FitchRatings

Insurance
Life Insurers
New Zealand

Manchester Unity Friendly Society

Key Rating Drivers

'Least Favourable' Business Profile: Fitch Ratings assesses Manchester Unity Friendly Society's (MUFS) business profile as 'Least Favourable' compared with that of other New Zealand life insurance companies due to its limited competitive positioning and diversification, and declining membership. MUFS is a small player in the domestic life insurance sector, with a market share of less than 1%. Most of its life products have been closed to new business since 2012. We score MUFS's business profile at 'b+' under our credit-factor scoring guidelines.

MUFS plans to change the structure of its two largest insurance benefit funds, the funeral assistance benefit fund and increasing assurance benefit fund, to non-insurance managed investment schemes. These funds are closed to new business. The change, which is subject to member and regulatory approval, would replace the policyholder protection afforded to fund members by the Insurance (Prudential Supervision) Act 2010 with the investor protection under the Financial Markets Conduct Act 2013.

Falling Premiums: Fitch considers MUFS's financial performance and earnings 'Moderately Weak' as premiums fell 4% in the financial year ended 31 May 2020 (FY20) and 4% in FY19 due to the decreasing membership and the closure of most of its insurance products to new business. MUFS is not a profit-maximising entity due to its mutual ownership.

Interest Rates Affect Earnings: MUFS recorded a net loss of NZD1.4 million in FY20 (FY19: NZD1.9 million profit) as a result of a liability-adequacy test, which increased insurance contract liabilities by NZD5.3 million due to lower interest rates. Rising interest rates supported a net profit of NZD1.0 million in 1HFY21. MUFS's mortality claims did not rise due to Covid-19 in light of New Zealand's success at containing the pandemic relative to other countries.

Adequate Capitalisation: We think MUFS's small absolute capital base and limited access to new capital leave it susceptible to external shocks and remote operational risks. MUFS's solvency margin improved to NZD11.8 million by 1HFYE21 (FYE20: NZD9.3 million) due to higher interest rates and a narrower duration gap. Consequently, coverage of the risk-based minimum solvency requirement improved to 178% from 157%. The regulator modified MUFS's licensing conditions in 2020, requiring the society to maintain a NZD9 million margin.

Asset-Liability Mismatch Reduced: The mismatch in the duration of MUFS's assets and liabilities has fallen with the purchase of long-dated bonds. Insurance liabilities have a longer duration than fixed-income investments, although MUFS increased the duration of its fixed-income portfolio to 8.3 years by 1HFYE21 (FYE19: 4.1 years).

Low Investment Risk: MUFS's risky assets ratio of 18% at 1HFYE21 remains well below Fitch's criteria guidelines for a 'BB' rated insurer. The ratio is driven by exposure to unaffiliated equity investments, which accounted for 5% of invested assets at 1HFYE21, and a small amount of unrated corporate debt. Fixed-income securities and cash were 67% of total investments and real estate was 28%.

Rating Sensitivities

Weaker Business Profile: We may downgrade MUFS's rating if there is a continued deterioration in the weak business profile, including a decrease in the number of lodges and significant reduction in the membership base.

Solvency Margin: We may downgrade the rating if there is a considerable weakening in MUFS's regulatory solvency margin.

Stronger Business Profile: We may upgrade the rating if there is a sustained improvement in the business profile, including growth in the society's membership base.

Rating

Manchester Unity Friendly Society

Insurer Financial Strength Rating	BB-

Outlook

Manchester Unity Friendly Society

Insurer Financial Strength Rating	Stable

Financial Data

Manchester Unity Friendly Society

(NZD 000)	FY20	FY19
Gross premiums written	1,218	1,270
Net profit	-1,444	1,870
Total assets	85,600	84,316
Pretax return on assets (%)	-1.7	2.2
Return on equity (%)	-5.4	7.1
Regulatiory solvency ratio (%)	157	129

Source: Fitch Ratings, Fitch Solutions, MUFS

Applicable Criteria

Insurance Rating Criteria (April 2021)

Related Research

Fitch Ratings Recaps Actions on Australia, NZ Insurers After Review of Coronavirus Impact (May 2020)

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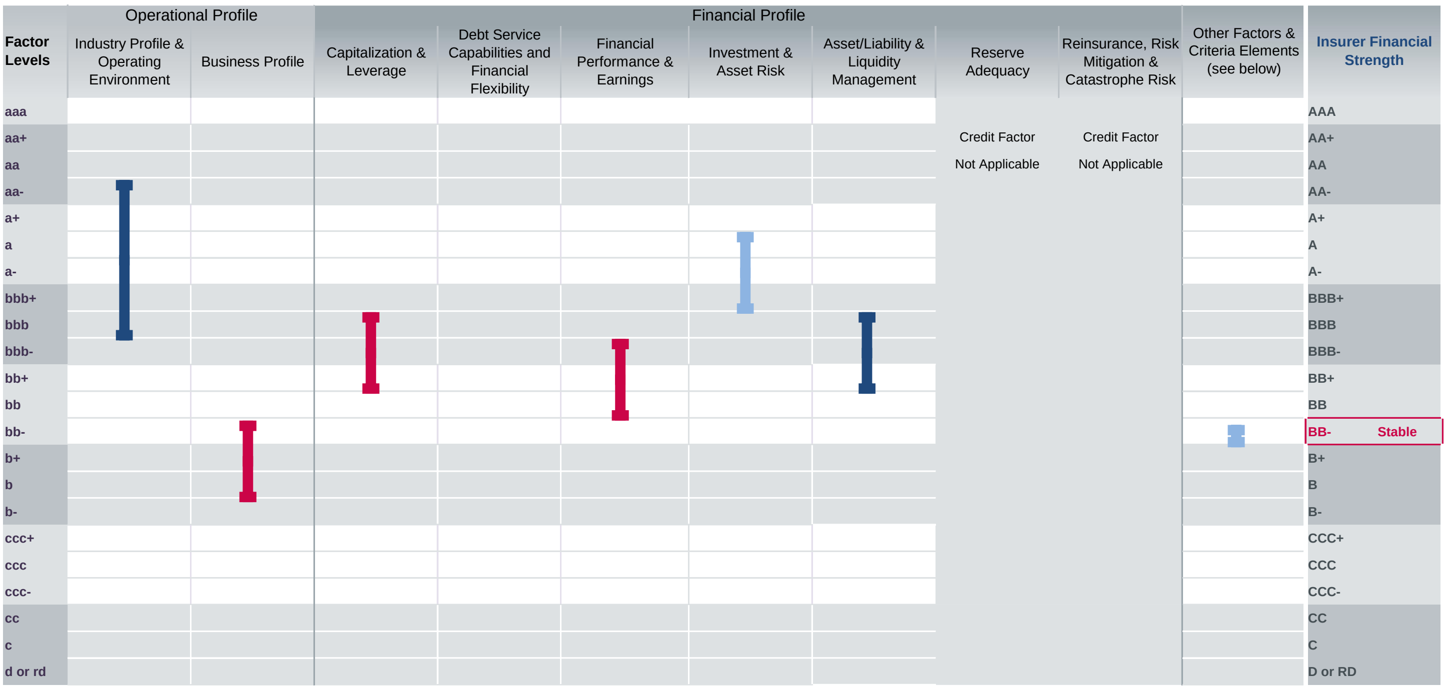
Key Credit Factors – Scoring Summary



Other Factors & Criteria Elements				
Provisional Insurer Financial Strength				**BB-**
Non-Insurance Attributes	Positive	**Neutral**	Negative	+0
Corporate Governance & Management	**Effective**	Some Weakness	Ineffective	+0
Ownership / Group Support	Positive	**Neutral**	Negative	+0
Transfer & Convertibility / Country Ceiling	Yes	**No**	AAA	+0
Insurer Financial Strength (IFS)			Final:	**BB-**
IFS Recovery Assumption	**Good**			-1
Issuer Default Rating (IDR)			Final:	**n.a.**

Bar Chart Legend

Vertical Bars = Range of Rating Factor
Bar Colors = Relative Importance
- Higher Influence
- Moderate Influence
- Lower Influence

Bar Arrows = Rating Factor Outlook
- ⇧ Positive
- ⇩ Negative
- ⇳ Evolving
- ▫ Stable

Latest Developments

- MUFS's recent financial performance has been affected by the volatility in interest rates.
- The society is considering changing the structure of its two largest insurance benefit funds to non-insurance managed investment schemes.

Peer Comparison

Click here for a report that shows a comparative peer analysis of key credit factor scoring.

Industry Profile and Operating Environment

See the Industry Profile and Operating Environment: New Zealand Insurance report for a summary of the main factors driving the industry profile and operating environment score.

Business Profile

Most Insurance Products Closed to New Business

MUFS's 'Least Favourable' business profile is due to its limited competitive positioning and diversification, and falling membership, which constrain its earnings generation. Therefore, Fitch scores MUFS's business profile at 'b+' under our credit-factor scoring guidelines.

MUFS's market share, measured by premiums, is less than 1% of New Zealand's life insurance market. The society is the country's largest fraternal services provider, but its membership has been falling as member deaths outpace the number of new members. MUFS's strategies do not include business development activities or selling objectives to expand its membership. Individuals must become members to hold a policy.

The society provides financial products, holiday accommodation and fraternal services for the benefit of its members. Its core financial product is insurance. A number of MUFS's plans provide short- and long-term investments, financial protection and death cover, which are closed to new business, and include endowment, whole-of-life and term-life policies. It can adjust bonus rates, appropriation rates and surrender values where payable. The only insurance products open for new business are medical and funeral insurance plans.

If management's plan to change the structure of its two largest insurance benefit funds to non-insurance managed investment schemes is successful, members will receive investor protection under the Financial Markets Conduct Act 2013, instead of policyholder protection provided by the Insurance (Prudential Supervision) Act 2010. These closed funds accounted for 98% of insurance liabilities at FYE20.

Ownership

We regard ownership as neutral for MUFS's rating. MUFS is a member-owned association and is classified and registered as a friendly society under the Friendly Society and Credit Unions Act 1982. MUFS's members belong to a network of 32 branches and each member, upon joining a branch, has one vote on any decisions that require a vote. Each branch then sends a delegate to vote on its behalf at MUFS's annual general meeting.

MUFS has limited ability to raise capital as a mutual society and therefore requires retained earnings to support financial flexibility.

Capitalisation and Leverage

Small Absolute Capital Base

MUFS's Fitch Prism model score has been 'Extremely Strong' in recent years. Nevertheless, the low absolute level of capital (total equity of NZD27 million at end-1HFY21) and limited access to new capital leave MUFS susceptible to larger, more remote operational risks and changes in the external operating environment. MUFS's mutual structure limits its ability to raise capital and therefore it uses retained earnings to support financial flexibility.

The Reserve Bank of New Zealand's requirement in 2020 for MUFS to maintain a solvency margin of NZD9 million above the minimum requirement as part of the change in its licensing requirements was due to the sensitivity of MUFS's solvency to falling interest rates caused by its asset and liability duration mismatch. MUFS purchased long-dated bonds in 2019 and 2020 to reduce the gap.

The solvency margin improved to NZD11.8 million by 1HFYE21 (FYE20: NZD9.3 million) following a rise in interest rates and the smaller duration gap. This helped the coverage of the risk-based minimum solvency requirement to improve to 178% from 157%.

The society has no debt and says it has no plans to raise any debt.

Fitch Expectations

- Regulatory solvency margin to remain steady.

Financial Highlights

(%)	FY20	FY19
Financial leverage ratio	0	0
Operating leverage (x)	2	2
Asset leverage (x)	2	2
Regulatory solvency ratio	157	129

Source: Fitch Ratings, Fitch Solutions, MUFS

Financial Performance and Earnings

Earnings Volatility Due to Interest Rate Movements

MUFS recorded a net profit of NZD1.0 million in 1HFY21 due to insurance liability valuation gains, following a loss of NZD1.4 million in FY20 (FY19: NZD1.9 million profit). The FY20 loss was mainly due to a fall in interest rates following the pandemic-driven economic downturn. This increased the present value of MUFS's funeral fund liability by NZD5.1 million following a liability adequacy test conducted by the external actuary. MUFS did not see a spike in mortality claims due to Covid-19 amid New Zealand's relative success at containing the pandemic.

Return on equity and return on assets (pretax) averaged 4% and 1%, respectively, in the last three years, comparing favourably with Fitch's criteria guidelines for a 'BB' rated insurer. However, premium volumes continued to contract (FY20: -4%, FY19: -4%) due to MUFS's declining membership base and run-off of its insurance products.

MUFS's investment portfolio supports earnings and the provision of member benefits. The board determines a share of net income to be distributed to members' benefit funds each year. Potential investment risks are mitigated as the participating nature of nearly all of the benefits and products means that investment losses or gains can be shared by adjusting crediting rates.

Fitch Expectations

- Premiums continue to drop alongside falling membership.

Financial Highlights

(%)	FY20	FY19
Net income (NZD 000)	-1,444	1,870
Return on equity	-5.4	7.1
Return on assets (pretax)	-1.7	2.2

Source: Fitch Ratings, Fitch Solutions, MUFS

Investment and Asset Risk

High-Quality Fixed-Income Portfolio

The society had 67% of its investments in cash (including term deposits) and fixed-income investments at 1HFYE21 (FYE20: 70%). The credit quality of its fixed-income portfolio is high with over 85% of assets invested in securities rated 'A-' or above. MUFS's risky assets ratio of 18% at 1HFYE21 (FYE20: 17%) is driven by exposure to unaffiliated equity investments, as well as a small amount of unrated corporate debt.

Around 28% of MUFS's invested assets are in commercial and leasehold properties and holiday homes. The risks in the commercial buildings appear reasonably modest, with all properties being single level, tenanted and not requiring any earthquake strengthening. Risks are low on the remaining property investments, with the society receiving ground rent on its leaseholds. It has no exposure to buildings on these properties. The holiday homes are run to cover costs and provide subsidised holiday accommodation for members.

Fitch Expectations

- Maintain a high-quality fixed-income portfolio.

Financial Highlights

(%)	FY20	FY19
Risky assets ratio	17	20
Below-investment-grade bonds to capital	3	5

Source: Fitch Ratings, Fitch Solutions, MUFS

Asset/Liability and Liquidity Management

Asset-Liability Mismatch Narrows

The mismatch in the duration of asset and liabilities has narrowed following the purchase of the long-dated bonds in 2019 and 2020. MUFS increased the duration of its fixed-income portfolio to 6.3 years by FYE20 and 8.3 years by 1HFYE21 from 4.1 years at FYE19.

MUFS's liquidity ratios have been very strong for the past five years, reflecting its conservative investment approach and large investment portfolio compared with the size of the society's policyholder liabilities. Its liquid assets ratio of 131% at 1HFYE21 compares well against our median criteria ratio guidelines.

MUFS's policyholder liabilities, due to their design, discourage early redemption and are mainly payable on death. Voluntary discontinuance rates over the past five years have averaged a low 1.3% and 0.5%, respectively, for the increasing assurance benefit fund and the funeral fund.

Fitch Expectations

- Sufficient liquidity to be maintained.

Financial Highlights

(%)	FY20	FY19
Liquid assets ratio	139	147
Cash and cash equivalents to policyholder liabilities	7	26

Source: Fitch Ratings, Fitch Solutions, MUFS

Appendix A: Other Ratings Considerations

Below is a summary of additional rating considerations that are part of Fitch's ratings criteria.

Group IFS Rating Approach

Not applicable.

Notching

Fitch assesses New Zealand's regulatory environment as 'Effective' and classified as following a ring-fencing approach for notching purposes.

Notching Summary

IFS Ratings
A baseline recovery assumption of 'Good' applies to the IFS Rating and standard notching was used from the IFS anchor rating to the implied operating company Issuer Default Rating (IDR)
Operating Company Debt
Not applicable
Holding Company IDR
Not applicable
Holding Company Debt
Not applicable
Hybrids
Not applicable

Source: Fitch Ratings

Short-Term Ratings

Not applicable.

Hybrid – Equity/Debt Treatment

Not applicable.

Corporate Governance and Management

We expect corporate governance and management to be adequate and neutral to the rating. MUFS's board consists of five members who are subject to prudential "fit and proper" standards.

Transfer and Convertibility Risk (Country Ceiling)

None.

Criteria Variations

None.

Appendix B: Environmental, Social and Governance Considerations

FitchRatings | Manchester Unity Friendly Society | **Insurance Ratings Navigator** APAC (Other Exc JP) Life

Credit-Relevant ESG Derivation

Manchester Unity Friendly Society has 6 ESG potential rating drivers

- Manchester Unity Friendly Society has exposure to compliance risk; treating customers fairly; pricing transparency; privacy/data security; legal/regulatory fines; exposure to own cyber risk but this has very low impact on the rating.
- Manchester Unity Friendly Society has exposure to social responsibility and its effect on brand strength; increased vulnerability due to credit concentrations but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	6	issues	3
not a rating driver	2	issues	2
	6	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events/natural catastrophes on operations or asset quality; credit concentrations	Financial Performance & Earnings; Investment & Asset Risk	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	1	n.a.	n.a.	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risk; treating customers fairly; pricing transparency; privacy/data security; legal/regulatory fines; exposure to own cyber risk	Industry Profile & Operating Environment; Business Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Corporate Governance & Management	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	3	Social responsibility and its effect on brand strength; increased vulnerability due to credit concentrations	Business Profile; Investment & Asset Risk; Financial Performance & Earnings; Reinsurance, Risk Mitigation & Catastrophe Risk	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Corporate Governance & Management; Business Profile	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Corporate Governance & Management	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Corporate Governance & Management; Ownership	3
Financial Transparency	3	Quality and timing of financial reporting and auditing processes	Corporate Governance & Management	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board(SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE
How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. ESG issues are credit neutral or have only a minimal credit impact on MUFS, either due to their nature or the way in which they are being managed by the company.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.