Q3 2021 Sales and Revenue Call

Company Participants

- Abigail Mukhuba, Financial Director
- Grant Davids, Executive Head-Investor Relations
- Mlondolozi Mahlangeni, Chief Risk Officer, Chief Actuary
- Paul Hanratty, Group Chief Executive Officer

Other Participants

- Akhona Matshoba
- Analyst
- Francois du Toit
- Kevin Harding
- Larissa Van Deventer
- Matthew Pouncett
- Michael Christelis
- Sarine Barnard
- Warwick Bam

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Sanlam Life Insurance Limited 10-month Operational Update. All participants are currently in listen-only mode and there will be an opportunity to ask questions later during the conference. (Operator Instructions) Also note that this call is being recorded.

I would now like to turn the conference over to Mr.Paul Hanratty. Please go ahead, sir.

Paul Hanratty {BIO 7445748 <GO>}

Chris, thanks a lot. Good afternoon, ladies and gentlemen, and thank you for joining us on this conference call. I'm joined today by Finance Director, Abigail Mukhuba; our Chief Actuary and Chief Risk Officer, Mlondolozi Mahlangeni; and the Head of Investor Relations, Grant Davids.

Sanlam released our operational update for the 10-month period to 31 October 2021 earlier this afternoon. I'd like to make a few comments before we proceed to questions. While 2021 continues to be a very challenging year, I'm absolutely delighted that the

Sanlam Group has made excellent progress both operationally and strategically. Operational results are outstanding and I believe that our results demonstrate the customers' value having in Sanlam as a trusted partner more than ever before. In every business line and customer segment, we've continued to strengthen our market position during 2021.

From a strategic perspective, the Group made significant progress since we announced our interim results in September. The development of Sanlam Investments as South Africa's leading black-owned asset manager and the proposed merger with Absa Investment Managers to create a scaled investment platform, offering diverse asset classes, will significantly improve our market position.

Strong client cash flows during the period underline the progress in the development of the Group's investment platform. The breadth of the offering, the integration of ESG principles into all of our investment processes and the ownership credentials of the business have combined to elevate our investment platforms prominence over the year.

We've launched a new set of health insurance offerings in partnership with AfroCentric to provide a more holistic product offering to our clients and to fulfill the market need for affordable health insurance. The proposed transactions with Alexander Forbes that we announced the other day will enable the Group to focus on providing umbrella pension fund solutions to the market and a full range of investment and insurance products to the corporate benefits market.

The focus will further strengthen the Group's competitive position in the corporate benefits market over time. And as our operational results indicate, the Sanlam Group's performance in this market is very strong and improving. We divested from our UK operations outside of asset management and formed by our capital allocation framework and strategic intent to develop the leading African insurance and asset management group.

We also took steps to further optimize the Pan-African portfolio through strengthening our position in key markets and exiting subscale operations. Our Pan-African general insurance portfolio recorded a net insurance margin of 19.5%, driven by a higher return on insurance funds and a net underwriting margin within our target range. Our Pan-African life portfolio recorded a strong performance. New business volumes were up by 22% and the value of new covered business by 87% in constant currency. This growth and strong performance as we integrate the various African operations into the Sanlam Group is very pleasing and supports our long-term ambitions for the continent.

From an operational perspective, the performance of our business in attracting new customers and deepening relationships with existing customers was outstanding. We're particularly pleased with the new business volumes in the life insurance and asset management product lines. Our strong platform and product offering meant that we were well-positioned to meet client needs in this regard. New business volumes across all product lines was 17% higher than 2020 and 46% higher than 2019. Obviously, asset management and life insurance numbers were much higher than that.

The value of new business covered was up by 55% on 2020 and was 23% higher than 2019. The new business margin of 2.65% was higher than 2020 and only very slightly below 2019. Net fund flows were incredible ZAR61.4 billion, 21% higher than 2020 and 41% higher than 2019. The COVID-19 pandemic continues to impact our business' profitability and return on group equity value. Significant excess mortality claims were recorded in our South African and Emerging Markets operations. The strength of our balance sheet, however, has enabled us to mitigate much of the impact of this on the earnings of our South African operations.

Sanlam Life and Savings paid gross mortality claims of more than ZAR14 billion in the first 10 months of 2021. This was 88% higher than the same period in 2020, significantly due to the impact of the third wave of COVID-19 in the third quarter of the year. Claims over and above the long-term expected level were ZAR3.42 billion, net of reinsurance and net of annuity and disability offsets within Sanlam Life and Savings, and ZAR536 million within Sanlam Emerging Markets.

As part of a package of basis changes, Sanlam Life and Savings has released discretionary reserves of ZAR2.85 billion to mitigate the impact of excess claims. Sanlam emerging markets holds more limited discretionary reserves and we will only consider releases in this regard at year-end based on full year experience.

We have taken very significant actions to mitigate the future impacts of COVID on the Group's business. These include extensive re-pricing of Group risk business, development of new underwriting standards and amended product design in our retail businesses, accompanied by a full review of actuarial valuation assumptions in the light of the pandemic. The latter will permit us to restore pandemic buffers over the next number of years from higher margins.

The net result from financial services increased by 24% on 2020, and was 4% higher than 2019 excluding one-off items. But it's extremely important to note that both 2020 and 2021 years contain quite a lot of very lumpy and unusual quarterly movements. So the current level of growth is therefore not expected to be maintained for the full year. We are however delighted that the current year profits are in line with 2019 results since we were targeting to restore profitability to 2019 levels as quickly as possible.

Overall, persistency trends remained excellent. The Group remains well-capitalized with Sanlam Group Solvency Capital Requirement cover ratio at a 176% on the 30th of September. Just maybe to point out that we do our valuations quarterly although we now are reporting a 10-month period and that's why we're quoting the solvency as at the end of September. Our solvency ratio is well within the target range set by the company. Our operating performance for the 10 months to October reflects the strength of the underlying operations and the ability to maintain value creation for our shareholders in various challenging times.

In conclusion, I'd like to say that we continue to actively manage the consequences of the COVID-19 pandemic and the emergence of the fourth wave in South Africa. The Group expects to retain modest discretionary reserves to mitigate any mortality losses after the end of the current financial year. The Group has, however as I mentioned just now, implemented far-ranging management actions to deal with the future impact of the pandemic on mortality experience.

On our best estimate assumptions, we believe that these management actions should eliminate future mortality losses. However, as I'm sure, you'll appreciate a large degree of uncertainty still exists with respect to future COVID-19 impact. In addition to the management actions taken, the Group will therefore maintain a higher level of discretionary capital that is normal for a period of time, and this period may indeed extend to several years in order to provide a buffer should the management actions taken prove to be inadequate in dealing with the financial consequences of the pandemic.

Over the medium to long term, we remain extremely confident of the growth prospects of all of the Group's businesses. Furthermore, we are very confident about the strong ongoing cash generation ability of our businesses and we expect that we'll be able to continue to deliver value to our shareholders and to other stakeholders.

I will now open the call to questions. So please let us have your questions as you're ready.

Questions And Answers

Operator

(Question And Answer)

Thank you, sir. (Operator Instructions) The first question is from Warwick Bam of Avior Capital Markets. Please go ahead.

Q - Warwick Bam {BIO 19921967 <GO>}

Hi, Paul and rest of the team. Thank you very much for the comments and the time. I start with three questions. Just the first one, in terms of the trend in new business volume growth, it seems to have continued in a similar manner to the first six months and in the third quarter. Just can you expand on whether the performance is similar to the first half if you drill down to a product level and distribution channel perspective? Any kind of color around those trends would be valuable.

Second, question is just on with 2021 new business volumes as a high base. Can you give us a sense of the chances of agents improving their productivity as to kind of where productivity stands? And then certainly in the investment and savings segment of the business that's benefited from the pandemic, but potentially you can add some color around the risk products and whether there is full capacity to improve sales volumes in 2022?

And then third question on the Indian Shriram General Insurance business is at currently at freeze in the third party premium increases. Is there any clarity on when that freeze will lift and what percentage of the book does that third-party freeze affect? Thanks.

A - Paul Hanratty {BIO 7445748 <GO>}

Warwick, thanks very much. I'm going to give you a high-level answer to the first question and see then with Abigail or Grant or maybe even Lotz can share any more detail on it. I'll then deal with your second question. And I'm not sure whether we have an answer to the third question at hand.

But let me start with the new business volume growth. I mean as you say, it has continued during this six-month period. And I think, I've been quite consistent in warning that at some point, as the economy goes back to normal and we would expect to see that that coming off. So I will see whether there are any detailed comments from my team because you asked for a bit of color along different product lines.

When I look at a high level at the different product lines and the different market segments, they've actually all been really high. So Sanlam Corporate has done very well, our Retail Mass business has grown extremely strongly. The investment business as you pointed out has grown pretty strongly, the one that's been a bit of a lag on in terms of growth is actually being the risk product sales in the effluent market. But I'll see whether the team want to add anything to that.

As far as 2021 being a high base, I think 2021 is an incredibly high base now. So when we look forward, we definitely don't anticipate seeing the same level of growth that we've seen in this year. You are specifically about agent productivity. We know that in our Retail Mass business, we believe that we can in fact lift the productivity and we've got very granular plans around doing that.

There's a tremendous difference in the productivity of very experienced agents and those with less experience. And so, it's equation of making sure that we nurture and keep people, so that they gain experience and that tends to drive up productivity. But we've got a number of measures in that place. But, I do take the general point that the base is high. I think it's important to point out that in the long-run of course growth is really important to us. In the short run you've got the strange effect that in fact slightly lower rate of growth can be helpful from a profit point of view, but not as helpful from a return on group equity point of view.

On the Indian GI business, I mean, it's quite interesting, the life business in India grew 60% and yet the overall business grew 3%, which I guess will give you a sense of what happened to the GI, but I don't know whether anyone on this call. I don't know, Grant whether you or Abigail or Lotz know exactly what proportion that particular product line, which has its premium set by the government use of the total GI book. So colleagues, does anybody want to come in and add or are we just going to leave Warwick with my answers.

A - Grant Davids {BIO 16315544 <GO>}

Maybe I can just add on the new business trends. It has -- trend has been quite stable or quite good across all lines. So one area, in same way that was a bit weaker was an asset management business, but as we know, it's a high base there from last year and that would tend to be a bit lumpy. But excluding that, all the trends generally across the business have been very strong.

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah. That's a good point. I actually missed that Grant. And Grant, do you know the split on the -- in the GI business of the -- that business is regulated premium-wise or not -- I don't expect you to know the answer, but if you do, it's a bonus.

A - Grant Davids {BIO 16315544 <GO>}

Yeah, it is the biggest part of the book. Paul, I can give the exact number, but it is --

A - Paul Hanratty {BIO 7445748 <GO>}

Maybe you can touch base with Warwick offline.

A - Grant Davids {BIO 16315544 <GO>}

Yeah, we'll do that.

Q - Warwick Bam {BIO 19921967 <GO>}

Thanks very much.

Operator

Thank you. The next question is from Michael Christelis of UBS. Please go ahead.

Q - Michael Christelis {BIO 15233664 <GO>}

Hi, guys. Can you hear me?

A - Paul Hanratty {BIO 7445748 <GO>}

Michael, perfectly yeah. Nice to hear you.

Q - Michael Christelis {BIO 15233664 <GO>}

That's good. Great to hear you. I'm hearing you too Paul thanks for, thanks for the time and for your team. Three questions if I can. So the first one, just around corporate. Maybe if you can give a little bit more color as to what's growing so well? I mean, it does seem like a market where all your competitor seem to be struggling? So, I mean can you maybe just comment on sort of the trends over the last four months around whether it's risk business, is it umbrella business, is it sort of lumpy annuity business? You maybe just some, some sort of guidance there would be great.

Then a little bit more technically, I guess around your discretionary margin. So it is a comment in the, in the pack that talks about reprocessing and basis changes will largely offset your best estimate of excess claims experienced for the full year in South Africa.

Now, if I look at your numbers that you've shown us today. It looks like there's about a 600 million shortfall between your discretionary reserve release and your excess claims. Does that mean there's 600 million of additional reserve releases coming which should bolster the run rate of earnings from where we are currently?

A - Paul Hanratty {BIO 7445748 <GO>}

Let me help you with that one, Michael straight away. Of course, now I forgotten the. So I think one of the problems with COVID that's been particularly vexatious, I think from making things easy and understandable is that -- it doesn't happen uniformly. So we're obviously through -- so you said premium rates as you'll understand for a full year and you pitch that deal with claims over the full year, but the pandemic comes in waves.

So we've clearly had the third wave, you would expect that claims in November and December would be much lighter and in fact, I mean, that's what we're seeing and you would know that from, the population numbers, are numbers internally and our patterns internally follow the population statistics. Are you going to have a better experience of debt claims in the last couple of months and then the other point is that because you're putting through pricing changes as schemes come up for renewal, you've got a bigger base of higher premiums for the last couple of months.

So the answer though in the expectation of further reserve releases, but rather the action and the interaction between the expected claims and the pricing. And Lotz you may want to help with that more that. Michael. I must apologize. I forgotten your first question is, your first question was about different product lines and corporate business mix.

Q - Michael Christelis {BIO 15233664 <GO>}

Corporate business. Yeah.

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah, the thing in corporate business as you probably know is, it's extremely lumpy. So again, it's probably not a good thing ever to look at short-term trends. It's something, I think that you do need to even internally, we always tease and ease but the fact is you can only look at it over the longer term. But look, we've had good wins in every product line, it's doing well. I mean, I actually -- yeah, I wouldn't have did actually giving up a bit of market share, obviously in the group risk space, but even there we've had good performance. But there's been just very good strong actually investment flows coming in as well as risk flows, annuity flows. So really across the board.

Q - Michael Christelis {BIO 15233664 <GO>}

Great.

A - Paul Hanratty {BIO 7445748 <GO>}

You probably have a third or fourth question and I apologize, I cut you off.

Q - Michael Christelis {BIO 15233664 <GO>}

No problem at all. I did have one more and that's just on the SEM side. Where again, if I read the comment that talks about discretionary reserves that will consider releases at the end of year. I mean, does that imply that the ZAR536 million you quote, as you excess it's there or if these claims there could be lower for the full year, if you do release some of those.

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah, it could be a little bit lower. But again, if you read the whole thing, we have indicated that our margins are modest in that space. We don't have the history of buffer that have been built up over time. So don't count too much good news.

Q - Michael Christelis {BIO 15233664 <GO>}

Okay, I appreciate it.

A - Paul Hanratty {BIO 7445748 <GO>}

Lotz I just wanted to ask, whether you wanted to add -- you can probably explain the thing better than me, maybe I even get the wrong answer. Can you just confirm I gave the right answer to Michael on the margins versus the position at the end of the year?

A - Mlondolozi Mahlangeni {BIO 21927635 <GO>}

Yes, Paul I can confirm that that was the correct answer.

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. Thanks.

Q - Michael Christelis {BIO 15233664 <GO>}

Thanks Paul. Appreciate it.

A - Paul Hanratty {BIO 7445748 <GO>}

No problem.

Operator

Thank you. The next question is from Francois du Toit of Anchor Stockbrokers. Please go ahead.

Q - Francois du Toit {BIO 20008533 <GO>}

Hi guys. Thanks for the chance to ask some questions. And just the first one, the most of my questions have been asked, but one quick one here on the Retail Mass and then another one. The Retail Mass volumes up 63% of -- and that's an acceleration from the half year and obviously post-COVID by base period was a bit stronger as well. So, where is that acceleration coming from? How much of that is from the Capitec Partnership, if you can maybe give us a bit of color to that for us, please?

And then another question more of interest to me, you mentioned that you plan to strengthen your mortality basis, mostly to provide for future pandemics, and that could have an impact on new business value. Can you maybe give us a sense of what the margins currently is in BrightRock for a typical effluent market protection policy? And how is it likely to change with the -- in mortality base strengthening? Just those two questions please.

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. So I'll try the first one, when I look down into the detail of this and to be honest it was a few weeks ago but from memory and said Grant, if you Abigail, you are younger than me, your memory is probably much better, but there is not a lot of difference between the performance coming out of more traditional Retail Mass business and distribution and there is our Capitec in fact, it's kind of neck-and-neck. So I guess the pickup is probably because as things have eased and there is more traditional channels have adjusted, they've been able to get back whereas Capitec had pretty probably steady performance throughout.

On your question on margins and mortality basis changes, again Lotz please you're going to have to come to the rescue here, but I don't believe we'll be making any changes at BrightRock. So, what we were referring to applies to the Sanlam balance sheet and business not to our investment in BrightRock. And I'm not sure that we disclose the margins, we can maybe take that offline. But Lotz, if you are able to answer better than me, please, have a go.

A - Mlondolozi Mahlangeni {BIO 21927635 <GO>}

Yeah. Thanks, Paul. I think the question in terms of what the impact of the basis changes we'll be making will be on VNB and VNB margins. As we indicated in the operational update, the basis changes, what are the material impact on VNB and VNB margins? So that is where the basic changes that we're making in strengthening our mortality basis. So those will carry through and don't have an impact on VNB or VNB margins.

Then the second question around, what is the typical margin for BrightRock. BrightRock is mainly a risk business and its margins will be in-line with the overall margins that you would see for Retail Affluent risk business. Thank you, Paul.

A - Paul Hanratty {BIO 7445748 <GO>}

I mean, I think I'm right in saying, we've got no plans to strengthen that mortality basis because that's for that board of that company to deal with.

A - Mlondolozi Mahlangeni {BIO 21927635 <GO>}

That is correct Paul.

Q - Francois du Toit {BIO 20008533 <GO>}

Okay, cool. Thanks guys. Maybe just one more quick question on the claims -- excess claims you mentioned ZAR3.4 billion of excess claims in Sanlam in Life and Savings that corresponding number at half year was ZAR1.4 billion if I'm not mistaken. So an additional ZAR2 billion in the last four months and that's meaning -- very meaningful increase and how much of that would you say was in the first quarter up to 30, September and how much cabin after that, because you gave us some guidance at your results presentation in September, which suggested that you'd only -- and I mean, we were probably past the peak of the wave already there and I think your guidance was somewhere between ZAR1.2 billion and ZAR1.5 billion?

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah, I think that's right. So it has definitely been well above the top end of what we anticipated. I don't think we should get down into which month things occurred in unless Lotz, you more on top of it than I am.

A - Mlondolozi Mahlangeni {BIO 21927635 <GO>}

Yeah. So Paul, I think what we -- at our Investor Day, we did indicate to the market that the experience that we are seeing from the third wave was far worse than the initial indication that had provided. And so we did say there was downside risk to the experience that we are observing. And what we are releasing now in our 10-month operational update, it is consistent with that downside risks that we had indicated when materializing.

Q - Francois du Toit {BIO 20008533 <GO>}

That's fine. Thanks. I'm just trying to get a sense of whether things are beginning to normalize. In other words, was it very much concentrated during the peak of the wave and getting back to --

A - Paul Hanratty {BIO 7445748 <GO>}

The third wave was very long. If you want to do website, always to have a look at, go to Worldometers, they graph it fantastically well, and you'll see that the third wave with almost a double peak. The first two waves were beautiful and symmetrical, like an artist drew them. This is the next one wasn't, and there are a lot of theories as to why, but I'm pretty sure that the civil unrest and so on probably had a factor to play in that.

Q - Francois du Toit {BIO 20008533 <GO>}

Thank you. And just in terms of, I'm beginning to see things normalize you care to elaborate, maybe?

A - Paul Hanratty {BIO 7445748 <GO>}

Well, I think that, from the question that Michael asked and the position between October and the end of the year, I suppose it all depends on what you mean by normalized but COVID claims have and again, you can look at the population, as statistics have fallen right off and one hopes and prays that continues through to the end of the year.

Q - Francois du Toit {BIO 20008533 <GO>}

Thanks guys.

Operator

Thank you. The next question is from Larissa Van Deventer of Barclays. Please go ahead.

Q - Larissa Van Deventer {BIO 21570130 <GO>}

Good afternoon everybody.

A - Paul Hanratty {BIO 7445748 <GO>}

Hi Larissa.

Q - Larissa Van Deventer {BIO 21570130 <GO>}

How are you, Paul.

A - Paul Hanratty {BIO 7445748 <GO>}

Good. You?

Q - Larissa Van Deventer {BIO 21570130 <GO>}

Very well, thank you.

A - Paul Hanratty {BIO 7445748 <GO>}

Excellent.

Q - Larissa Van Deventer {BIO 21570130 <GO>}

At the risk of sounding genuinely stupid and I apologize if I am. From an IFRS perspective on these claims, we had existed of 3.4. We are releasing discretionary reserves of 2.8. Does that mean that we have an IFRS loss of 0.6 billion or are these EV metrics well as an IFRS metrics?

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. Lotz or Abigail, do you want to help answer that question?

A - Mlondolozi Mahlangeni {BIO 21927635 <GO>}

Hi Paul, so I can answer that question. So at the stage that we are quoting those figures are all in increase and it is a figure for the 10 months up to 31, October 2021. So, we had a different excess claims net of tax insurance and offsets of ZAR3.4 billion, and we have release this Q3 margins of 2.85 billion and that's where you get to the figure of the 600 million that, that you are referring to. When we look at the remainder of the year, we then have to look at what is going to be the excess claim that we're going to be having for the remainder of the year, taking into account the mitigation actions that have been taken that had Paul referred to.

So looking at that number and what we expect to be exiting for the remainder of the year that we expect experience to be positive, given the actions that have been taken. So that risk pricing outcome plus there's reserve releases will offset the overall excess claims experienced for the year when you look at 2021 and it is entirety.

So if we look at the excess claims did 31 October and if you look at the reserve releases, you do see that gap that 600 million, but you must look at it with the remainder of the two months for the year, take into account whatever the outcome of the risk litigation action that will be taken. So we expect that position net-net for the end of the year will be zero. And that's what we've indicated in the operational update.

Q - Larissa Van Deventer {BIO 21570130 <GO>}

Okay, but Lotz, when we look at net results from Financial Services being up 24% year-on-year to the 10 months ended October. Does that include the 600 million loss that you refer to? Okay.

A - Paul Hanratty {BIO 7445748 <GO>}

Yes. Remember Larissa that last year Santam had a massive hit in quarter three. And that's -- so your question by the way wasn't stupid at all. It comes back little bit to the question that Michael asked and this point that we're making that we've got 2020 and 2021 do not have four smooth quarters and therefore, we've got to be very careful, when you look at some of growth or whatever relative to the prior year. And so that's why we've tried to provide some guidance for you to think through to it on a full year basis.

Q - Larissa Van Deventer {BIO 21570130 <GO>}

Okay. Thank you. You've actually answered two of my three questions with that. So thank you for the detail. The last one is related on future COVID waves, you spoke a lot about the vaccine hesitancy when you did the half year results, but there's no mention of it in this trading update. Is that a lesser issue or are you simply expecting future ways to have a lower impact on mortality or how should we think about the future on this and -- Sanlam reserves them?

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. So what I would say to you is what I've been saying pretty consistently is I don't believe anyone who tells you that they've -- they're able to predict the future of COVID. I mean, we obviously do try to model, but I think it is extremely difficult. And you have something like a new variant comes along. I'm sure you are following it very closely and you know that we do not know whether it's dangerous or not. We don't know whether it's going to be severe amongst people who haven't been vaccinated. What we do know at this point is what vaccination rates sit at in the country, so we monitor that very closely.

What I will say is that and I think we've in the sort of fuller document, we have actually outlined that I do believe that by the end of February, we will have a few things, we'll have a much better idea of what this wave is doing. And I think it will be quite critical. Lotz, Lotz is actually busy doing the modeling but the modeling is, obviously always only as good as the assumptions and therefore the data.

So, truthfully and we do expect to still see a higher level of debts into next year despite vaccinations. And the pricing changes that we put through, are obviously designed to deal and the underwriting changes are designed to do with that -- to deal with that, sorry. And then it's going to depend on how -- for how long does that sustain and when does it start tailing off. So, we still are going to see higher debts I believe for quite some time. But we don't know the extent of it.

Q - Larissa Van Deventer {BIO 21570130 <GO>}

And that is currently in the modeling, is that correct? So do we get the assumptions?

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah.

Q - Larissa Van Deventer {BIO 21570130 <GO>}

Thank you.

Operator

Thank you. The next question is from Akhona Matshoba of Moneyweb. Please go ahead.

Q - Akhona Matshoba

Good afternoon, everyone. My question relates to -- sorry, can you hear me.

A - Paul Hanratty {BIO 7445748 <GO>}

Perfectly, Akhona, go ahead.

Q - Akhona Matshoba

My question relates to the premium charges that Sanlam will be charging unvaccinated new life insurance clients and what position will you be taking there. Will those unvaccinated clients expect higher premiums and if so, when should this policy start coming into effect?

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah, so we're not taking a view that we're going to divide you like smokers and non-smokers into two categories with different premium rates. What we know about vaccination is that it's actually more important for people with comorbidities and at older ages. So we're taking very much a risk-based approach to this thing. It's not to say that

COVID won't kill you, if you are unvaccinated at age 25, but the probabilities of it are much lower than for an older person with comorbidities. So we are pricing at quite a granular level and it isn't a simple you're vaccinated or you're not vaccinated.

Q - Akhona Matshoba

Thank you.

Operator

The next question is from Kevin Harding of Investec. Please go ahead.

Q - Kevin Harding {BIO 20584267 <GO>}

Hi Paul and team, thanks for the time. Just one question for myself. Perhaps you are able to comment on whether you know the vaccination status across your various policyholder books and whether you've seen that sort of the vaccination rates improve from the half year or if that's just very much an unknown at this stage that data point? Thank you.

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah Kevin. So thanks a lot. Nice to hear from you. Look, the fact is we don't know in detail because obviously, we don't have access to the data that would enable that, but we do have estimates. And I think, it's fair to say that the insured population is more heavily vaccinated, but different segments. There isn't just one insured population in inverted commas. I think, if you at this trading update and you just look at the extent of the excess claims coming out of the group risk book that and you compare that to the losses coming out of our Affluent book or Retail Mass, that will tell you that does -- those few numbers paint a real picture that this thing is not -- is by no means evenly distributed.

So our view and our modeling is based on the fact that yes, vaccination rates have increased. But clearly vaccination rates are nowhere near yet where they need to be, I think we all know that. We as a country need to push hard to get these things, these rates up higher.

Q - Kevin Harding {BIO 20584267 <GO>}

Perfect. Thanks very much.

Operator

Thank you. The next question is from (inaudible). Please go ahead.

Q - Analyst

Hi guys, thanks for the call. You intend to beef up the discretionary capital as the group, does that have any implication on the dividend expectation going forward? Should we expect dividends to perhaps grow at a lower rate than cash earnings from the next year or two? Or would it come mainly out of the sales out of the UK and alike?

A - Paul Hanratty {BIO 7445748 <GO>}

Yes. First, great to hear from you. So it's a great question. The simple answer is what we're trying to do is to fill up our discretionary capital bucket with the proceeds of sales and then continue to grow our profits and as you know our policy is to distribute cash and pretty much profits is not far off cash in the Sanlam Group. So our expectation is for dividends to be -- to grow in line with profits going forward, but to the extent that we have worst mortality experience than is built into the pricing and the underwriting, we've got a discretionary reserve that can be or a discretionary capital that can be used to plug those gaps. So that's really the answer.

And I guess if our your next question in anticipation will be well, if your pricing assumptions and so on are borne out, what will you do well then we will have to release the discretionary capital back to shareholders. I think you pretty well aware of the waterfall that we go through to do that either just special dividends or share buybacks.

Q - Analyst

Excellent. Thank you. Thanks, Paul.

Operator

Thank you. And next question is a follow-up from Warwick Bam. Please go ahead.

Q - Warwick Bam {BIO 19921967 <GO>}

Thanks. Just one, just trying to -- can you just explain the nature and materiality of the derivative losses from the hedging instrument that you -- I'm having the BBB special purpose vehicle, its reduced the headline earnings growth number. I think at the half here, there was only commentary around a reversal of an impairment?

A - Paul Hanratty {BIO 7445748 <GO>}

That's a great question. Warwick, if you get enough light then I will understand it is well, Abigail, you are the expert on that.

A - Abigail Mukhuba {BIO 20217730 <GO>}

Thanks Paul. I just want to make sure I've got the question right. You were asking about the B-BBEE SPV and the impairment reversal that we marked or that we reversed in interim?

Q - Warwick Bam {BIO 19921967 <GO>}

No. The question actually revolves around I guess, the current operating update, specifically the headline earnings number. It mentions hedging losses from the special purpose vehicle.

A - Abigail Mukhuba {BIO 20217730 <GO>}

I will double check, then I'll get back to you. The ones that I'm aware of from the SPV would be only as relate to the some of the underlying loans that we have with Standard Bank on the entities on the SPV entities. So it would be that.

Q - Warwick Bam {BIO 19921967 <GO>}

Thanks. Maybe just one more confirmation Paul. Just to double-check your potential basis changes on the embedded value at year end. Are there any thing -- is anything that we should expect beyond mortality?

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah. Look I think well we all do a full -- a full review we've basically done the mortality one. Lotz and his team are still finalizing but I wouldn't expect a huge amount more. I think we did draw attention to the continuing good persistency. And so that's clearly an area that we're going to have a look at as well. But we don't want to make any commitments in that regard yet.

Q - Warwick Bam {BIO 19921967 <GO>}

Thanks.

Operator

Thank you. The next question is from Matthew Pouncett of Laurium Capital. Please go ahead.

Q - Matthew Pouncett {BIO 19550562 <GO>}

Thanks so much for the time today guys, and a simple question from me. The 4% growth of between 2019 base, you said, it excludes once off items would that then exclude the sort of ZAR600 million mortality loss or --

A - Paul Hanratty {BIO 7445748 <GO>}

No, there were some big releases at the end of 2019, actually ironically from the General Insurance Book in India. They were some others, but forcing me to dredge my memory bank, but that is the one that I recall that stands out. It was a big clean-up of the reserve. I think we've explained to you guys though.

Q - Matthew Pouncett {BIO 19550562 <GO>}

Sure.

A - Paul Hanratty {BIO 7445748 <GO>}

Yes. There was a big clean-up in 2019. So there was a big one off release at the end of 2019 off the back of that. I know, there were some other items which Grant or Lotz or Abigail probably will be able mention.

Q - Matthew Pouncett {BIO 19550562 <GO>}

Okay, so effectively you are 4% ahead of the 2019 basis plus ZAR600 million if we were to look through the COVID impact. And then going forward, with the sort of mentality strengthening at year end and the re-pricing, effectively again and your current base assumptions COVID shouldn't have an earnings impact going forward, is ever got that point.

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah, it shouldn't. It shouldn't, but just again and I know you're going to say I've told you this but of course that is all subject to us, being right about the assumptions and that's a big if. And hence the need for a bigger discretionary capital buffer.

Q - Matthew Pouncett {BIO 19550562 <GO>}

Excellent. Thank you, guys.

A - Paul Hanratty {BIO 7445748 <GO>}

My pleasure Matthew.

Operator

Thank you. The last question is from Sarine Barnard of Ninety One. Please go ahead.

A - Paul Hanratty {BIO 7445748 <GO>}

Hi Sarine, I wondered what happened to you?

Q - Sarine Barnard {BIO 6259120 <GO>}

I pressed the button too late. Are you well?

A - Paul Hanratty {BIO 7445748 <GO>}

Wonderful. Nice to hear you do well here. Go ahead, so we'll try and help you.

Q - Sarine Barnard {BIO 6259120 <GO>}

Great. Also a follow-up on the base effect of 2019. So you point out that we shouldn't extrapolate the 2021 over 2020 growth rate, so if we compare the normalized plus 4 to the 2019 basis, is there anything else that's funny in the last two months of 2019 that we should bear in mind in thinking about the run rate?

A - Paul Hanratty {BIO 7445748 <GO>}

Abigail, Lotz, Grant, you can -- I can't think of anything.

A - Abigail Mukhuba {BIO 20217730 <GO>}

Never going to happen. Can't think of anything that would normalize.

Q - Sarine Barnard {BIO 6259120 <GO>}

Okay, great. So it's probably better to reference versus 2019 than to try and reference versus 2020 because of all the filings.

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah. Look, I mean, it depends on how important it is for you to forecast earnings to the end of the year. What we didn't want you to do was just take 2020 and multiply by 2022 --

Q - Sarine Barnard {BIO 6259120 <GO>}

Okay. Fair enough. Okay.

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah.

Q - Sarine Barnard {BIO 6259120 <GO>}

And then I wanted to ask so on the rebuild of the pandemic reserve, so that's clearly going to have an impact as you point out on the embedded value. So, when we think about the order of magnitude in terms of what you want to re-establish. Is it fair to think the previous pandemic reserve was about 760, but clearly it wasn't sufficient, so, I think of the previous pandemic reserve platform?

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah. Look, I think -- this is obviously quite a detailed question and I think it's something that we will deal with quite possibly better at the year-end. But we're all thinking is that the kind of margin that we've had historically coming out of our mortality, we should think about having twice the size but instead of releasing it into profits, actually keeping half of it and building up a buffer, which I guess is a little bit hoping that the seven good years come before the years of seven and that's obviously the problem with pandemic as they come very erratically, but that's kind of the thinking that we're taking on board.

Q - Sarine Barnard {BIO 6259120 <GO>}

Okay, great.

A - Paul Hanratty {BIO 7445748 <GO>}

And there's no thinking globally on this, actually it's quite difficult to work out. But it seems, if you talk to some of the big global reinsurers that that's not a million miles away from where they think the things should be. The whole world is probably under-priced for pandemics.

Q - Sarine Barnard {BIO 6259120 <GO>}

If you provide for that pandemic reserve, can we then go back to a situation where Sanlam produce consistent positive mortality experience over time?

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah. Of course.

Q - Sarine Barnard {BIO 6259120 <GO>}

Okay, great. And maybe then just the last question, you talked about the excess mortality claims in South Africa. What are you seeing in Africa in terms of the trend?

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. So a lot later that it has arrived, it's very patchy and it hasn't -- it is undoubtedly as we said led to ZAR0.5 billion of losses, which is quite a lot because the business is obviously -- these are all small businesses that are still growing and building up. So it's significant. I think, it gets lost a bit in everybody focusing on the situation in SA.

My own view is that you're not going to see vaccination programs of any consistency or scale across our other markets. So in a sense, we're just going to have to live with permanently higher mortality, and hence while we re-priced in those markets now -- but that those markets are much easier to re-pricing than in South Africa, because the competitors are -- is it -- they're just isn't the same competitive pressures?

Q - Sarine Barnard {BIO 6259120 <GO>}

Okay, great. Thanks so much. Very clear.

Operator

Thank you. So we do have another follow-up question from Francois -- Barnard.

Q - Francois du Toit {BIO 20008533 <GO>}

Hi, it's Francois. Just quickly on related to Sarine's last question, there also on the competitive environment in South Africa. I mean, it does look like sitting in the group risk space. You're getting new business and I think your commentary suggests you've hiked your prices sufficiently to cover what you expect from COVID next year? So it does look at the competitive environment, is such that you can meaningfully increase group risk prices, so one, can you maybe just elaborate or confirm that?

And then just maybe a related question in the current environment with interest rates that's going up in long bond yields that's fairly steep in pricing and quite a bit of risk. Where are the opportunities are you seeing, the pricing for annuity business and risk business change favorably and are there new business opportunities in the back of that?

A - Paul Hanratty {BIO 7445748 <GO>}

Yeah. Okay. And so Francois, sure, sorry, I was thinking about your second question, so I forgot the first question you had. You asked about whether it's possible to re-price in the group risk market. Look the group risk market is extremely competitive and as schemes are come up and can be rebuilt every year. So, we've obviously pushed through pricing that we think is fair.

I guess whilst its competitive, if you think of the scale of the losses that we've reported in that line of business, you have to assume and we know what our competitors totals, we don't know what the split is but I would suggest that their experience is at least as bad as ours, if not worse. And so while there may be a temptation to price very keenly I suppose at some point you run out of money. So anyone who wants to be reckless and irresponsible will, yeah, I can certainly gain market share. Just the question is, how much, how deeply you pocket.

And actually, it's very stupid strategy because at some point, prices will come back down and they will just lose that business to people you haven't made all the losses. And so, I think that the re-pricing on an annual basis of that business and the fact that it can move means that people can't be too stupid about their pricing doesn't mean they're nice, but that shouldn't be. And so I think, net-net I think we've been able to put through the increases. I wouldn't say we haven't lost any clients, but we certainly had -- it hasn't been a major problem.

Your second question was about do higher yields open up opportunities, I think on the annuity front of course, you could only take an annuity when they retire. So I gave to some degree the pool of opportunity is driven by life, life events rather than by -- you cannot by the bond yield. I think what is true is that there's been a big switch to the more guaranteed annuity because, and away from the kind of unit-linked annuity as people have actually understood the value of locking in the guarantees. So I guess, you will see a bit of that switch but I wouldn't imagine that it will affect the total volumes of annuity sold, that might affect the mix of what gets sold.

Q - Francois du Toit {BIO 20008533 <GO>}

Excellent. Thank you. And then how does that mix compare guaranteed annuity more profitable to you higher margins than --

A - Paul Hanratty {BIO 7445748 <GO>}

Yes, it's a good question. I mean Lotz or Grant, do you know the answer to that question. We perhaps put up more on capital of course, but Lotz do you know the answer to that.

A - Mlondolozi Mahlangeni {BIO 21927635 <GO>}

Thanks Paul. Yeah, so I think currently the annuity is we deploying our balance sheet and putting up capital. So from a margin perspective they have got a higher margin for us compared to the investment-linked annuity type product, so currently the annuities are higher margins, Paul.

A - Paul Hanratty {BIO 7445748 <GO>}

Yes, but return on capital of course, is may be good. But on a pure index-linked annuity is infinite, close to infinite.

A - Mlondolozi Mahlangeni {BIO 21927635 <GO>}

That is correct Paul. So when you're looking from a return on capital perspective (inaudible).

Q - Francois du Toit {BIO 20008533 <GO>}

Thanks.

Operator

Thank you. So we have no further questions on the queue. Do you have any closing comments?

A - Paul Hanratty {BIO 7445748 <GO>}

No, I just firstly, Chris, thank you very much for being a good host. And to thank everybody who called in and for all the people who asked questions, thank you for your time. And we wish you all a very wonderful holiday. I'm sure everybody needs it. So have a break and yeah, please stay safe and enjoy time with your families. And thanks very much for all of your support for us at Sanlam.

Operator

Thank you very much, sir. Ladies and gentlemen, that then concludes this event, and you may now disconnect.