

## CREDIT RATING REPORT

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# NATIONAL REINSURANCE CORPORATION OF THE PHILIPPINES

Analyst: LENY JANE V. PE

LOURDES B. TABARINA

## Assigned Financial Strength Rating: PRS A plus

An insurer rated 'PRS A' has STRONG financial security characteristics but is somewhat more likely to be affected by adverse business conditions compared to higher-rated insurance companies. The sign further qualifies the rating.

## Assigned Outlook: Stable

A stable outlook is defined as 'the rating is likely to be maintained or to remain unchanged in the next 12 months'.

## RATIONALE

The assigned financial strength rating for National Reinsurance Corporation of the Philippines (NRCP) takes into consideration the company's:

- **Solid market franchise;**
- **Shareholders of good standing;**
- **Experienced management which has contributed to the company's growth;**
- **Sound investment portfolio; and**
- **Improving, but still volatile, profitability**

NRCP has a solid market franchise, given its status as the Philippines' leading professional reinsurer. NRCP directly competes with foreign reinsurance companies with agents licensed by the Insurance Commission (IC), and to a lesser extent with domestic insurance companies, which are also licensed to sell reinsurance. NRCP, nonetheless, has to its advantage Presidential Decree (PD) No. 1270, which mandates "all life and non-life insurance and reinsurance companies doing business in the Philippines to cede to the company (NCRP) at least 10% of their outward reinsurance placed with unauthorized foreign reinsurers." Of the licensed insurance companies in the Philippines as of December 31, 2016, NRCP had existing reinsurance agreements with 50 (out of 66) non-life insurance companies, all of the 27 life insurance companies and three (out of four) composite companies. As of report writing date, NRCP is the Philippines' sole domestic professional reinsurer. NRCP's marketing strategy is supported by its technical know-how, industry track record and familiarity with the domestic market.

NRCP is led by a competent management team with extensive experience and understanding of the insurance and financial markets, both domestic and global. While relatively new to the

company (average of 3 years), members of the management team brings with them solid experience in the insurance industry. Management is led by Augusto Hidalgo, who is Director, Chief Executive Officer (CEO) and President of NRCP. Mr. Hidalgo, 49 years old, has been with the company since April 2014. Mr. Hidalgo worked as a strategy executive, heading Mergers and Acquisitions (M&A), of Peak Reinsurance Hong Kong in the last eight years, and also as Managing Partner of New World Financial Canada.

Other members of the NRCP's management team are similarly well-experienced in the insurance business. Mr. Allan R. Santos, FSA, FASP, serves as management consultant for data, analytics and technology. Prior to joining NRCP in April 2016, Mr. Santos was Chief Operating Officer (COO) for Affiliate Companies and Head of Vitality of Philippine American Life and General Insurance Company. Previous to that, he was Regional Chief Finance Officer (CFO) for Europe of CIGNA based in Belgium. Mr. Santino U. Sontillano is Senior Assistant Vice President and Head of Finance. Mr. Sontillano joined NRCP as Head of Internal Audit in January 2016. He worked as Assistant Vice President for Finance at Argus Group Holdings Limited, and as an Audit Senior at KPMG in Bermuda. NRCP's current management team has played an important role in the gradual improvement of the company's core business and growth trajectory in recent years.

NRCP's investment strategy is grounded on the principle of diversification, spread over the medium to long term. PhilRatings positively notes the company's highly diversified investment portfolio. Low-risk bonds comprised half of the total portfolio. Bond investments include government securities (by the Republic of the Philippines, other foreign governments) and debt issues of Philippine private corporations. Equity securities, on the other hand, appeared to have an increasing share in the

company's investment portfolio. As of end-2016, equity securities represented 29.5% of the total portfolio. Equity securities consist mainly of shares of stocks (common and preferred) in companies listed in the Philippine Stock Exchange (PSE). NRCP's equity investment placements were largely with blue chip companies in various industries. Cash and cash equivalents, which include cash in banks and short-term placements, represented 12.7% of the investment portfolio, as of December 31, 2016. Representing the balance were loans and receivables (6.4%), mutual funds and the company's investment in Asian Reinsurance Corporation (Asian Re, 0.4%). NRCP closed 2016 with total investment assets worth P7.2 billion.

NRCP's profitability is considered weak for the historical period 2011 to 2015, although underwriting profit margin and returns have improved beginning 2014. While investment yields have been consistently positive, volatile growth across business lines and higher than expected loss and expense ratios negatively impacted operating performance.

Except in 2016, underwriting margins were negative for the historical period covered. In 2012, NRCP almost doubled its incurred cost for excess of loss (XoL) cover in relation to large losses from the Thailand flood in 2011. The severe flooding began with the landfall of Tropical Storm Nock-ten (locally known as Tropical Storm Juaning) in July 2011, and persisted in some areas of Thailand until mid-January 2012. Net underwriting performance, however, improved beginning 2013, despite losses brought about by calamities which affected the Philippines, including Typhoon Yolanda and the earthquakes in the provinces of Cebu and Bohol.

For the first quarter of 2017 (1Q17), NRCP posted net underwriting loss mainly due to combined increases in claims/losses and commissions.

Pre-tax income went down by 39.5% to P7.6 million in 1Q17. Combined with significantly higher tax expense, NRCP recorded a net loss amounting to P39.1 million. The 298% increase in tax expense resulted mainly from temporary differences between tax and accounting regulations, and is expected to normalize by end-2017.

NRCP expects positive underwriting margins and returns in 2017 and 2018. Premiums written, gross and net, are projected to grow at double-digit rates. Non-life business will continue to drive premium income growth, with fire and casualty to remain as major contributors. Continued improvement in combined ratio will buoy overall profitability for the projected period. Return on assets and revenues are also expected to improve, going forward. Operating targets will be mainly supported by continued portfolio diversification and technical capability building.

## BUSINESS PROFILE

NRCP, also doing business under the names and style of Philippine Reinsurance Company or PhilNaRe, is a domestic

professional reinsurance firm providing life and non-life reinsurance in the Philippines and neighboring Asian insurance markets. Major business lines under the non-life category include fire, marine and aviation, and casualty and others. NRCP offers reinsurance in both facultative and treaty arrangements.

NRCP was incorporated on June 7, 1978 pursuant to PD No. 1270. The decree designated NRCP as the national institution which is authorized to participate in Asian Re, a multi-government-initiated reinsurance corporation which was established to promote cooperation among insurance companies doing business in the Asian region. Asian Re is based in Bangkok, Thailand.

On March 6, 2006, NRCP completed its merger with Universal Malayan Reinsurance Corporation (UMRC) to become the sole domestic professional reinsurance company in the country. The merger was undertaken to bring about a bigger and more competitive reinsurance provider. UMRC was the Philippines' second largest domestic reinsurer. NRCP has no subsidiary, as of end-2016. NRCP's principal place of business is located at the 31<sup>st</sup> floor, BPI-Philam Life Building, Makati City.

NRCP directly competes with foreign reinsurance companies with agents licensed by the IC, and to a lesser extent with domestic insurance companies, which are also licensed to sell reinsurance. NRCP believes, however, that the core business of domestic insurance companies is writing direct insurance for the general population, and hence their reinsurance operations are considered secondary. NRCP, nonetheless, has to its advantage PD No. 1270, which mandates "all life and non-life insurance and reinsurance companies doing business in the Philippines to cede to the company (NRCP) at least 10% of their outward reinsurance placed with unauthorized foreign reinsurers." Of the licensed insurance companies in the Philippines as of December 31, 2016, NRCP had existing reinsurance agreements with 50 (out of 66) non-life insurance companies, all of the 27 life insurance companies and three (out of four) composite companies. The company's ten largest customers for 2016 represented 85% of gross premiums written (GPW). NRCP's business generation is mainly driven by direct private deals and portfolio transfers.

In terms of geographic exposure, NRCP continued to write reinsurance largely for the domestic market. It should be noted, however, that business generated from foreign sources have grown overtime, especially in the last two years. This was in line with the company's diversification strategy.

NRCP is listed in the PSE. As of July 20, 2017, the company's total market capitalization stood at P1.8 billion.