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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

- Low industry and country risk because most business is generated in the German property/casualty (P/C) sector.
- Improving operating performance, especially in the German Public Law Insurance (PLI) business.
- Ongoing strong competition in international reinsurance puts some pressure on the group's prospective growth outside the PLI sector.

Financial Risk Profile: Very Strong

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

Other Factors

- We view DR's financial risk profile as very strong and business risk profile as strong, resulting in an anchor of either 'a+' or 'a'. We continue to opt for the 'a+' anchor, given the group's extremely strong risk–based capital (measured using our model), which would enable the group to absorb large losses if required.

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Outlook: Stable

The stable outlook on the entities of German reinsurance group Deutsche Rueckversicherung (DR) reflects S&P Global Ratings' view that the group will be able to maintain healthy business generation in the PLI sector as well as in broader market business over the next 12-24 months. We also incorporate in our outlook our expectation that DR will keep extremely strong capital and earnings over this period, supported by conservative reserving and moderate earnings.

Downside scenario

We could lower the ratings on DR if:

- The group discloses a weaker underlying profitability against peers than we expect in our base-case assumptions, especially in its PLI business, causing us to question its competitive strength;
- 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. We could raise the rating if we revised upward our assessment of the group's business risk profile. This could be triggered if the group diversifies its business and earnings outside the German reinsurance market and gains significant market share in markets where it is active, which we currently see as unlikely.

Base-Case Scenario

Macroeconomic Assumptions

- German 10-year government bond yields declining to 0.1% in 2016 but increasing to 0.7% in 2017 and 1.1% in 2018.
- Real German GDP growth of 1.8% in 2016, declining to 1.3% in 2018.
- Decline in Germany's unemployment rate to 4.2% in 2016 from 4.6% in 2015, remaining stable in 2017 with a small increase to 4.4% in 2018.
- Weak business conditions in the global P/C reinsurance sector.

Company-Specific Assumptions

- A premium increase of about 3% in 2016, driven by pricing restructuring measures and an increase in the non-traditional reinsurance business, with a subsequent decline of 0%-3% based on strong competition and conservative underwriting over the following two years.
- Stable reported non-life operating performance compared with 2015, with combined ratios of about 100% in the absence of major natural catastrophe events and a continued conservative reserving policy.
- 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 decline in the group's investment yield over the next three years of about 30-70 bps due to prevailing low interest rates.

Key Metrics

(Mil. €)	2017F	2016F	2015	2014	2013
Gross premium written	>1.000	>1.100	1,077	1,038	994
Net income	>10	>10	14.3	7.8	1.0
Return on shareholders' equity (%)	>5	>5	6.7	3.8	0.5
P/C net combined ratio (%)	<100	~100	99.9	105.8	114.9
Net investment yield (%)	2,0 - 2,5	2,0 - 2,5	2.7	3.3	3.3
S&P Capital Adequacy	Extremely strong	Extremely strong	Extremely strong	Extremely strong	Extremely strong
Fixed-charge coverage (x)	>10	>6	8.1	1.7	(11.8)
Financial leverage %	<10	<10	9.0	9.6	9.5

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/Positive/--). 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 2015, representing about 55% of net premiums, followed by motor (20%), liability (9%), 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: Strong

We regard DR's business risk profile as strong. The group benefits from the healthy and stable German economy, where it generates 86% of its premiums. We believe that the group's enhanced profitability in the PLI business underlines DR's important role within the PLI system and stabilizes its strong competitive position. However, the group's competitive power outside the PLI market is, in our view, less prominent.

Insurance industry and country risk: Focus on the German property and casualty market, cautiously expanding within Europe

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 2016-2018 in light of the group's focus on the German P/C market.

Table 1

Deutsche Rueckversicherung Group IICRA

Insurance sector	IICRA	Business mix (%)
Germany P/C	Low	82
Austria P/C	Low	6
Germany Life	Intermediate	4
United Kingdom P/C	Intermediate	1
Italy P/C	Moderate	1
Spain P/C	Intermediate	1
Norway P/C	Low	1
Global P/C reinsurance	Intermediate	5
Weighted average IICRA	Low	100

IICRA--Insurance Industry And Country Risk Assessment. P/C--Property and casualty.

Competitive position: Stabilized by profitability enhancement in the PLI business, but competition in the non-PLI business is high

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 demonstrate a turnaround of the profitability of its PLI business over the past two to three years, underlying 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 32% to DR's overall premiums. We see this diversification as the group's prospective main growth driver, but competition in the international reinsurance market, resulting from high capacity, is vigorous. We believe that, based on the current pricing environment, the non-PLI business will stagnate over the coming years as the group's focus is on economic profitable business generation rather than growth. We also believe that the group's competitive strength outside the PLI sector is less developed than in the PLI market.

Overall gross premiums increased in 2015 by 3.8%, which was somewhat higher than we expected. On a net basis, premiums increased by 5.2%, boosted by growth in the property business, reflecting the group's restructuring and profitability initiatives. We assume in our base case that net premium will increase in 2016 by about 5% as a consequence of a further pricing adjustments in the PLI business and a one-off increase in non-traditional reinsurance, but decline by 0%-3% over the following two years because of a focus on underwriting quality in the competitive reinsurance market.

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 in our view provides good portfolio stability.

Table 2

Deutsche Rueckversicherung Group Competitive Position					
(Mil. €)	**2015**	**2014**	**2013**	**2012**	**2011**
Gross premium written (GPW)	1,077	1,038	994	969	902
Change in gross premium written (%)	3.8	4.4	2.7	7.3	(1.9)
Net premium written	668	635	649	620	576
Change in net premium written (%)	5.1	(2.1)	4.7	7.7	(4.3)
Reinsurance utilization (%)	38.8	38.8	34.7	36.0	36.2
Business segment (% of GPW)					
Life/health	3.9	3.6	3.6	4.7	4.5
Property/casualty	96.1	96.4	96.4	95.3	95.5

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.

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 further recovered in 2015, after assuming a high amount of losses in 2013, through earnings retention and strong reserving.

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 modest contribution from reported earnings. We expect only moderate growth of 2%-4% in the group's capital requirements as a consequence of a cautious increase in credit risk in the current low interest rate environment. Management's ability to preserve capital and earnings at the current level is key to the current rating.

In 2015, DR's earnings strengthened compared with the results in 2014. The restructuring measures in the PLI business are showing their first fruits, with an overall reported net combined ratio of 99.9% in 2015 versus 105.8 in 2014 and 114.9% in 2013. We believe that DR's reserving policy remains conservative, which means that it has a stronger underlying technical result than the published figures suggest.

Table 3

Deutsche Rueckversicherung Group Capital

(Mil. €)	2015	2014	2013	2012	2011
Common equity	221	207	203	206	205
Change in common equity (%)	7.1	2.0	(1.7)	0.5	2.6
Total capital (reported)	306	292	288	291	290
Change in total capital (reported) (%)	5.0	1.4	(1.2)	0.4	1.8

Table 4

Deutsche Rueckversicherung Group Earnings

(Mil. €)	2015	2014	2013	2012	2011
Total revenues	715	685	700	669	632
EBIT adjusted*	20.5	11.5	7.9	10.0	20.6
Net income	14.3	7.8	1.0	5.0	8.4
Return on revenue (%)	2.9	1.7	1.1	1.5	3.3
Return on shareholders' equity (reported) (%)	6.7	3.8	0.5	2.5	4.1
P/C: Net expense ratio (%)	29.4	29.7	28.3	28.7	28.0
P/C: Net loss ratio (%)	70.5	76.1	86.5	73.7	75.7
P/C: Net combined ratio (%)	99.9	105.8	114.9	102.4	103.8

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

In our base-case scenario for 2016-2018, we assume that DR will continue to take advantage of the portfolio restructuring measures and its cautious underwriting strategy, and will generate 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 of about 100%, in the absence of major catastrophe losses such as experienced in 2013. However, we believe that DR's reserving policy remains 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 30-70 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 €12 million-€14 million annually.

Risk position: Moderate risk with lower capital volatility compared with global reinsurance peers

In our view, DR's risk position is moderate, primarily due to its natural catastrophe risk exposure, which, however, is still lower than some global reinsurers'. Furthermore, the company's exposure to underwriting and investment risk is modest.

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 quote-share cover for its non–proportional storm risks complements the group's reinsurance structure.

Table 5

Deutsche Rueckversicherung Group Risk Position

(Mil. €)	2015	2014	2013	2012	2011
Total invested assets	1,700	1,596	1,642	1,548	1,538
Net investment income	45	53	53	49	52
Net investment yield (%)	2.7	3.3	3.3	3.2	3.5
Net investment yield including realized capital gains/(losses) (%)	2.9	3.4	3.5	3.5	4.0
Net investment yield including all gains/(losses) (%)	2.8	3.4	3.3	3.8	3.9
Investment portfolio composition (%)					
Cash and short-term investments	6.2	4.4	7.9	1.3	6.2
Bonds	59.6	62.5	64.5	70.9	68.1
Equity investments	23.0	21.5	20.0	20.3	20.2
Real estate	-	-	-	-	-
Mortgages	3.5	4.2	2.1	1.9	0.8
Loans	0.1	0.2	0.2	0.2	0.2
Investments in affiliates	7.7	7.3	5.2	5.5	4.5

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, about 75% 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 equivalent, 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, not jeopardizing the group's current risk position.

Financial flexibility

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 reduce and be around 7% for the next few years based on the lower debt level. We expect fixed-charge coverage to remain stable in 2016 but to improve in the next two years, driven by the lower interest burden after the hybrid refinancing, 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

	2015	2014	2013	2012	2011
Fixed-charge coverage (x)	8.1	1.7	(11.8)	5.0	4.6
Financial leverage (%)	9.0	9.6	9.5	9.4	11.5

Other Assessments

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

Enterprise risk management: Enhancement in risk return considerations, but recent changes need a track record

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.

We assess DR's strategic ERM capabilities as neutral. 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 in our view helps effective steering of underwriting decisions during renewal phases. We also view positively that the retrocession strategy is informed by risk return considerations. However, this framework was fully formalized relatively recently and we await a track record period to measure the sustainable positive benefit on the group's underwriting performance.

Management and governance: Profitability turnaround in PLI business underlines ability to execute strategy, but challenges remain

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, although we expect a slight increase in investment risk as a consequence of the low interest rates.

In line with DR's value-based management techniques, its main performance metric is the return on risk-adjusted capital, which translates into a target economic combined ratio of lower than 100% on average. The group managed to fulfill this target in the non-PLI business, but had some challenges to generate economic profitable business in the PLI sector. We have seen a material improvement over the last two to three years, reaching break-even in 2014 and further enhancing profits in 2015 and 2016, aligning overall underlying results with those of reinsurance peers. We believe that the profitability turnaround in the PLI business underlines DR's ability to execute its strategy, but the successes are fairly recent. Additionally, the high competition in the reinsurance market and the challenging investment environment might put pressure on the group's earnings.

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, Nov. 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
- Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010

Ratings Detail (As Of December 22, 2016)	
Operating Companies Covered By This Report	
Deutsche Rueckversicherung AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
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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