reconcile the internal view with these binding constraints? • How do you persuade the market that this is a 'real' measure?	• What metrics will you use to judge capital and performance? • How do you ensure the group is steered in a consistent way? • How do you link to measures of value and risk management view as appropriate? • What do you use the internal model for? What happens to EV? • How do you rationalise this to the outside world?

Break on capital flexibility

Whether or not companies view SAM or alternative versions such as internal economic capital models as the best proxy for economic value in the business, it will be local solvency rules and rating requirements that are likely to be the decisive factor in calculating how much cash is available to be reinvested in the business, or is legally available to pay dividends or fund possible share buy-backs.

Once again, market movements come into play here as there may be more volatility in available capital than under the existing regulatory capital regimes. Today's point estimates are therefore likely to be redundant and will need to give way to dynamic analysis under a comprehensive range of scenarios.

Next steps

The first key step is to determine whether the SAM numbers are going to be an important performance driver in allocating capital across the group or will be viewed more from a compliance perspective. If SAM numbers will be the core basis for decision-making and performance management, then your Pillar III disclosures are clearly going to be a vital part of how management and investors will assess your strategy and track progress against objectives. But you will need to think through how to make information intended to be used for regulatory reporting genuinely insightful for you in performance reporting, and how to tie this together with other perspectives of your business (bearing in mind that there is resolutely no 'one view' that can tell you everything you need to know). A particular area of focus should be on how to make P&L attribution analysis useful to you as a business tool.

For those who have less appetite for using SAM as a basis for valuation, capital allocation and performance management at a group level, a further decision needs to be made as to how to build and embed a more coherent approach without this leading to regulators questioning compliance with the 'use test' if the internal model route is being considered; alternatively, these insurers may decide to manage the group using local regulatory bases.

Whichever approach is adopted, there will be a raft of additional challenges; for example, for those looking to design an alternative to SAM, how to embed a metric in your business that may not actually be a binding constraint – as well as to have clear links to what will actually drive your 'real-world' capital flexibility.

Clearly, clarity on the final direction of SAM will be needed before insurers can fully engage with this issue. But there are steps that are very relevant now. For example, insurers still need to think through the consequences of SAM for their business, and to start to plan ahead for future reporting – for example, where will EV data fit in? And can we use this information to address investor concerns around the business, and around reporting more specifically?

Once there is more certainty over the final shape of SAM, companies will need to ask how financially stable the business will look under the qualitative public disclosures? How does this compare to your competitors? How does it square with the measures used by analysts and investors to rate performance?

It is also important to look at how the changes to your reporting support your 'equity story'. This includes explaining to analysts and investors the extent to which SAM legislation is likely to change the KPIs you use to run the business and how your strategic objectives accord with your regulatory requirements.

Unwelcome surprises

Working out the implications of these reporting changes for your business and how to address them is going to take many months and a considerable amount of high level input. Given that insurers already often struggle to communicate effectively with investors, it is crucial that you get on top of the disclosure challenges well in advance. Leaving them until it is too late could leave you open to unwelcome surprises, create an unfavourable impression in comparisonwith your competitors and put you on the back foot when competing for investment. In this respect, we think there is a slight risk of seeing SAM as the answer to some current problems when in actual fact this may present you with a whole new set of challenges.

With the 1 January 2015 SAM effective date looming, insurers should see the next two years as an opportunity to focus on remaining technical challenges and practical implementation. It's important to bear in mind that shareholders reward good performance and potential rather than good models. In other words, our message is to plan ahead to address these key areas, and not leave this until it is too late.

6.2 How this links into the future of insurance reporting

The previous section explored some of the immediate investor relations and communication challenges created by the move to SAM. In this section we examine how this might influence longer term changes in insurance reporting and how we believe these will take shape.

In particular, given investors continued frustrations with how insurers communicate on value, performance and risk, the combination of Pillar III reporting and potential IFRS 4 phase II present the opportunity for a broader rethink of insurance reporting and disclosure aimed at communicating the strength and potential of the business in a more understandable, accessible and, ultimately, value-enhancing way. Further opportunities to cut through the complexity of reporting are going to come from the market push for more straightforward and comprehensible products.

So what could this new reporting framework look like and how can it benefit your business?

The gap between what analysts and investors want from reporting and what they actually receive from many insurers has long been a cause for concern.

The markets want a clear indication of how insurers make money, both now and how they intend to in the future (underwriting, fees or investment returns) and how these funds would translate into 'real' distributable cash. To be credible and informative, these metrics need to be consistently prepared (across years and between companies) and actually be used within the insurer itself.

In most analysts' view, what they currently get, particularly with respect to the life insurance industry, could be improved. There are essentially two main issues to overcome: comprehensibility and comparability. Our research globally has consistently highlighted market concerns over what analysts and investors believe are disjointed and opaque insurance financial statements, creating various numbers that are difficult to comprehend and compare against other sectors and which often fail to tell them what is actually happening within the insurer. Comparability is compromised by material inconsistencies in approach in relation to almost all aspects of reporting. The numbers are produced on a different basis from insurer to insurer and might not even correspond with the measures that are being used to run the business. We highlighted the different supplementary profit measures used by South African insurers last year.

At a time when competition for capital has rarely been more intense, the difficulties in understanding the strategic direction and value potential within insurance businesses mean that they may lose investment to industries that offer seemingly more transparent and easily discernible opportunities. Equally, policyholders want products that are easy to understand and compare. We have already seen the rapid rise of price comparison sites for many forms of insurance.

As a lot of the complexity is stripped out of product design, it should be possible to cut out some of the corresponding complexity in reporting to create solvency statements that all stakeholders can understand. For example, simpler products are likely to require less sophisticated investments, which will make risk evaluation more straightforward and the resulting reports and disclosures more concise and comprehensible.

A new framework

As we have highlighted in the previous section, the way insurers approach SAM is going to vary. Some will be looking at it as a binding capital constraint, while others will want to place greater emphasis on the evaluations within management information and external reporting. Differences in regulatory frameworks could act as a further constraint on comparability, as quite a number of the African operations of South African groups could be measured on a different basis. Given these factors and the continued drive by the South African industry to expand their African operations, a possible view that SAM could represent a fresh start for the industry from a reporting perspective may be rather naive.

However, when put in the context of the far-reaching changes to financial reporting likely represented by IFRS 4 Phase II, the insurance industry is going to have to rethink how it judges all aspects of performance over the next decade, and it would clearly be a wasted opportunity if this was not used to fix some of the problems highlighted above.

From this perspective, as well as focusing on the technical challenges of these new standards, insurers need to think about how they use SAM and IFRS 4 Phase II data to answer the key questions that are relevant to management of the business and to what investors need to know.

In our global investor survey earlier this year, analysts told us that insurance reporting consistently failed to answer some of the following points:

- How do insurers make money? Here, existing reporting often provides only the most tangential clues as to what drives profits, whether on an IFRS or embedded value basis.
- How do we know that the reinvestment in the business is of good quality? Investors are increasingly sceptical as to whether new business profits are really achieved, and whether published internal rate of returns or payback periods really match reality.
- How do insurance earnings turn into distributable cash? While there have been attempts by several insurers to try and answer this question, the outputs are often not robust or linked to the 'real world'.
- Does the company have sufficient capital? This may seem like a straightforward question but the myriad of different views of capital and frequent company confusion mean that a clear answer can often be lacking.

We are not suggesting that these are the only issues, and clearly there are numerous other considerations that are of equal importance to management and investors. However, it is not a stretch to understand how SAM and IFRS could be used to try and address these questions, and to deliver a far more coherent approach to internal and external analysis than the patchwork of disjointed metrics that tend to represent the reporting dashboard of many insurers in today's environment.

For example, using scenario analysis built around SAM data would go a long way towards giving analysts the prospective information on cash generation they are looking for and helping them to track the most important risk and value drivers that influence this. As a result, solvency statements will provide a more balanced evaluation of risk and reward and the strategies that underpin this. The information would ideally be available in an accessible and concise format.

Industry investment in new technology could support these developments by speeding up the supply of key information. To manage their businesses, management would then have online access to value creation and risk information through dashboards. Once the link between SAM and IFRS is bedded down, we may also see the emergence of a core suite of metrics to manage and communicate the performance of the business on a consistent basis.

Of course, unanswered questions remain as to how far the African markets will go along with approaches often built from a market-consistent approach; in this respect, multi-national insurance groups are likely to have to continue to grapple with multiple reporting approaches for many years to come. A further consideration is the complexity of the SAM and IFRS 4 Phase II reporting, which could just as easily make current confusion even worse if not handled properly. However, there is a clear prize here for the insurers who get this right – and focus beyond technical considerations to make the outputs of the significant investment in reporting useful and insightful.

Presenting a clearer, more concise and more compelling approach to reporting would remove much of the 'mystery' from insurance disclosure and help companies to compete for investment on a more favourable basis with other sectors, while being more transparent to shareholders, policy-holders and other external stakeholders.

7. Key industry statistics

7.1 Long-term insurers

R'millions	Discovery			Change	Liberty			Change	MMI			Change	Old Mutual (Emerging Markets)			Change	Sanlam			Change	Combined		Change
	2012	2011	2010	%	2012	2011	2010	%	2012	2011	2010	%	2012	2011	2010	%	2012	2011	2010	%	2012	2011	%
Group consolidated IFRS earnings																							
Total comprehensive income attributable to equity holders	2,681	2,675	1,744	0%	3,780	2,736	2,302	38%	3,069	1,454	1,948	111%	5,100	7,496	4,535	-32%	5,760	5,601	5,115	3%	20,390	19,962	2%
Equity attributable to equity holders of parent	12,882	10,844	9,168	19%	15,410	13,211	11,716	17%	23,066	22,311	22,572	3%	21,839	26,929	18,987	-19%	36,919	33,822	31,778	9%	110,116	107,117	3%
Return on average equity	23%	27%	21%		26%	22%	21%		14%	6%	9%		21%	33%	24%		16%	17%	17%		19%	20%	-5%
Group consolidated embedded value																							
Group embedded value	33,413	28,416	24,074	17.6%	32,740	28,639	26,030	14.3%	33,453	30,811	31,118	8.6%	45,386	39,778	34,058	14.1%	75,352	63,521	57,361	19%	220,344	191,165	15%
Group embedded value profit / (losses)	5,667	4,827	3,557	17.4%	5,886	3,981	3,223	47.9%	5,493	1,659	n/a	231.1%	7,585	5,517	5,779	37.5%	14,310	9,405	9,322	52%	38,941	25,389	53%
Return on group embedded value	19.9%	20.1%	17.0%		20.8%	15.3%	13.4%		17.8%	5.3%	n/a		10.7%	11.9%	13.2%		22.5%	16.4%	18.3%		18.9%	14.0%	36%
Embedded value of South African new business																							
Present value of new business premiums (PVNBP)	14,040	14,440	14,318	-3%	33,510	28,329	22,498	18%	32,646	36,038	40,054	-9%	40,661	35,755	32,165	14%	27,321	23,353	20,287	17%	148,178	137,915	7%
Embedded value of new business (VNB)	904	1,047	840	-14%	660	389	252	70%	601	541	570	11%	1,590	1,021	814	56%	939	701	507	34%	4,694	3,699	27%
Value of new business margin	6.4%	7.3%	5.9%	-11%	2.0%	1.4%	1.1%	43%	1.8%	1.5%	1.4%	23%	3.9%	2.9%	2.5%	34%	3.4%	3.0%	2.5%	15%	3.2%	2.7%	19%
Average payback period (years)	7.7	8.2	8.4	-6%	5.7	5.6	5.3	1%	7.3	7.3	7.5	0%	6.7	6.6	6.6	2%	5.2	5.0	4.6	4%	6.3	6.3	
Cost management																							
Acquisition costs	1,796	1,547	1,555	16%	3,397	2,890	2,652	18%	2,554	2,784	2,421	-8%	3,031	2,596	2,477	17%	2,057	1,968	1,824	5%	12,835	11,785	9%
General marketing and administration expenses	1,499	1,306	1,224	15%	4,769	4,364	4,141	9%	3,603	3,588	3,462	0%	13,869	12,525	10,643	11%	3,328	3,175	2,941	5%	27,068	24,958	8%
Annualised Premium Equivalent (APE)	1,831	1,767	1,700	4%	5,917	5,041	4,259	17%	4,474	4,937	5,371	-9%	6,066	5,456	4,862	11%	5,290	4,695	4,424	13%	23,579	21,896	8%

R'millions	Discovery			Change	Liberty			Change	MMI			Change	Old Mutual (Emerging Markets)			Change	Sanlam			Change	Combined		Change
	2012	2011	2010	%	2012	2011	2010	%	2012	2011	2010	%	2012	2011	2010	%	2012	2011	2010	%	2012	2011	%
Investment performance																							
Invested assets	**28,323**	**19,377**	**13,378**	**46%**	**282,394**	**243,580**	**228,169**	**16%**	**315,334**	**269,660**	**263,665**	**17%**	**472,518**	**410,285**	**393,097**	**15%**	**394,361**	**340,589**	**322,279**	**16%**	**1,492,930**	**1,283,491**	**16%**
Investments	26,600	16,799	11,482	58%	276,067	236,916	222,311	17%	294,001	253,133	244,890	16%	461,281	406,027	381,367	14%	379,409	326,212	310,091	16%	1,437,358	1,239,087	16%
Cash and cash equivalents	1,723	2,578	1,896	-33%	6,327	6,664	5,858	-5%	21,333	16,527	18,775	29%	11,236	4,258	11,729	164%	14,952	14,377	12,188	4%	55,571	44,404	25%
Income on invested assets	2,632	469	918	461%	42,897	19,227	26,200	123%	43,006	19,526	27,365	120%	68,237	29,426	46,066	132%	54,840	19,446	37,175	182%	211,612	88,094	140%
Return on average invested assets	11.0%	2.9%	8.2%	284%	16.3%	8.2%	12.0%	100%	14.7%	7.3%	n/a	101%	15.5%	7.3%	12.3%		14.9%	5.9%	11.9%		15.2%	7.0%	
Adjusted net worth per embedded value report	3,628	3,088	2,329	17%	15,701	13,636	12,481	15%	13,188	12,981	n/a	2%	25,034	22,206	18,545	13%	14,946	14,553	14,033	3%	72,497	53,483	36%
Income on adjusted net worth	315	111	117	184%	1,168	536	594	118%	1,172	n/a	n/a		2,355	1,048	1,742	125%	1,720	855	1,415	101%	6,730	2,550	164%
Return on average adjusted net worth	9.4%	4.1%	4.1%		8.0%	4.1%	4.9%		9.0%	n/a	n/a		10.0%	5.1%	10.2%		11.7%	6.0%	10.0%		10.7%	5.1%	
Capital and solvency																							
Capital adequacy requirement cover	3.9	4.4	3.9	-11%	2.7	2.9	2.7	-6%	2.4	2.3	2.5	4%	3.9	4.0	3.9	-3%	4.3	3.7	3.4	16%			

7.2 Short-term insurers

R'millions	Absa			Mutual & Federal			Outsurance			Santam			Zurich			Combined		Change
	2012	2011	2010	2012	2011	2010	2012	2011	2010	2012	2011	2010	2012	2011	2010	2012	2011	%
Revenue																		
Gross written premiums	4,340	3,911	3,466	9,706	8,865	8,442	7,628	6,479	n/a	19,386	17,707	15,855	3,767	3,890	4,632	44,826	40,852	10%
Movement in Unearned premium liability	4	-230	88	-339	-295	-208	-451	-190	n/a	-323	-241	65	7	80	74	-1,101	-876	26%
Outward reinsurance	-1,280	-819	-609	-1,991	-1,735	-1,583	-183	-84	n/a	-3,564	-3,033	-2,336	-828	-912	-979	-7,846	-6,583	19%
Movement in reinsurance unearned premiums	44	97	-60	-	-	-	-	-	n/a	127	219	-34	-11	-56	-13	160	260	-39%
Net earned premiums	3,108	2,959	2,885	7,377	6,835	6,650	6,994	6,205	n/a	15,626	14,652	13,550	2,934	3,002	3,714	36,039	33,653	7%
Fee and commission income	-	-	-	338	396	317	-	-	n/a	516	321	236	146	163	169	1,001	880	14%
Expenses																		
Claims and benefits	-2,138	-1,981	-1,977	-6,310	-4,914	-4,931	-3,719	-3,112	n/a	-12,167	-10,788	-9,531	-2,928	-2,152	-3,506	-27,262	-22,947	19%
Reinsurance recoveries	-	-	-	950	477	656	187	70	n/a	1,488	1,384	848	725	174	929	3,349	2,105	59%
Acquisition costs	-468	-455	-448	-1,392	-1,269	-1,233	-69	-100	n/a	-2,540	-2,324	-2,311	-586	-624	-748	-5,055	-4,772	6%
Operating and administrative expenses	-344	-320	-309	-1,067	-1,106	-939	-2,037	-1,669	n/a	-2,349	-2,114	-1,648	-608	-579	-692	-6,405	-5,788	11%
Key ratios																		
Claims ratio	68.8%	66.9%	68.5%	72.7%	64.9%	64.3%	50.5%	49.0%	n/a	68.3%	64.2%	64.1%	75.1%	65.9%	69.4%	66.4%	61.9%	7%
Acquisition cost ratio	15.0%	15.4%	15.5%	14.3%	12.8%	13.8%	1.0%	1.6%	n/a	13.0%	13.7%	15.3%	15.0%	15.3%	15.6%	11.3%	11.6%	-3%
Expense ratio	11.1%	10.8%	10.8%	14.4%	16.2%	14.1%	29.1%	26.9%	n/a	15.0%	14.4%	12.2%	20.7%	19.3%	18.6%	17.8%	17.2%	3%
Combined ratio	94.9%	93.1%	94.8%	101.4%	93.9%	92.2%	80.6%	77.5%	n/a	96.3%	92.3%	91.6%	110.8%	100.5%	103.6%	95.4%	90.7%	5%
Underwriting margin	5.1%	6.9%	5.2%	-1.4%	6.1%	7.8%	19.4%	22.5%	n/a	3.7%	7.7%	8.4%	-10.8%	-0.5%	-3.6%	4.6%	9.3%	-50%

R'millions	Absa			Mutual & Federal			Outsurance			Santam			Zurich			Combined		Change
	2012	2011	2010	2012	2011	2010	2012	2011	2010	2012	2011	2010	2012	2011	2010	2012	2011	%
Investment performance																		
Invested assets	n/a	n/a	n/a	6,968	6,647	7,032	5,256	5,470	4,628	13,902	13,390	12,906	2,876	3,123	3,144	29,001	28,630	1%
Investments	n/a	n/a	n/a	5,467	5,227	5,685	3,553	4,053	3,110	11,431	11,792	11,763	2,264	2,142	2,071	22,715	23,213	-2%
Cash and cash equivalents	n/a	n/a	n/a	1,501	1,420	1,347	1,703	1,418	1,518	2,471	1,598	1,143	612	982	1,072	6,287	5,417	16%
Income on invested assets	n/a	n/a	n/a	403	303	554	325	327	n/a	1,339	865	1,170	364	246	335	2,431	1,741	40%
Return on average invested assets	n/a	n/a	n/a	5.9%	4.4%	8.5%	6.1%	6.5%	n/a	9.8%	6.6%	9.3%	12.1%	7.8%	11.0%	8.4%	6.2%	37%
International solency margin																		
Equity attributable to equity holders of parent	n/a	n/a	n/a	3,594	3,694	4,205	3,527	3,571	2,689	5,509	6,036	5,126	2,020	2,015	1,884	14,649	15,315	-4%
Total comprehensive income attributable to equity holders	n/a	n/a	n/a	143	408	701	1,510	1,212	n/a	1,050	1,484	1,690	41	143	225	2,744	3,247	-15%
Return on average equity	n/a	n/a	n/a	4%	10%	19%	43%	37%	n/a	18%	27%	35%	2%	7%	13%	18%	24%	-25%
International solency margin	n/a	n/a	n/a	47%	52%	61%	47%	47%	n/a	41%	48%	45%	69%	68%	52%	43%	49%	-12%

8. Basis of information provided

The primary focus of this publication is to consider the results of the South African insurance business of the companies listed above for the calendar year ended 31 December 2012. Where companies have 30 June year-ends, the financial information has been reconstituted to reflect the calendar year ended 31 December where possible.

- Although we endeavour to provide at least three years of information, some information for 2010 was not available as a result of the following:MMI Holdings was formed in December 2010 with the merger of Momentum Group Limited and Metropolitan Holdings Limited and consolidated group information is not available for the combined group prior to 30 June 2010. We have assumed for the purpose of comparative 2010 information that annual results for the year ended 30 June 2010 was earned on a straight-line basis throughout the financial year. As such, we have included half of this annual result to derive comparative information for 2010.
- The Sanlam employee benefit business is included in the Sanlam Investment segment and has not been included in this publication. The results in this publication consider the Sanlam Personal Finance segment, unless otherwise stated.
- 2011 was the first reporting period for which detailed financial information was available for Outsurance as it is now a subsidiary of RMI Holdings Ltd. Previously only limited information was available and as a result, comparative information for 2010 has not been presented.

Other pertinent matters to note on the information presented:

- Information for Old Mutual relates to the Emerging Market Segment, which primarily includes Old Mutual South Africa, but also developing markets in Asia and Latin America (for which separate information is not available). The embedded value of new business information included in this publication relates to South African business only. Old Mutual is the only company in this publication that follows the Market Consistent Embedded Value (MCEV) principles as published by the European CFO Forum. The other companies apply the principles set out in APN 107 "Embedded value reporting" as published by the Actuarial Society of South Africa.
- Return on average equity has been calculated as total comprehensive income attributable to the equity holders of the parent divided by the average shareholders equity (opening equity plus closing equity divided by two).
- The embedded value information for Discovery represents the Discovery Life and Invest segments and excludes the Health, Vitality, PruHealth and PruProtect segments, which do not represent South African life insurance operations.
- The financial information for ABSA Insurance represents the Short-term insurance segment included in the Absa Financial Services segment report and excludes the Life insurance, Investments, Fiduciary services and Other segments, which do not represent short-term insurance operations. Segmented balance sheet information is not available for ABSA Insurance, therefore the following ratio's were excluded from the analysis as it could not be calculated, namely return on invested assets, return on equity and solvency ratio.
- Outsurance changed its accounting policy governing non-claims bonuses. The 2011 insurance contract liabilities and claims expense has been restated to reflect the change in accounting policy.
- The return on average invested assets has been calculated from the information provided by the insurers as follows: income on invested assets divided by the average total invested assets.
- The return on average adjusted net worth has been calculated from the information provided by the insurers as follows: income on adjusted net worth divided by the average adjusted net worth.
- The following companies are included in ASISA's 'large offices' category, namely Liberty Group Ltd (including Capital Alliance Life Ltd), Metropolitan Life Ltd, Momentum Group Ltd, Old Mutual Life Assurance Co (SA) Ltd (OMSA) and Sanlam Life Insurance Ltd.
- Where companies have classified some of their financial assets as "available for sale financial assets", the fair value gains and losses recognised in Other Comprehensive Income have been reclassified in the income statement for companies to be comparable with their peers.
- The International solvency margin has been calculated from the information provided by the short-term insurers as follows: shareholders equity divided by gross written premium net of reinsurance. The only exception is Santam where they include their long-term debt as part of share capital for the purposes of this calculation.

9. Contacts

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