

Media Release:

Ratings On South China Insurance Co. Ltd. Affirmed At 'twAA' On Group Support; Outlook Stable

November 21, 2022

Overview

- The ratings on property and casualty insurer **South China Insurance Co. Ltd.** reflect the insurer's strategically important status to the wider Hua Nan FHC group. The ratings are equivalent to the group credit profile to reflect the insurer's obligation to provide resource support to weaker group members under the group's highly integrated structure.
- South China Insurance's capitalization has weakened due to valuation losses of its bond and equity investments in 2022. We are keeping our assessment of its capital and earnings as very strong but now with a limited rating buffer.
- The valuation losses have also stressed the insurer's liquidity and we have lowered our assessment of this to adequate from exceptional previously. The impact on the ratings is neutral and we believe the insurer has no material liquidity risks.
- The outlook on the ratings remains stable to reflect the trend of the Hua Nan FHC group credit profile.

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Rating Action

Taiwan Ratings Corp. today affirmed its 'twAA' long-term financial strength rating and issuer credit rating on South China Insurance. The outlook on the ratings is stable.

Rationale

*South China Insurance remains a strategically important member of the wider **Hua Nan Financial Holdings Co. Ltd. (Hua Nan FHC) group.*** The rating affirmation reflects our view that the insurer remains an integral part of the wider Hua Nan FHC group and is important to the group's long-term business strategy. We continue to view South China Insurance as a strategically important group member and as such the ratings on South China Insurance continue to be capped by the consolidated group credit profile. Therefore, the ratings and outlook reflect our view of the trend of the group credit profile.

South China Insurance's capitalization was weakened and remains very sensitive to unexpected market volatility over the next one to two years. Like other local peers, the insurer has recorded increased valuation losses on its bond and equity investments in 2022. These unrealized losses are booked under the insurer's shareholder's equity. The insurer's valuation losses reached over new Taiwan dollar (NT\$) 250 million as of June 30, 2022 and could rise further amid likely continuing capital market volatility over next few quarters.

At the same time, mid-to-large size fire claims in early 2022 also had a negative effect on the company's underwriting profits and earnings, as was also the case for many of its local peers. Meanwhile, COVID-19 related policy claims have been manageable, given the minimal number of policies sold by the insurer. Consequently, South China Insurance's net income was NT\$148.7 million in the first half of 2022, compared with NT\$484.6 million in the same half of 2021. The insurer's net combined ratio also deteriorated to 100.4% as of June 30, 2022, compared with an average of 95.5% in 2019-2021.

We project the insurer's capital and earnings will remain very strong but now with a limited buffer for capital market volatility over the next one to two years. Capital and earnings remain very sensitive to unfavorable deviations from our base case assumptions. These could include further enlarged valuation losses, unfavorable underwriting performance, lower retention of profit, an increase in retained catastrophe exposure, and an aggressive investment strategy.

Under our base case for South China Insurance, we forecast the insurer will sustain its capital adequacy through controlled growth in risk-based assets, particular for equity investments, and maintain good underwriting skills. We also continue to assess South China Insurance's competitive position as satisfactory with a stable market share and good operation efficiency over the next one to two years. These factors underpin the insurer's overall creditworthiness which is comparable to other similarly rated peers in Taiwan.

Liquidity has weakened to adequate from exceptional. We now assess South China Insurance's liquidity as adequate due to recent valuation losses. These have reduced the insurer's liquidity sources while at the same time its liability related use of liquidity has continued to grow. Nevertheless, the impact on the ratings is neutral and we see no material liquidity risks for the insurer. In our view, South China Insurance has sufficient cash flows to cover its short-term debt and stressed insurance liability outflows.

Outlook

The stable rating outlook on South China Insurance reflects the trend of the Hua Nan FHC group credit profile, which in turn mirrors the stand-alone credit profile of the group's flagship unit, **Hua Nan Commercial Bank Ltd.** We anticipate South China Insurance's strategic importance to the group will not change over the next two years and as such the ratings on the insurer will move in tandem with the group credit profile.

Downside scenario

We may lower the ratings on South China Insurance if the group's banking arm fails to sustain its strong capitalization which would in turn weaken the group credit profile. A consistent drop in the bank's risk-adjusted capital ratio to below 10% would indicate such a decline and could result from more aggressive growth or higher risk taking by the bank at home or overseas than we previously forecast.

Upside scenario

We see only a remote possibility of an upgrade for South China Insurance over the next two years, given the ratings are capped by the group credit profile and our view that the group's business position is unlikely to improve significantly under its capital policy and business growth plan.

Ratings Score Snapshot

South China Insurance Co. Ltd.

	To	From
Business Risk Profile	Satisfactory	Satisfactory
Competitive position	Satisfactory	Satisfactory
IICRA	Intermediate	Intermediate
Financial Risk Profile	Very strong	Very strong
Capital and earnings	Very strong	Very strong
Risk exposure	Moderately low	Moderately low
Funding structure	Neutral	Neutral
Modifiers		
Governance	Neutral	Neutral
Liquidity	Adequate	Exceptional
Financial Strength Rating	twAA	twAA

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria & Research

Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- Criteria | Insurance | General: Insurers Rating Methodology - July 01, 2019
- General Criteria: Principles Of Credit Ratings - February 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model - June 07, 2010

Related Research

- Taiwan Ratings' Ratings Definitions – November 11, 2021

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings List

Ratings Affirmed

South China Insurance Co. Ltd.

Issuer Credit Rating	twAA/Stable
Financial Strength Rating	twAA/Stable

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.taiwanratings.com for further information.

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