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Deutsche Rueckversicherung AG

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Deutsche Rueckversicherung AG

SACP* Assessments					SACP*		Support		Ratings
Anchor	a+	+	Modifiers	0	= a+		+ 0		= Financial Strength Rating

Anchor		Modifiers		SACP*		Support		Ratings
Business Risk		ERM and Management	0	Liquidity	0	Group Support	0	A+/Negative/--
Strong								
Financial Risk		Holistic Analysis	0	Sovereign Risk	0	Gov't Support	0	
Very Strong								

*Stand-alone credit profile.
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

Rationale

Business Risk Profile: Strong

- Low industry and country risk because most business is generated in the German property/casualty (P/C) sector.
- Strong competitive position, owing to its ties to the German Public Law Insurance (PLI) sector, although earnings generated in this sector are flagging.
- Pressure on underwriting performance and somewhat below reinsurance peers.
- Increasing diversification outside the PLI sector focusing on selected clients in Europe.

Financial Risk Profile: Very Strong

- Extremely strong capital adequacy, supported by conservative reserving.
- Moderate risk position compared with peers, but potential for lower earnings, alongside exposure to natural catastrophe risk, which may increase volatility of its capital position.
- Strong financial flexibility, owing to its ability to share risk with the PLI sector.

Other Factors

- Our combined view of Deutsche Rueckversicherung group (DR)'s business and financial profiles leads to an anchor of either 'a+' or 'a'. We assess the anchor at 'a+' to reflect the strength of the group's capital adequacy, which provides ability to absorb large losses.

Outlook: Negative

The negative outlook on DR reflects that we could lower our ratings on the group by one notch over the next 12–24 months if we believe that the group cannot turn around the profitability of the PLI business to bring overall operating performance more in line with reinsurance peers. Additionally, capital and earnings volatility could increase due to lower earnings and the group's exposure to catastrophe risk.

Downside scenario

We could lower the ratings on DR if:

- The group discloses a negative underlying profitability over the next 12-24 months, especially in its PLI business, causing us to question its competitive strength;
- Capital adequacy deteriorates to very strong or strong from extremely strong;
- Capital and earnings volatility could potentially increase, for example because of increasing net exposure to natural catastrophes; or
- The group's strong ties to the German PLI sector decrease significantly.

Upside scenario

We could revise the outlook to stable if we believed that the company's underlying profitability was becoming more competitive with that of its reinsurance peers, which would demonstrate the strength of DR's strategic ties with the German PLI sector.

Base-Case Scenario

Macroeconomic Assumptions

- German 10-year government bond yields declining to 0.5% in 2015 but recovering to 0.9% in 2016 and 1.4% in 2017.
- Real German GDP growth of slightly below 2% annually until 2017.
- A small decline in Germany's unemployment rate to 4.7% in 2017 from 5.0% in 2014.
- Competitive business conditions in the non-life sector, with moderate premium growth.

Company-Specific Assumptions

- A small decline in premiums in 2015 of about 1% and a moderate premium growth of 1%–3% annually over the following two years.
- Improvement in the group's reported non-life operating performance compared with 2014, with combined ratios of about 100% in the absence of major natural catastrophe events and a continued conservative reserving policy.
- At least economically profitable business in both PLI and non-PLI sectors over the next two years.
- Limited premium contribution of about 4% from the life business.
- Capital adequacy at the 'AAA' level, supported by earnings retention and moderate growth in capital requirements.
- A slight decline in the group's investment yield over the next three years of about 30-80 bps, due to prevailing low interest rates.

Key Metrics

(€ in Mil)	2016f	2015f	2014	2013	2012
Gross premium written	>1,030	>1,020	1,038	994	969
Net income	> 7.0	> 3.0	7.8	1.0	5.0
Return on shareholders' equity (%)	<4.0	<2.0	3.8	0.5	2.5
P/C net combined ratio (%)	>100	>100	105.8	114.9	102.4
Net investment yield (%)	2.5 - 3.0	2.5 - 3.0	3.3	3.3	3.2
S&P Capital Adequacy	Extremely strong	Extremely strong	Extremely strong	Extremely strong	Extremely strong
Financial leverage	~ 10.0	~ 10.0	9.6	9.5	9.4

F--Forecast based on Standard & Poor's base-case scenario. P/C--Property/casualty.

Company Description: Transforming From A Public-Law Reinsurer To A Europe-Focused Open Market Non-Life Reinsurer

DR comprises Germany-based Deutsche Rueckversicherung AG (DRAG) and its core Swiss subsidiary, Deutsche Rueckversicherung Schweiz AG (DRS). DRAG is 100% owned by members of the German PLI sector and plays a significant strategic role for this sector as a provider of diversification and know-how to regionally concentrated public law insurers. PLI companies transfer the portion of property risk that exceeds their net retention capabilities to DRAG. In turn, DRAG pools this regional risk and transfers large portions of the business back to the PLI sector through retrocession, effectively improving the geographic diversity of individual public law insurers.

DRAG owns 75% of DRS, and the remaining 25% is owned by Hannover-based insurance group VHV Vereinigte Hannoversche Versicherung (core operating entities rated A/Stable). DRS started operations in 2001, and offers traditional and non-traditional products, particularly in long-tail lines such as motor and general liability, contributing to DR's diversification strategy.

DR has been cautiously transforming itself from a captive-like reinsurer for PLIs into a Europe-focused open market non-life reinsurer since 2003. It originates about 86% of its premiums in Germany, with the remainder coming from other European countries, mainly Austria.

Property business comprised the bulk of the group's portfolio in 2014, representing about 55% of net premiums, followed by motor (20%), liability (10%), and life (4%). About 74% of the non-life business is written on a proportional basis and mostly acquired directly from cedents.

Business Risk Profile: Strong

We regard DR's business risk profile as strong. Its operations are mainly in the German property and casualty (P/C) sector. The group's strong competitive position is mainly built on DR's role and reputation within the PLI sector. However, DR has not consistently leveraged this strategic role effectively to generate at least economically profitable business (i.e., not influenced by conservative reserving) in the PLI business over the past few years.

Insurance industry and country risk: Low risk, owing to DR's large exposure to the German property and casualty market

In our opinion, DR faces low industry and country risk as it generates about 82% of its business in the German P/C sector, which we consider to be low risk. DR also has some exposure to the German life sector and to other countries and sectors in Europe, but this has a negligible impact on our assessment of the group's industry and country risk. We are unlikely to change this assessment over the period 2015-2017 in light of the group's focus on the German P/C market.

Table 1

Deutsche Rueckversicherung Group Industry And Country Risk		
Insurance sector	IICRA	Business mix
Germany P/C	Low	82%
Austria P/C	Low	5%
Germany Life	Intermediate	4%
United Kingdom P/C	Intermediate	2%
Switzerland P/C	Very Low	1%
Italy P/C	Moderate	1%
Spain P/C	Intermediate	1%
Norway P/C	Low	1%
Other*	Low	4%
Weighted average IICRA	Low	100%

*Average.

Competitive position: Strong position in the German market but challenged by economic losses in the PLI business

DR has a strong competitive position, in our view, mainly due to its strong and longstanding role as the preferred property reinsurer in the German PLI sector. However, although the group is almost 100% owned by public law insurers, DR has not consistently leveraged its strategic role effectively to generate at least economically profitable PLI business over the past few years. As a result, DR's overall operating performance compares unfavorably with that of its reinsurance peers. An ongoing underperformance in PLI business would question, in our view, DR's ability to translate its unique position within the PLI market into economic healthy operations, therefore challenging our view of the group's competitive strength.

To diversify its premiums, the group is expanding outside the PLI sector both through DRAG and DRS, focusing on selected clients in Europe. The traditional non-PLI reinsurance business represents about 41% of the group's net premiums, to which DRS contributes about 35%. Together with its non-traditional business, DRS contributes about 31% to DR's overall premiums. We see this diversification as the group's main growth driver, but competition in the international reinsurance market, resulting from high capacity, is vigorous. We also believe that the group's competitive strength outside the PLI sector is less developed than in the PLI market.

Gross premiums increased in 2014 by 4.4%, which was somewhat higher than expected. The main growth driver was a premium increase in the PLI property business of about 12%. However, on a net basis, premiums decreased by 2.5% driven by an increased retrocession. We assume in our base case that gross premium will slightly decline in 2015 by about 1% as a consequence of a more selective underwriting and remain modest at 1%-3% over the following two years.

We regard DR's control over its distribution channels as a positive factor, given that the group generates about 90% of its business through direct relationships with clients. This direct access provides good portfolio stability.

Table 2

Deutsche Rueckversicherung Group Competitive Position

(Mil. €)	**2014**	**2013**	**2012**	**2011**	**2010**
Gross premium written (GPW)	1,038	994	969	902	920
Change in gross premium written (%)	4.4	2.7	7.3	(1.9)	(8.7)
Net premium written	635	649	620	576	601
Change in net premium written (%)	(2.1)	4.7	7.7	(4.3)	(9.6)
Reinsurance utilization (%)	38.8	34.7	36.0	36.2	34.6
Business segment (% of GPW)					
Life/health	3.6	3.6	4.7	4.5	4.7
Property/casualty	96.4	96.4	95.3	95.5	95.3

Financial Risk Profile: Very Strong

We regard DR's financial risk profile as very strong, mainly on the basis of the group's extremely strong capitalization, conservative reserving, and ability to withstand large natural catastrophe events with low volatility in its capital adequacy. Nevertheless, the potential for lower earnings alongside the group's exposure to natural catastrophe risk may increase the volatility of DR's capital position.

Capital and earnings: Capitalization is the main rating strength, supported by strong reserving

In our opinion, DR has extremely strong capital and earnings, with capital adequacy in the 'AAA' range, according to our risk-based capital model. Economic capital recovered in 2014 after assuming a high amount of losses in 2013, although the recovery has been less than expected due to modest profits.

We anticipate in our base case that the group will continue to increase capital over the next two years, mainly through further building of reserves and despite modest contribution from reported earnings. In line with our growth expectations, we expect only moderate growth of 2%-4% in the group's capital requirements. At the same time, we assume that DR's business mix and asset allocation will not change materially. Management's ability to preserve capital and earnings at the current level is key to the current rating.

In 2014, DR's earnings strengthened compared with the results in 2013, when performance was severely set back by natural catastrophe losses. However, the recovery, especially in the PLI business, was lower than expected, with an overall reported net combined ratio of 105.8% in 2014 versus 114.9% in 2013. While we believe that DR's reserving policy is conservative, which means that it has stronger underlying technical result than the published figures suggest, we still see a deficiency in the PLI results.

Table 3

Deutsche Rueckversicherung Group Capital

(Mil. €)	2014	2013	2012	2011	2010
Common equity	207	203	206	205	200
Change in common equity (%)	2.0	(1.7)	0.5	2.6	3.0
Total capital (reported)	292	288	291	290	285
Change in total capital (reported) (%)	1.4	(1.2)	0.4	1.8	2.1

Table 4

Deutsche Rueckversicherung Group Earnings

(Mil. €)	2014	2013	2012	2011	2010
Total revenues	685	700	669	632	659
EBIT adjusted*	11.5	7.9	10.0	20.6	18.7
Net income	7.8	1.0	5.0	8.4	3.7
Return on revenue (%)*	1.7	1.1	1.5	3.3	2.8
Return on shareholders' equity (reported) (%)	3.8	0.5	2.5	4.1	1.9
P/C: Net expense ratio (%)	29.7	28.3	28.7	28.0	29.8
P/C: Net loss ratio (%)	76.1	86.5	73.7	75.7	73.6
P/C: Net combined ratio (%)	105.8	114.9	102.4	103.8	103.4

*Before (un-)realized capital gains/losses.

In our base-case scenario for 2015-2017, we continue to assume that DR will underwrite at least economically profitable business in both the PLI and non-PLI sectors. This is a key support of the current ratings on the group. We expect that DR will report net combined ratios slightly above 100%, in the absence of major catastrophe losses. However, we believe that DR's reserving policy is conservative, which means that it has a stronger underlying technical result than the published figures suggest. We also expect the group's investment results will decline due to low interest rates, with a likely decrease in net investment yields of 30-80 bps over the next three years. We consequently expect in our base case that net income will remain modest over the next three years, at €3 million-€8 million annually.

Risk position: Moderate risk with low capital volatility compared with peers

In our view, DR's risk position is moderate, reflecting moderate underwriting and investment risk. In terms of the group's natural catastrophe risk exposure, we believe that potential capital volatility is limited compared with some global reinsurers.

We base our view mainly on the group's ability to maintain extremely strong capital adequacy in the event of a one-in-250-year claim. While DR's earnings are susceptible to large claims because of the group's relatively weak reported earnings base, we believe that risk pooling within the PLI sector, as well as the group's existing retrocession approach, limits capital volatility risk in the event of extreme claims. Risk pooling provides DR with a proportional cover for claims coming from the PLI business. In addition, the group has excess-of-loss and stop-loss cover that enables it to sustain losses from natural catastrophe claims within its risk tolerances. As a consequence of the losses experienced in 2013, DR added in 2015 a quota-share cover for its non-proportional storm risk. Nevertheless, the potential for lower earnings, alongside the group's exposure to natural catastrophe risk, may increase volatility of DR's capital position.

Table 5

Deutsche Rueckversicherung Group Risk Position

(Mil. €)	2014	2013	2012	2011	2010
Total invested assets	1,596	1,642	1,548	1,538	1,485
Net investment income	53	53	49	52	55
Net investment yield (%)	3.3	3.3	3.2	3.5	3.8
Net investment yield including realized capital gains/(losses) (%)	3.4	3.5	3.5	4.0	3.9
Net investment yield including all gains/(losses) (%)	3.4	3.3	3.8	3.9	3.7
Investment portfolio composition (%)*					
Cash and short-term investments	4.4	7.9	1.3	6.2	5.2
Bonds	62.5	64.5	70.9	68.1	69.3
Equity investments	21.5	20.0	20.3	20.2	20.7
Real estate	-	-	-	-	0.3
Mortgages	4.2	2.1	1.9	0.8	0.6
Loans	0.2	0.2	0.2	0.2	0.2
Investments in affiliates	7.3	5.2	5.5	4.5	3.8

* Investment portfolio composition based on annual account figures

DR's investment strategy is conservative, with only moderate market and credit risk and limited concentration risk. Based on market values and taking a look-through approach on investment funds, about 76% of invested assets are invested in bonds with an average credit quality in the 'A' range, while equity investments account for 8% of the total. Real estate investments represent about 7%, cash or cash equivalents 2%, and the remainder consists of reinsurance receivables and other investments. We do not expect major changes in DR's investment policy or any increase in risk appetite that would have an impact on the group's risk position.

Financial flexibility

DR has strong financial flexibility, in our view, thanks to its ability to share risks with the PLI sector, and the ability to raise funds from its PLI shareholders in the form of equity and hybrid capital. The group has outstanding debt of €85 million, which has been issued to members of the PLI sector. We assume that financial leverage (debt plus hybrids to economic capital) will remain at about 10% for the next few years. Fixed-charge coverage was low in 2014 and 2013 as a consequence of the weak technical profits, but we expect it will recover to 4x-5x over the next two years, including transfers from the equalization reserve to operating profit. The coverage ratio is based on reported figures, and we believe that it is somewhat understated due to DR's conservative reserving strategy.

Table 6

Deutsche Rueckversicherung Group Financial Flexibility					
	2014	**2013**	**2012**	**2011**	**2010**
Fixed-charge coverage (x)*	1.7	(11.8)	5.0	4.6	4.2
Financial leverage (%)	9.6	9.5	9.4	11.5	10.2

*Including change in equilization reserve.

Other Assessments

DR's enterprise risk management (ERM) and management and governance practices are supportive factors for the rating.

Enterprise risk management: Adequate, with strong risk controls

In our view, DR's ERM is adequate, with strong risk controls. We think it unlikely that DR will experience losses in excess of its risk tolerance. ERM is of high importance for the ratings, mainly driven by the group's natural catastrophe exposure in Germany. The major factors supporting the overall assessment are our positive views on risk culture, risk controls of the most significant risk types, and risk models.

We view the group's risk culture as positive, with a sound governance structure, clear risk policies, and regular risk reporting across the organization, supported by a group chief risk officer and a strong, independent central underwriting management function. We assess the group's controls for its main types of risk as positive. DR consistently uses a stochastic approach for pricing and risk controls, and its catastrophic event modeling provides a powerful tool to monitor and price windstorm, flood, and hail accumulation risk. Our neutral view of DR's strategic ERM capabilities reflects risk-reward analyses that are not yet applied fully or consistently across the group. We nevertheless take a positive view of the progress made toward an optimized, risk budget-allocation approach, and the developments around a group model.

Management and governance: Strong track record, but some challenges still ahead

DR's management and governance is satisfactory, in our opinion. The group has a track record of diligent strategic planning, experienced management, conservative balance sheet management, and clearly defined risk tolerances. This enabled the group to expand outside the PLI sector generating mostly profitable business. Our view of DR's management is based on its focus on core lines of business, profitability, and efforts to cautiously expand the group's business model. The execution risk that is usually associated with expanding a business model is, in our view, largely reduced by the group's underwriting and enterprise risk management capabilities and is concentrated on clients seeking long-term relationships.

We consider the group's financial management as conservative. DR primarily uses its capital to support underwriting rather than investment risk. In line with DR's value-based management techniques, its main performance metric is the underlying combined ratio, which it targets at lower than 100% on average. The group managed to fulfil this target in the non-PLI business, but has some challenges of continuing earnings pressure in the PLI segment.

Liquidity: Exceptional

We regard DR's liquidity as exceptional, owing to the strength of available liquidity sources and robust cash flows. There are no refinancing concerns, and we believe that the group is capable of managing unexpectedly large claims and liquidity stresses.

Accounting Considerations

Both DR and DRAG report according to German generally accepted accounting principles (GAAP), whereas DRS' financial statements are prepared under Swiss GAAP. Our analysis is based mainly on the consolidated accounts. The group applies a strong level of conservatism in its accounting figures.

In our assessment of earnings, we take into account internal figures on ultimate loss and combined ratios following a review of the group's reserves. We also adjust reported net incomes for movements in equalization reserves.

We assess the group's capital adequacy based on reported local GAAP figures. Our main adjustments are:

- Off-balance-sheet unrealized gains other than life bonds.
- Equalization and similar reserves and 67% of the non-life loss reserve discount not included in the balance sheet.
- 50% of the loss reserve surplus.

Related Criteria And Research

Related Criteria

- Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves - November 26, 2013
- Group Rating Methodology, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings Detail (As Of December 18, 2015)	
Operating Companies Covered By This Report	
Deutsche Rueckversicherung AG	
Financial Strength Rating	
Local Currency	A+/Negative/--

Ratings Detail (As Of December 18, 2015) (cont.)	
Counterparty Credit Rating	
Local Currency	A+/Negative/--
Deutsche Rueckversicherung Schweiz AG	
Financial Strength Rating	
Local Currency	A+/Negative/--
Issuer Credit Rating	
Local Currency	A+/Negative/--
Domicile	Germany

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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