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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
Business Risk		ERM and Management	0	Liquidity	0	Group Support	0	A+/Stable/--
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

- We consider that the Deutsche Rueckversicherung group (DR) carries low industry and country risk because it generates most of its business in the German property/casualty (P/C) sector.
- The group has a strong competitive position thanks to its ties to the German Public Law Insurance (PLI) sector and increasing diversification in the non-PLI business.

Financial Risk Profile: Very Strong

- Capital and earnings have been hit by severe natural catastrophe losses but the group has maintained extremely strong capital adequacy, supported by conservative reserving.
- DR has a moderate risk position compared with its peers due to low capital volatility from large claims.
- The group has strong financial flexibility thanks to its ability to share risk with the PLI sector.

Other Factors

- Our combined view of 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: Stable

The stable outlook on DR reflects our view that the group will maintain its strong ties to the German PLI sector in terms of premium generation and underwriting risk pooling. We also incorporate in our outlook the assumptions that the group's capital and earnings will remain extremely strong, supported by conservative reserving and moderate earnings.

Downside scenario

A negative rating action over the next 12-24 months is unlikely, but we might lower the ratings if:

- The group's strong ties to the German PLI sector decrease significantly;
- Capital adequacy deteriorates to very strong or lower;
- Capital and earnings volatility shows potential for increase, for example because of increased net exposure to natural catastrophes; or
- Earnings weaken to substantially less than our base-case assumptions over a protracted period as a consequence, for example, of inadequate pricing.

Upside scenario

A positive rating action is remote at this stage. We assess the group's business risk profile as strong, which limits the ratings at the 'A+' level, and do not anticipate a change in this assessment.

Base-Case Scenario

Macroeconomic Assumptions

- Slight declines in German 10-year government bond yields to 1.3% in 2014 and 1.1% in 2015, with a modest recovery to 1.4% in 2016.
- Real German GDP growth of slightly below 2% annually until 2016.
- A small decline in Germany's unemployment rate to 4.9% in 2016 from 5.3% in 2013.
- Competitive business conditions in the non-life sector, with moderate premium growth.

Company-Specific Assumptions

- Moderate premium growth of 1%–3% annually over the next three years.
- Improvement in the group's reported non-life operating performance compared with 2013, with combined ratios of about 100% in the absence of major natural catastrophe events and a continued conservative reserving policy.
- Limited premium contribution of about 5% 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

(Mil. €)	2015f	2014f	2013	2012	2011
Gross premium written	> 992	> 990	994	969	902
Net income	> 5,0	> 4,0	1.0	5.0	8.4
Return on shareholders' equity (%)	< 4	< 3	0.5	2.5	4.1
P/C net combined ratio (%)	> 100	> 100	114.9	102.4	103.8
Net investment yield (%)	2,5 - 3,0	2,5 - 3,0	3.3	3.8	3.9
S&P Capital Adequacy	Extremely strong	Extremely strong	Extremely strong	Extremely strong	Extremely strong
Financial leverage	~ 10,0	~ 10,0	9.5	9.4	11.5

Company Description: Continuing Transformation 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 them 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 2013, representing about 52% of net premiums, followed by motor (21%), liability (10%), and life (4%). About 71% 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. We base this assessment on the group's low industry and country risk as it mainly operates in the German non-life insurance sector. We also factor in DR's strong role in the PLI sector.

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 our assessment during 2014-2016 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%
Germany Life	Intermediate	4%
Switzerland P/C	Very Low	1%
Austria P/C	Low	6%
Italy P/C	Moderate	1%
Spain P/C	Moderate	1%
United Kingdom P/C	Intermediate	2%
Norway P/C	Low	1%
Other*	Intermediate	3%
Weighted average IICRA	Low	100%

*Average

Competitive position: Strong in the PLI sector, gradually expanding in the broader German and European reinsurance market

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. To diversify its premiums, the group is expanding outside the PLI sector both through DRAG and DRS, focusing on selected clients in Europe. The non-PLI business represents 59% of the group's net premiums, to which DRS contributes about 54 percentage points. We see this diversification as the group's main growth driver, but competition in the international reinsurance market, resulting from high capacity, is high. 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 2013 by 2.7%, in line with our expectation. The main growth driver was a premium increase in the non-PLI business, adding diversification to the group's portfolio. We assume in our base case that premium growth will remain modest, at 1%-3% over the next three 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. €)	**2013**	**2012**	**2011**	**2010**	**2009**
Gross premium written (GPW)	994	969	902	920	1,008
Change in gross premium written (%)	2.7	7.3	(1.9)	(8.7)	(0.8)
Net premium written	649	620	576	601	665
Change in net premium written (%)	4.7	7.7	(4.3)	(9.6)	(5.1)
Reinsurance utilization (%)	34.7	36.0	36.2	34.6	34.0

Table 2

Deutsche Rueckversicherung Group Competitive Position (cont.)					
Business segment (% of GPW)					
Life/health	3.6	4.7	4.5	4.7	5.1
Property/casualty	96.4	95.3	95.4	95.3	94.9

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.

Capital and earnings: Capitalization at the 'AAA' level 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--even after large natural catastrophe claims in 2013. We anticipate in our base case that the group will be able to recover the losses assumed in 2013 within the next two years. This should restore capital adequacy to the levels of 2012, 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.

DR was hit by a series of natural catastrophe losses in 2013 that raised the reported net combined (loss and expense) ratio by about 10 percentage points to 115%. The majority of losses stemmed from the PLI business, where the group has historically had a weaker performance than in non-PLI business. The low technical margin in the PLI business is caused by high levels of proportional reinsurance as well as the group's efforts to offer attractive reinsurance products to its shareholders.

Table 3

Deutsche Rueckversicherung Group Capital					
(Mil. €)	**2013**	**2012**	**2011**	**2010**	**2009**
Common equity	203	206	205	200	194
Change in common equity (%)	(1.7)	0.5	2.6	3.0	8.2
Total capital (reported)	288	291	290	285	279
Change in total capital (reported) (%)	(1.2)	0.4	1.8	2.1	5.6

Table 4

Deutsche Rueckversicherung Group Earnings					
(Mil. €)	**2013**	**2012**	**2011**	**2010**	**2009**
Total revenues	700	669	632	659	720
EBIT adjusted *	8.0	10.0	21.0	19.0	1.0
Net income	1.0	5.0	8.4	3.7	19.5
Return on revenue (%)*	1.1	1.5	3.3	2.8	0.1
Return on shareholders' equity (reported) (%)	0.5	2.5	4.1	1.9	10.5

Table 4

Deutsche Rueckversicherung Group Earnings (cont.)					
P/C: Net expense ratio (%)	28.3	28.7	28.0	29.8	30.4
P/C: Net loss ratio (%)	86.5	73.7	75.7	73.6	68.3
P/C: Net combined ratio (%)	114.9	102.4	103.8	103.4	98.7

*Before (un)realized capital gains/losses

In our base-case scenario for 2014-2016, we expect that DR will return to break even in terms of its reported underwriting result, achieving net combined ratios of about 100%, in the absence of major catastrophe losses. We also think the group's investment results could decline due to low interest rates, with a likely decrease in net investment yields of 30-80 basis points 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. 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. This implies an improvement of the five-year average combined ratio by about five percentage points.

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 1-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. 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.

Table 5

Deutsche Rueckversicherung Group Risk Position					
(Mil. €)	**2013**	**2012**	**2011**	**2010**	**2009**
Total invested assets	1,642	1,548	1,538	1,485	1,386
Net investment income	53	49	52	55	55
Net investment yield (%)	3.3	3.2	3.5	3.8	4.1
Net investment yield including realized capital gains/(losses) (%)	3.5	3.5	4.0	3.9	4.1
Net investment yield including all gains/(losses) (%)	3.3	3.8	3.9	3.7	5.8
Investment portfolio composition (%)	**2013**	**2012**	**2011**	**2010**	**2009**
Cash and short-term investments	7.9	1.3	6.2	5.2	4.0
Bonds	64.5	70.9	68.1	69.3	72.4
Equity investments	20.0	20.3	20.2	20.7	19.0
Real estate	-	-	-	0.3	0.3
Mortgages	2.1	1.9	0.8	0.6	0.0
Loans	0.2	0.2	0.2	0.2	0.2
Investments in affiliates	5.2	5.5	4.5	3.8	4.0

DR's investment strategy is conservative, with only moderate market and credit risk and limited concentration risk. About 70% of invested assets are invested in bonds with an average credit quality in the 'A' range, while equity investments account for only 5% of the total. Real estate investments represent about 5%, cash or cash equivalents 2%, and the remainder consist 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: Strong

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. We assume that financial leverage (debt plus hybrids to economic capital) will remain at about 10% for the next few years and that fixed-charge coverage will remain at 4x-5x, 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

	2013	2012	2011	2010	2009
Fixed-charge coverage (x)	(11.7)	5.0	4.6	4.2	13.9
Financial leverage (%)	9.5	9.4	11.5	10.2	10.3

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 fully applied across the group. We nevertheless take a positive view of the progress made toward an optimized, risk budget-allocation approach, and development of 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. However, it faces the challenges of its continuing business transformation and profitable expansion in Europe.

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.

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

- 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 Outlook, Sept 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings Detail (As Of December 17, 2014)	
Operating Companies Covered By This Report	
Deutsche Rueckversicherung AG	
Financial Strength Rating	
Local Currency	A+/Stable/--

Ratings Detail (As Of December 17, 2014) (cont.)	
Counterparty Credit Rating	
Local Currency	A+/Stable/--
Deutsche Rueckversicherung Schweiz AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
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.

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