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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 competitive position benefiting from strong ties with the German public law insurance (PLI) sector and a stabilization of underwriting results.
- Low industry and country risk because most business is generated in the German property/casualty (P/C) sector.
- Limited growth expected due to strong prevailing competition in international reinsurance.

Financial Risk Profile

- Extremely strong capital adequacy, supported by conservative reserving.
- Modest capital and earnings volatility reflecting exposure to high natural catastrophe events, albeit less pronounced than that of peers.
- Adequate financial flexibility, owing to its limited track record of raising funds outside the PLI sector, particularly when compared to reinsurance peers.

Other Factors

- Our view of DR's very strong financial risk profile and strong business risk profile form the basis of our assessment of the DR's creditworthiness. We take a particularly positive view of the group's extremely strong capitalization (according to our capital model), which would enable the group to absorb large losses if required.

Outlook

The stable outlook on the entities in the German reinsurance group Deutsche Rueckversicherung (DR) reflects our view that the next two years the group will be maintain an extremely strong capital and earnings, benefiting from an ongoing prudent reserving strategy. We also expect that DR will generate healthy business in the PLI sector as well as in the broader market over the next 12-24 months.

Downside scenario

We could lower the ratings on DR if:

- The group discloses weaker underlying profitability against peers than we expect in our base-case assumptions;
- The group's capital adequacy deteriorates below the 'AAA' range;
- We believe the group's capital and earnings volatility could 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 see a positive rating action as remote at this stage due to its limited diversification outside the German reinsurance market.

Base-Case Scenario

Macroeconomic Assumptions

- German 10-year government bond yields increasing to 0.4% in 2017, 0.8% in 2018, and 1.1% in 2019.
- Real German GDP growth of 2.0% in 2017, declining to 1.7% in 2018 and 1.5% in 2019.
- Decline in Germany's unemployment rate to 3.7% in 2017 from 4.2% in 2016, and further declining to 3.4% in 2018 and 3.3% in 2019.

Company-Specific Assumptions

- We believe DR will continue to focus on profitability more than on growth. We believe that expected price increases in the global reinsurance sector in 2018 will only moderately affect DR's exposure in view to its focus on Germany and Europe.
- We anticipate that continued restructuring efforts will further stabilize underwriting results, and we expect the DR to report healthy underwriting results and combined ratios barring any extraordinary natural catastrophe events of about 97%-98% in 2017, and below 100% in 2018-2019.
- In particular, we expect that the PLI and non-PLI business will remain economically profitable.
- We expect that DR will maintain its conservative reserving strategy and capital buildup, leading to a fostering of capital adequacy above the 'AAA' level.
- We assume a decline in the group's investment yield over the next three years of about 30 bps due to prevailing low interest rates.

Key Metrics

(Mil. €)	2018f	2017f	2016	2015	2014
Gross premium written	>1,100	>1,100	1,175	1,077	1,038
Net income	12-14	12-14	14.5	14.3	7.8
Return on shareholders' equity (%)	~5	~5	6.4	6.7	3.8
P/C net combined ratio (%)	<100	~97-98	96.8	99.9	105.8
Net investment yield (%)	1.8-2.1	2.1-2.4	2.4	2.7	3.3
S&P Global Ratings capital adequacy	Extremely strong	Extremely strong	Extremely strong	Extremely strong	Extremely strong
Fixed-charge coverage (x)*	>10	>10	12.3	8.1	1.7
Financial leverage (%)	~6	~6	6.4	9.0	9.6

f--Forecast based on S&P Global Ratings' base-case scenario. P/C--Property/casualty. *Including change in equalization reserve.

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 81% 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 2016, representing about 51% of net premiums, followed by liability, accident, motor (34%), and life (4%). About 72% of the non-life business is written on a proportional basis and mostly acquired directly from cedents.

Business Risk Profile

We view DR's business risk profile as strong. We consider that DR benefits in particular from its strong ties with the German PLI sector, and the sound and stable economic environment in which it generates 86% of its premiums.

Insurance industry and country risk: Low risk due its focus on the German property and casualty market

We assess DR's industry and country risk as low because it generates most of its business (about 82%) in the German P/C sector, which we consider low risk. In our view, the German P/C market shows solid underwriting performance and a conservative reserving strategy.

DR also has some exposure to the German life reinsurance sector and to other countries and sectors in Europe, but given its limited exposure this has only a marginal impact on our overall assessment.

Table 1

Deutsche Rueckversicherung Group IICRA

Insurance sector	IICRA	Business mix (%)
Germany P/C	Low	82
Austria P/C	Low	6
Norway P/C	Low	1

Table 1

Deutsche Rueckversicherung Group IICRA (cont.)		
Insurance sector	**IICRA**	**Business mix (%)**
United Kingdom P/C	Intermediate	1
Italy P/C	Intermediate	1
Spain P/C	Intermediate	1
Netherlands P/C	Intermediate	1
Switzerland P/C	Very Low	0
Global P/C reinsurance	Intermediate	4
Germany life	Intermediate	4
Global life reinsurance	Low	0
Weighted-average IICRA	Low	100

IICRA--Insurance industry and country risk assessment. P/C--Property and casualty.

Competitive position: Profitability has further improved, bolstered by regional focus on Germany with strong ties to PLI sector

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.

Following a period of unprofitable business generation in the PLI business and high natural catastrophe losses in 2013, the group initiated different countermeasures, in collaboration with the public law insurers, to enhance the underlying quality of the business. In our view, DR has been able to improve the profitability of the business significantly. Its combined ratio improved to 96.8% in 2016, compared to 105.8% in 2014 and 114.9% in 2013. We expect DR's ongoing measures to continue to support the underwriting performance over 2017-2019.

We believe the group benefits from its direct relationships with clients (about 90% of its business stem from own sales forces). This direct access enables a good portfolio stability, in our view, and facilitates the restructuring measures in the 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 traditional non-PLI reinsurance business represents about 40% of the group's net premiums, to which DRS contributes about 35%. Together with its non-traditional business, DRS contributes about 35% to DR's overall premiums. We see this diversification as the group's prospective main growth driver, albeit we see DR's competitive strength as less pronounced compared to the PLI market.

Overall gross premiums increased in 2016 by about 9%, which was higher than we had expected. We understand the growth is due to one-time individual contract increases and exposure growth in core business lines.

We anticipate that price increases in the PLI sector will abate. Given that the group focuses on profitability more than on growth, we expect premium to decline by about 1% in 2017. For 2018 and 2019, we anticipate flat premiums, supported by our expectation of some rate increases in the international reinsurance market.

Table 2

Deutsche Rueckversicherung Group Competitive Position					
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Gross premium written (GPW)	1,175	1,077	1,038	994	969
Change in gross premium written (%)	9.1	3.8	4.4	2.7	7.3
Net premium written	719	668	635	649	620
Change in net premium written (%)	7.7	5.1	(2.1)	4.7	7.7
Reinsurance utilization (%)	38.8	38.0	38.8	34.7	36.0
Business segment (% of GPW)					
Life/health	4.0	3.9	3.6	3.6	4.7
Property/casualty	96.0	96.1	96.4	96.4	95.3

Financial Risk Profile

We view DR's financial risk profile as very strong. We believe DR benefits from extremely strong capitalization and conservative reserving, and consequently the ability to withstand large natural catastrophe events.

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

We regard DR's capital and earnings as extremely strong, with capital adequacy in the 'AAA' range, according to our risk-based capital model. Benefiting from a benign claims environment in 2016 and the restructuring efforts in the PLI business, the group further strengthened its economic capital base via earnings retention and strong reserving.

In our base case, we expect that the group will continue to increase capital over the next two years, mainly through further building of reserves and a modest contribution from reported earnings. We anticipate only moderate growth of about 2% in the group's capital requirements, mainly based on a conservative increase in credit risk in the current low interest rate environment.

In 2016, DR's underwriting results and earnings strengthened further in the wake of positive outcomes from the restructuring measures in the PLI business. The good results have also been supported by benign claims, leading to a reported net combined ratio of 97% in 2016.

Table 3

Deutsche Rueckversicherung Group Capital					
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Common equity	232	221	207	203	206
Change in common equity (%)	5.0	7.1	2.0	(1.7)	0.5
Total capital (reported)	294	306	292	288	291
Change in total capital (reported) (%)	(4.0)	5.0	1.4	(1.2)	0.4

Table 4

Deutsche Rueckversicherung Group Earnings					
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Total revenues	769	715	685	700	669
EBIT adjusted*	24.7	20.5	11.5	7.9	10.0

Table 4

Deutsche Rueckversicherung Group Earnings (cont.)

(Mil. €)	2016	2015	2014	2013	2012
Net income	14.5	14.3	7.8	1.0	5.0
Return on revenue (%)*	3.2	2.9	1.7	1.1	1.5
Return on shareholders' equity (reported) (%)	6.4	6.7	3.8	0.5	2.5
P/C: Net expense ratio (%)	34.9	29.4	29.7	28.3	28.7
P/C: Net loss ratio (%)	61.9	70.5	76.1	86.5	73.7
P/C: Net combined ratio (%)	96.8	99.9	105.8	114.9	102.4

*Before (un)realized capital gains/losses.

For 2017, we expect a similar combined ratio, based on benign claims so far compared to 2016. In general, we anticipate that DR will continue its profitability-orientated strategy in the PLI and non-PLI sectors. On a normalized basis, barring any extraordinary natural catastrophe events, we therefore expect DR to report net combined ratios below 100% in 2018 and 2019. We also believe that DR's reserving policy remains conservative.

Furthermore, we anticipate DR's investment results will decline due to low interest rates, with a likely decrease in net investment yields of about 30 basis points over the next three years. We consequently expect in our base case that net income will remain at €12 million-€14 million over 2017-2019 annually.

Risk position: Moderate risk thanks to reduced capital volatility compared with global reinsurance peers

We assess DR's risk position as moderate. We believe the group is exposed to earnings volatility, primarily due to its natural catastrophe risk exposure, as evidenced by nat cat events in 2013. However, we also believe volatility is lower than for many global reinsurers that carry a higher risk position. Furthermore, the company's exposure to underwriting and investment risk is marginal.

We base our view mainly on the group's ability to maintain at least very 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 low reported earnings base, we believe that DR's capital buffer--which is over our 'AAA' requirements based on our capital model--as well as the group's existing retrocession approach, limits capital volatility risk in the event of extreme claims. Risk pooling provides DR with 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. A quota-share cover for its non–proportional storm risks complements the group's reinsurance structure.

Table 5

Deutsche Rueckversicherung Group Risk Position

(Mil. €)	2016	2015	2014	2013	2012
Total invested assets	1,822	1,700	1,596	1,642	1,548
Net investment income	42	45	53	53	49
Net investment yield (%)	2.4	2.7	3.3	3.3	3.2
Net investment yield including realized capital gains/(losses) (%)	2.5	2.9	3.4	3.5	3.5
Net investment yield including all gains/(losses) (%)	2.5	2.8	3.4	3.3	3.8

Table 5

Deutsche Rueckversicherung Group Risk Position (cont.)					
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Investment portfolio composition (%)					
Cash and short-term investments	6.7	6.2	4.4	7.9	1.3
Bonds	55.5	59.6	62.5	64.5	70.9
Equity investments	24.7	23.0	21.5	20.0	20.3
Real estate	-	-	-	-	-
Mortgages	5.3	3.5	4.2	2.1	1.9
Loans	0.1	0.1	0.2	0.2	0.2
Investments in affiliates	7.7	7.7	7.3	5.2	5.5

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, more than 70% of invested assets are invested in bonds with an average credit quality in the 'A' range, while equity investments account for 10% of the total. Real estate investments represent about 8%, and the remainder consists of cash or cash equivalents, reinsurance receivables, and other investments. We understand that the group's credit risk might increase over the coming years, driven by an increase of illiquid assets to partly offset the consequences of the low interest rates. However, we believe that a credit risk increase will be minor and well monitored and is unlikely to jeopardize the group's current risk position.

Financial flexibility: Adequate, benefitting from ability to share risks with the PLI sector

DR has adequate 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 €62 million, which was issued to members of the PLI sector to refinance a €85 million hybrid that was called in October 2016. However, the group has a limited track record of raising funds from the wider capital market, especially when compared with larger reinsurance peers. We assume that financial leverage (debt plus hybrids to economic capital) will remain stable around 6% for the next few years based on the lower debt level. Fixed-charge coverage has been volatile in recent years due to changes in equalization reserve that we take into account in our calculations. Having said that, we believe fixed-charge coverage will remain above 10x if the equalization reserve remains stable. 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					
	2016	**2015**	**2014**	**2013**	**2012**
Fixed-charge coverage (x)*	12.3	8.1	1.7	(11.8)	5.0
Financial leverage (%)	6.4	9.0	9.6	9.5	9.4

*Including change in equalization reserve.

Other Assessments

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

Enterprise risk management: Beneficial framework and low likelihood of losses in excess of risk tolerances

We assess DR's ERM as adequate with strong risk controls. We think it is 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.

The group has fully developed and embedded a framework for risk return optimization. There is clear consistency between the group's technical pricing and risk return measures, which we consider aids effective steering of underwriting decisions during renewal phases. We also acknowledge the beneficial role of the ERM framework in the portfolio restructuring process.

However, we are monitoring whether DR can achieve technical prices sustainably, which currently constrains our view of the group's strategic ERM capabilities.

Management and Governance: Turnaround in PLI business successfully implemented

We regard DR's management and governance as satisfactory. 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 understand that the current CEO will leave the group by the end of August 2018. As of now, we do not expect any material change in the group's overall strategy and underwriting discipline.

We consider the group's financial management to be conservative. DR primarily uses its capital to support underwriting rather than investment risk, although we expect a slight increase in investment risk as a consequence of the low interest rates.

Liquidity: Exceptional, benefiting from liquidity sources

We view DR's liquidity as exceptional, thanks to the strength of available liquidity sources and ongoing solid premium cash flows. From our perspective 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 degree 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

- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria - Insurance - Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Criteria - Financial Institutions - General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Criteria - Financial Institutions - Banks: Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings Detail (As Of December 14, 2017)	
Operating Companies Covered By This Report	
Deutsche Rueckversicherung AG	
Financial Strength Rating	
Local Currency	A+/Stable/--

Ratings Detail (As Of December 14, 2017) (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. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' 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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