

# Ghana Reinsurance Company Limited

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Reinsurance Analysis

Security class	Rating scale	Currency	Rating	Expiry Date	Rating watch
Claims paying ability	National	Cedi	AA+	07/2006	No
Claims paying ability	International	US\$	BB+	07/2006	No

## Fundamentals

Ghana Reinsurance Company Limited (“Ghana Re”) is wholly owned by the Ghanaian Government, and currently sources 93% of its business from Ghana. Ghana Re underwrites a broad spectrum of risks, including proportional and non-proportional treaty reinsurance and facultative reinsurance across all classes of business.

## Rating rationale

The rating is based on the following key factors:

- Ghana Re’s leading market position in Ghana was positively viewed, although cognisance was taken of the impact of a change in the domestic regulatory environment, which should see legal cession fall away.
- The reinsurer’s strong balance sheet structure supported the rating. This is indicated by its high solvency margin and a strong liquidity position, as reflected by its claims cash coverage ratio of 45 months.
- The international scale rating was constrained by Ghana’s sovereign rating and the high level of exposure to non-investment grade (or unrated) entities in terms of its investments and its retrocession programme.
- Cognisance was taken of the fact that the company is wholly owned by the Ghanaian Government.
- Business risk is exacerbated by Ghana Re’s expansion into new markets, as well as its exposure to an increased level of competition.

## Capital structure / risk management

Following a 22% increase in shareholders interest to C197bn, Ghana Re’s international solvency margin (as measured by the ratio of shareholders funds to NPI) rose to 138% in F04 (F03: 123%). Likewise, the company’s financial base ratio also increased to 185% (F03: 170%), indicative of relatively conservative provisioning. Solvency is considered to be comparatively high, particularly in view of the conservative premium growth targets going forward (NPI is forecast to grow by an average of 15% per annum over the next 2 years), although cognisance must be taken of the sizeable portion of the debtors book that is potentially uncollectible. If all debtors over 6 months in arrears were charged off against capital, shareholders interest would be reduced to C112bn, equating to an international solvency margin of 79%. Liquidity is considered to be more than adequate, highlighted by the very high cash claims coverage ratio of 45 months.

## Major risks

- The difficult operating environment in the region, characterised by low economic growth, a high level of competition and, to an extent, unscrupulous insurance practice, presents a challenge to Ghana Re. In this regard, growing the business whilst maintaining underwriting quality may prove difficult, particularly since legal cession will fall away shortly.



## Background

Ghana Reinsurance Company Limited (“Ghana Re”) commenced operations in 1972. Ghana Re underwrites a broad spectrum of risks, including proportional and non-proportional treaty reinsurance and facultative reinsurance across all classes of business. The reinsurer also introduced life business as part of its product offering in 1984, although this comprises a small component of the overall book. The company is a 100% held subsidiary of the Ghanaian government and currently employs 52 staff members.

### Operating environment

There are currently 17 registered insurance companies operating in Ghana. Ghana Re leads over 75% of the treaties placed. The market is relatively well regulated and profitable, although growth, which has mainly stemmed from corporate business over the past few years, is beginning to stagnate. Market penetration in the personal lines industry is comparatively high in the upper income groups, particularly in the motor class. This is due to the legal requirement of insurance for all motor vehicles, which has also historically supported the profitability of the industry. However, penetration in the lower and middle income groups and other risks (for example householders) remains very low, largely due to a lack of awareness. Notwithstanding the potential for growth in the longer term, and the current buoyant GDP growth in the country, competition for market share is expected to intensify following the entrance of several new players.

As it stands, by law Ghana Re enjoys 20% policy cession on all non-life business from all insurance companies registered in Ghana. In addition, the company is also required to accept 5% of every reinsurance treaty between any local insurance company and an external reinsurer. This has historically provided Ghana Re with a guaranteed premium base, with legal cession premiums accounting for 70% of GPI in F04. However, the revision of this law is expected to result in the elimination of compulsory cession, which poses a significant threat to Ghana Re. Industry consensus indicates that the change in regulation will be implemented from January 2007, although a definite date has not yet been finalised. Notwithstanding the challenge posed to Ghana Re, the following factors may serve to soften the impact on the business:

- It is anticipated that legal cession will be phased out over 2 years.
- Ghana Re is a well established player, having dominated the market for several decades. Accordingly, the reinsurer has strong relationships with all the market participants.

Currently, Mainstream Re (the only other local player) has significantly less capacity and is not viewed as a major competitive threat. However, the opening of the market is likely to see a substantial escalation in competitive pressures, particularly in view of the profitability of the Ghanaian insurance market in general. More specifically, Africa Re has already shown increased signs of aggression (although it already participates in the market to a degree).

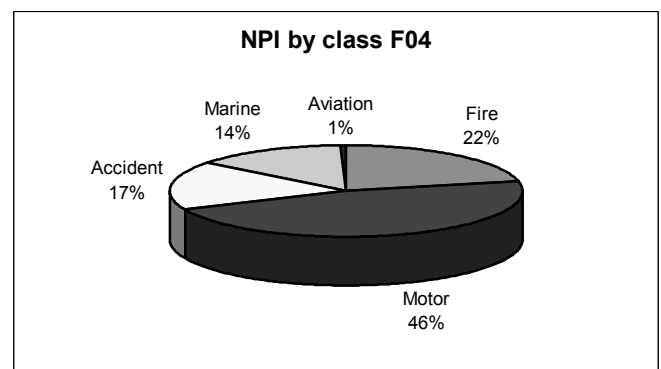
### Risk diversification

Premiums sourced in Ghana accounted for around 93% of GPI in F04 (F03: 93%). However, in view of the saturation of the Ghanaian insurance industry and the anticipated changes in the regulatory environment, management are focusing on growth outside of Ghana going forward.

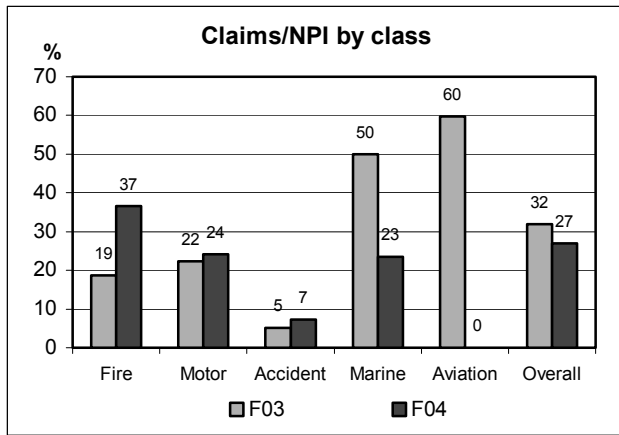
In terms of its client and broker spread, Ghana Re’s book was considered to be relatively well diversified, with no single client or broker accounting for more than 4% of gross premiums.

### General business

The reinsurer accepts treaty and facultative business in all major risk classes. The fire and motor classes comprised a combined 65% of total GPI in F04 (30% and 35% respectively). The fire account, however, is heavily reinsured, and thus accounts for a lower 22% of NPI, whilst the motor class represents 46% of the book. Overall, the majority (73%) of GPI relates to proportional business.



As reflected in the following chart, claims experience as a percentage of NPI is relatively low. A significant portion of Ghana Re’s underwriting profit in F04 was sourced from the motor class (44%), underpinned by the low claims and substantial volumes.



### Life business

Overall, life business accounts for a small component of Ghana Re's premium income, at less than 3% in F04. Group schemes business (mainly funeral) accounted for the largest component of the life portfolio, with a 43% share of GPI. Recurring premium employee benefits business and recurring premium individual life business comprised a further 30% and 23% respectively.

### Asset management

Ghana Re has a comparatively conservative asset management policy in place, with a focus on liquidity and the preservation of capital. For funds in excess of solvency and liquidity requirements, however, the company is able to accept a higher level of risk in return for superior investment performance. Cash and equivalents accounted for a substantial 65% of the overall investment portfolio in F04, with Ghanaian government securities comprising a further 24%. The vast majority (over 75%) of cash and short term deposits were US\$ or Pound Sterling denominated, placed mainly with Ghana International Bank ("GIB"). A detailed analysis of counterparties is contained in the section discussing foreign currency rating factors.

Property accounted for a small portion (5%) of investments, whilst listed and unlisted equities comprised the remaining 6%. Listed equities mostly include blue chip equities, including amongst others Enterprise Insurance (the second largest short term insurer in Ghana), BAT, Unilever, Guinness Ghana Breweries, Standard Chartered Bank and Mobil. Unlisted equities included a shareholding in Donewell Insurance Company. There was also a component of foreign equities, notably including Ecobank (C1.7bn) and Africa Re (C0.7bn). It is noted that investments are classified as held to maturity and are reported at cost on the balance sheet, except where there is a permanent diminution in value.

Investment portfolio At cost (Cbn)	F03	%	F04	%
Bank and cash	32.2	16.0	29.4	13.1
Short term deposits	94.8	47.2	116.9	51.9
Govt securities	51.6	25.7	54.7	24.3
Investment property	10.7	5.3	10.7	4.8
Listed securities	6.2	3.1	7.2	3.2
Unlisted securities	5.2	2.6	6.2	2.8
<b>Total</b>	<b>200.8</b>	<b>100.0</b>	<b>225.2</b>	<b>100.0</b>

Overall, the substantial cash holdings gave rise to a very high claims cash coverage ratio of 45 months (F03: 36 months).

### Capital adequacy

Following a 22% increase in shareholders interest to C197bn (on the back of substantial profits), Ghana Re's international solvency margin (as measured by the ratio of shareholders funds to NPI) rose to 138% in F04 (F03: 123%). Likewise, the company's financial base ratio also increased to 185% (F03: 170%), indicative of relatively conservative provisioning. Solvency is considered to be relatively high, particularly in view of the conservative premium growth targets going forward (NPI is forecast to grow by an average of 15% per annum over the next 2 years), although cognisance must be taken of the sizeable portion of the debtors book that is potentially uncollectible. Assuming all debtors over 6 months in arrears were charged off against capital, shareholders interest would be reduced to C112bn, equating to an international solvency margin of 79%, which is still considered to be adequate.

Adjusted solvency calculation	Cbn
Reported capital (F04)	196.6
Net arrears over 6 months	(84.2)
<b>Adjusted capital (F04)</b>	<b>112.4</b>
Reported solvency	138.3%
Adjusted solvency	79.0%

### Retrocession

The retrocession programme is led by GIC India (with an 18%) share, with Africa Re taking a further 17.5%. Given the relatively small individual risk exposures, Ghana Re retains 100% of the life business for its own account. General business cover includes various proportional and non-proportional treaties including the following non proportional treaties:

- *Fire and engineering XOL*: Up to US\$750,000 per risk in excess of US\$250,000, with 2 full reinstatements.
- *Fire and engineering CAT*: US\$4m in excess of US\$1m, with 1 full reinstatement.
- *Marine XOL*: US\$400,000 in excess of US\$400,000 – 2 full reinstatements.

- *Third party bodily injury, WCA and third party liability*: C60m in excess of C40m.
- *Motor physical damage only*: C300m in excess of C100m.
- *Inward acceptances (risks outside Ghana)*: Net retention of US\$300,000, with cover up to US\$2m. This equates to C2.7bn, or 1.3% of shareholders capital.

In addition to the above, there are 3 surplus treaties in place for the fire, engineering and marine accounts.

## **Financial performance**

A 5 year financial synopsis is reflected at the end of this report and brief comment follows hereafter. It is noted that the life office results have been consolidated with the general insurance results.

Following 3 consecutive years of strong GPI growth of above 25%, GPI growth slowed to 13% in F04, with gross premium income totalling a record C195bn. In line with management's stated target, around 27% of premiums were retroceded, leaving NPI of C142bn. A substantially lower transfer to insurance funds of C4.5bn further boosted net premiums earned, which rose by 27% to C138bn for the year.

Due to unusually benign weather and few catastrophes, the reported claims experience was relatively favourable in F04. In this regard, claims reduced by 9% to C39bn, with the earned loss ratio improving to a review period low of 28% (F03: 39%). Notwithstanding the 11% increase in commissions, as a percentage of earned premium acquisition costs declined from 28% to 25%. Following significant retrenchments in F03 (headcount was reduced from 122 to 52) and the associated once-off costs thereof, management costs jumped 52% to C30bn. This increased further in F04, with management costs rising by 35% to C48m, largely due to the cost of modernising the company's outdated IT systems and bad debt charges. In F04, of the C48bn in reported management costs, around C21bn or 44% related to bad debt charges (F03: C14bn). Around 53% of the bad debts written off in the past year relate to legal cession premiums, whereby although companies are obliged to cede the premium, extracting payment has historically been difficult, as the business cannot be cancelled. With bad debts only written off after 2 years, there remains a substantial component of uncollected premium outstanding, with net premiums receivable totalling a substantial C165bn. At 83% of shareholders equity this exceeds the international average. Albeit improved from 3 years ago, this equates to an average debtors collection period of 273 days, which is well above industry norms.

Despite the higher management costs, a substantial underwriting profit of C17bn was reported in F04, equating to a high underwriting ratio of 13%. This was a substantial improvement from F03, where a breakeven underwriting result was recorded, although cognisance must be taken of the high level of reserving and once off retrenchment costs. Investment income declined slightly to C22bn, whilst other income (predominantly realised exchange gains) further boosted income to a record of C46bn for the year. It is noted that the company is not liable for taxation.

## **International foreign currency rating factors**

In according the international foreign currency rating the following four main factors were considered.

- **Income/asset and liability matching**

Around 90% of premium income is generated in Ghana, with premiums (and obligations) denominated in Ghanaian Cedi. The 10% of premium collected outside of Ghana is charged in US\$, with cover also being provided in US\$. Therefore, the currency conversion risk rests with the client, with premiums effectively matched to obligations. It is noted that to overcome extreme currency movements a currency fluctuation clause would typically be in place (normally applicable to non-proportional treaties). This clause effectively states that in the event of a large depreciation in a currency other than that stated in the agreement (usually US\$), the net retention and programme limits will be calculated according to the prevailing rate at the commencement date of the contract. This potentially exposes Ghana Re to a depreciation of currencies against the US\$. For example: a client has a US\$1m net retention. A loss exceeding US\$1m occurs in another currency, which has depreciated by 20% since the commencement of the contract. The new net retention will be calculated equivalent to the original value in local currency terms, meaning that the programme attaches at a lower point in US\$ terms (the new net retention is US\$0.83m). Theoretically, this suggests potentially higher losses incurred by Ghana Re, although programme limits would be reduced as well. Accordingly, currency risk is considered to be fairly low.

- **Asset conversion risk**

<b>Total assets (Cbn)</b>	<b>F03</b>	<b>%</b>	<b>F04</b>	<b>%</b>
Cash holdings	127.0	37.3	146.3	35.9
Govt securities (Ghana)	51.6	15.2	54.7	13.4
Investment property (Ghana)	10.7	3.2	10.7	2.6
Listed & unlisted equities	11.4	3.4	13.4	3.3
Premiums receivable	126.3	37.1	165.5	40.6
Fixed & other assets	13.1	3.9	17.2	4.2
<b>Total</b>	<b>340.2</b>	<b>100.0</b>	<b>407.9</b>	<b>100.0</b>

As a percentage of total assets investment property represented a relatively low 2.6%. However, the company plans to construct its new headquarters in Accra (at a cost of US\$20m or C184bn), which should see the proportion rise to around 30%. The building will be funded by US\$8m equity (of which US\$6m will be new equity) and US\$12m in long term debt.

Sizeable investment in fixed assets exacerbates convertibility risk and is not normally considered appropriate for a reinsurance company. However, it is conceded that in Africa, property tends to be one of the better forms of capital preservation, whilst the remainder of the investment portfolio (i.e. cash etc) is considered to be ample to meet its obligations. Furthermore, the building is expected to generate income of US\$1.7m per annum based on current rentals in the area.

Ghanaian government securities formed a sizeable component of the asset base, at 13% in F04, while cash and equivalents comprised a substantial 36% of total assets in F04. The following table gives a breakdown of cash and equivalents (including liquid government bonds) by currency and counterparty as at August 2005.

Counterparty (Cbn) Aug 2005	US\$	GBP	Cedi	% of total
GIB	43.2	47.0		49.7
Local banks	5.4	-	12.2	9.7
Other Govt bonds	5.0			2.8
Ghana Govt bonds	-	-	68.8	37.9
<b>Total</b>	<b>53.6</b>	<b>47.0</b>	<b>80.9</b>	<b>-</b>
<b>% of cash &amp; equiv.</b>	<b>29.5</b>	<b>25.9</b>	<b>44.6</b>	<b>-</b>

#### Currency exposure

As indicated, a large component of cash and equivalents are US\$ and GBP denominated, which collectively accounted for 55% of cash and equivalents. A further 45% is held in Cedi (mainly Ghana Government securities) to fund day to day operations.

Given that at least C200bn of the reinsurer's asset base is Cedi denominated (including premiums outstanding), it can be said that a 1% movement in the value of the Cedi would result in a 1% movement in the capital base in US\$ terms. Excluding the premiums receivable, currency sensitivity increases.

#### Counterparty exposure

Although a significant component of Ghana Re's asset base is US\$ and Pound denominated, an important factor in the international rating is the reinsurer's exposure to the credit risk of the institutions holding its deposits. The credit quality of the counterparty on an international scale is typically constrained by its ability to access US\$ and meet foreign currency

obligations, referred to as transfer and convertibility risk. In this case, the international scale rating ceiling for Ghana Re's domestic deposits, as well as the Ghana Government bonds, would be constrained to B+ (Ghana's sovereign rating). Although GIB is wholly owned by the Ghanaian Government, which implies a ceiling, a level of comfort is provided by the fact that it is incorporated in the UK and regulated by the Financial Services Authority.

#### • Sovereign risk

Ghana Re is wholly owned by the Ghanaian government. Although there is little operational interference at present (even dividend policy is currently determined by management without undue interference), Ghana's sovereign rating is a significant constraining factor on the international rating.

#### • Retrocession

The counterparties to Ghana Re's excess of loss programme, which forms the main component of the retrocession programme, are indicated in the following table (the retrocessionaire's international rating is indicated in brackets where applicable/available). As evidenced, the majority of the participating retrocessionaires are unrated, although the diversity of counterparties provides a degree of comfort.

Retrocession counterparties	% of total
GIC India (BB)	18.0
Africa Re (BBB+)	17.5
CICA Re	11.0
Fair pool	10.0
Sen Re (B-)	8.0
Zim Re	7.0
SCR Morocco (BBB)	5.0
WAICA pool	5.0
ZEP-RE (BBB-)	4.0
Kenya Re	4.0
Others*	10.5
<b>Total</b>	<b>100.0</b>

\* Comprises 7 other reinsurers

#### Peer comparison

The following table compares the balance sheet and income statements of Ghana Re, Africa Re and ZEP-RE. Ghana Re's figures have been converted to US\$ at a rate of C9,200/US\$.

Peer comparison (US\$m) F04	ZEP RE	Africa Re	Ghana Re
<b>Income statement</b>			
Gross premium income (GPI)	24.4	299.1	21.2
Net premium income (NPI)	18.8	264.0	15.4
Underwriting profit/(loss)	2.4	4.0	1.9
Net income after tax	2.0	9.7	5.0
<b>Balance sheet</b>			
Shareholders' equity	12.4	130.0	21.4
Total assets	29.5	476.3	44.3
<b>Ratios (%)</b>			
Shareholders' funds/NPI	66.0	49.2	138.3
Retention ratio	77.3	88.2	72.8
Earned loss ratio	52.2	59.8	28.3
Trade ratio	87.6	98.2	87.4
Underwriting ratio	12.4	1.8	12.6

As reflected in the above table, ZEP-RE and Ghana Re are considerably smaller than Africa Re in terms of premium income. Although Ghana Re wrote less premium in F04, its capital base was nearly 2 fold that of ZEP-RE, whilst its reported a comparatively high solvency margin of 138%. However, cognisance must be taken of Ghana Re's sizeable debtors book, which if written off (arrears over 6 months) would reduce the capital base to around US\$13.4m. Ghana Re outperformed ZEP-RE in terms of profitability in F04, reporting net income after tax of US\$5m, albeit largely due to its higher investment income.

### Future prospects

Budget F05	Excl. legal cession		Incl. legal cession	
	Cbn	% increase	Cbn	% increase
GPI	119.8	(38.6)	226.2	15.9
Retrocession	(32.1)	(39.4)	(45.6)	(14.0)
<b>NPI</b>	<b>87.7</b>	<b>(38.3)</b>	<b>180.6</b>	<b>27.0</b>
Unearned prem. prov	26.7	n.a.	(16.9)	n.a.
<b>Earned premiums</b>	<b>114.4</b>	<b>(16.9)</b>	<b>163.7</b>	<b>18.9</b>
Claims incurred	(22.1)	(43.3)	(47.8)	22.6
Commissions	(27.6)	(18.1)	(49.4)	46.6
Management costs	(42.8)	(10.3)	(40.8)	(14.4)
<b>Underwriting result</b>	<b>21.9</b>	<b>26.6</b>	<b>25.7</b>	<b>48.6</b>
Investment income	20.5	(5.1)	29.2	35.2
<b>NPBT</b>	<b>42.4</b>	<b>(7.0)</b>	<b>54.9</b>	<b>20.3</b>

Management have prepared 2 budgets depicting financial performance with and without legal cession in F05. As can be seen gross premium income is expected to contract substantially without legal cession in F05, although NPBT is forecast to be only 7% down due to the release of reserves, reduced costs and improved claims experience. Although factored in

to the budgets for F05, legal cession is only expected to be phased out from F07.

Besides a contraction in premium, an additional outcome of the change in the regulatory environment is that insurers may now be reticent to reinsure profitable books of business (for example the motor class), which may negatively impact the quality of the book. However, the removal of legal cession may have the following positive side effects:

- The level of underwriting discretion will improve, with Ghana Re now able to choose not to participate in undesirable risks.
- Debtors days should reduce significantly as cover can be cancelled on the basis of non-payment of premiums.

Overall, a key challenge remains the company's ability to adapt to a competitive environment. Firstly it will now have to compete for business in its core market. Second, the company will be exposed to the vagaries of the broader African reinsurance market in terms of its growth strategy. In this regard, a key risk remains the relative lack of experience (in other African countries), although management contend that growth will be on a measured and conservative basis.

As previously mentioned, the company's strategy is to expand internationally. In this regard, certain key African markets have been identified, including neighbouring countries, as well as countries where no physical reinsurance presence exists. In such cases, Ghana Re is considering the possibility of opening local offices. In addition, general measures taken to improve the marketability of the company include:

- Improving the IT system.
- Intensive staff training.
- An increased focus on broker and client relationships and an intensification of marketing efforts by senior personnel.