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Research Update:

Munich Reinsurance Co. 'AA-' Ratings Affirmed On Revised Capital Model Criteria; Outlook Positive

April 15, 2024

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Overview

- On Nov. 15, 2023, we published our revised criteria for analyzing insurers' risk-based capital (see "Insurer Risk-Based Capital Adequacy--Methodology And Assumptions").
- Under the revised criteria, Munich Reinsurance Co.'s (Munich Re's) capital buffer improves. We continue to consider its capital and earnings to be very strong.
- We therefore affirmed our 'AA-' issuer credit and insurer financial strength ratings on Munich Re.
- The positive outlook reflects our view that the group will preserve its excellent competitive position and conservative capital management through its operating divisions' continuous earnings diversification.

Rating Action

On April 15, 2024, S&P Global Ratings affirmed its 'AA-' issuer credit and insurer financial strength ratings on Munich Re (all affected entities are part of the ratings list at the end of this article). The outlook is positive.

Impact Of Revised Capital Model Criteria

- The improvement in capital adequacy primarily reflects an increase in total adjusted capital (TAC) owing to the removal of haircuts to liability adjustments, such as property/casualty (P/C) reserve redundancies, and the full recognition of the contractual service margin (CSM).
- We have also captured the benefits of risk diversification more explicitly in our analysis, which supports capital adequacy.
- The recalibration of our capital charges to higher confidence levels somewhat offsets these improvements.

Credit Highlights

Overview

Key strengths	Key risks
A leading position in the global P/C and life reinsurance markets, with a well-recognized brand name.	Exposure to tail risks, such as natural disasters, leading to potential earnings volatility.
Earnings supported by strong diversification across regions and products to peers, and a strong contribution from the primary insurance business.	
A strong track record of maintaining healthy capital adequacy under regulatory requirements and based on S&P Global Ratings' capital model, backed by well-defined risk-management practices and strong reserve adequacy.	

Outlook

The positive outlook reflects our view that the group will preserve its excellent competitive position and conservative capital management over the next two years through its operating divisions' continuous earnings diversification and improvements, with a return on equity (ROE) above 14% in 2024.

Downside scenario

We could revise the outlook to stable over the next 12-24 months if the group appears likely to perform below our expectations or below higher-rated peers, or if its risk-based capital adequacy declines and remains below the 99.95% confidence level for a prolonged period. This could occur after materially higher investment charges or significant unexpected losses from large natural catastrophes.

Upside scenario

We could raise the ratings by one notch over the next 12-24 months if Munich Re continues to demonstrate a strong operating performance that compares well with higher-rated peers and if it benefits from continued diversification from its various operations.

Rationale

Munich Re will maintain its excellent franchise as one of the leading global reinsurance companies, supported by its solid and conservative financial capabilities. The group has one of the most recognized brands in the global reinsurance sector, offering life and P/C reinsurance products, with an extremely diverse mix of regions and business lines and the capability to lead the coordination of large reinsurance contracts. In addition to its market-leading position in reinsurance, Munich Re has sizable primary insurance operations in Germany, Europe, and Asia, mainly under the ERGO brand, offering P/C, life, and health insurance products.

Munich Re, whose earnings diversification improved significantly in the past couple of years, generated strong and well-diversified earnings in 2023. This was backed by a reported net income of €4.6 billion, an ROE of 16.1%, and a consolidated combined ratio of 86.3%--including the P/C reinsurance unit, ERGO Germany, and ERGO International--based on international financial reporting standard 17 (IFRS 17) and S&P Global Ratings' financial ratio definition. Munich Re's earnings diversification benefited from sound technical performance in all major divisions, namely P/C reinsurance, global specialty, its retail primary insurance arm ERGO, and life reinsurance. ERGO's earnings contribution stabilized in the past few years and is gradually improving. Life reinsurance also improved significantly after a COVID-19-related drop in income in 2020 and 2021. The group therefore benefits from higher diversification and lower dependence on cyclical businesses, such as short-tail P/C reinsurance, compared with most reinsurance peers.

Munich Re is well placed to continue to leverage the favorable market environment for P/C reinsurance, as demonstrated by high growth rates in the past years that exceeded those of most peers. In addition, we believe Munich Re will benefit from a gradual rise in investment income, due to higher reinvestment rates. We think Munich Re is well placed to post a net income of about €4.5 billion-€5.0 billion in 2024, with an ROE above 14% and a consolidated combined ratio of about 84%-86% in 2024. In our base-case scenario, we take into account that about 14 percentage points of the P/C reinsurance business's combined ratio stem from natural catastrophe and manmade large losses, while about 5 percentage points are positive run-off results from loss reserves in the previous year.

In our view, capital management remains conservative. Under the revised criteria, Munich Re's capital adequacy in 2023 improves above the 99.99% confidence level. We believe the group will maintain very strong capital and earnings in 2024 and 2025, with capital adequacy comfortably above the 99.95% confidence level. We also believe the group's sound earnings will enable it to finance its growth and capital repatriation via dividends and share buybacks.

Munich Re's Solvency II ratio remained high at 267% in 2023, comparing well with peers. We anticipate that the group will cope well with current challenges, such as high inflation and capital market volatility, based on its conservative balance sheet and strong reserving. We think Munich Re is exposed to large tail risks, such as natural catastrophes, which could lead to some capital and earnings volatility. However, the group's extremely diversified portfolio, strong risk controls, and cautious reserving practices offset these risks, in our view.

Environmental factors are a moderately negative consideration in our credit rating analysis of Munich Re. The group's exposure to environmental and social risks is consistent with that of the global insurance industry and broadly in line with global reinsurance peers. However, we consider the group's exposure to losses from extreme weather events is a source of potentially material capital and earnings volatility. Nevertheless, Munich Re has built a strong capital buffer to safeguard its business against adverse market developments--including high catastrophe losses, such as those seen in recent years--by diversifying its portfolio across various business lines and regions.

Given Munich Re's strong risk management and modeling capabilities, we think the group is unlikely to experience climate change-related losses that will exceed its risk tolerance.

Ratings Score Snapshot

Financial strength rating	AA-/Positive
Anchor*	aa-
Business risk	Very strong
IICRA	Intermediate

Competitive position	Excellent
Financial risk	Strong
Capital and earnings	Very strong
Risk exposure	Moderately high
Funding structure	Neutral
Modifiers	
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Support	
Group support	0
Government support	0

IICRA--Insurance Industry And Country Risk Assessment. *The anchor reflects the group's position as global market leader in global reinsurance and diverse business operations in the primary market, as well as its very strong reserving.

Related Criteria

- Criteria | Insurance | General: Insurer Risk-Based Capital Adequacy--Methodology And Assumptions, Nov. 15, 2023
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed	
Munich Reinsurance Co.	
New Reinsurance Co. Ltd	
Munich Re of Malta PLC	
Great Lakes Insurance SE	
Issuer Credit Rating	AA-/Positive/--

Ratings Affirmed	
Munich Reinsurance Co.	
Princeton Excess & Surplus Lines Insurance Co.	
New Reinsurance Co. Ltd	
Munich Reinsurance Co. of Canada	
Munich Reinsurance Co. of Australasia Ltd.	
Munich Reinsurance Co. of Africa Ltd.	
Munich Reins America Inc.	
Munich Re of Malta PLC	
Munich Re of Bermuda, Ltd.	
Munich American Reassurance Co.	
Great Lakes Insurance UK Ltd.	
Great Lakes Insurance SE (Australia Branch)	
Great Lakes Insurance SE	
ERGO Versicherung AG	
American Alternative Insurance Corp.	
Financial Strength Rating	
Local Currency	AA-/Positive/--
American Alternative Insurance Corp.	
Princeton Excess & Surplus Lines Insurance Co.	
Munich Reinsurance Co. of Canada	
Munich Reinsurance Co. of Australasia Ltd.	
Munich Reins America Inc.	
Munich American Reassurance Co.	
Great Lakes Insurance UK Ltd.	
Great Lakes Insurance SE (Australia Branch)	
ERGO Versicherung AG	
Issuer Credit Rating	
Local Currency	AA-/Positive/--
ERGO Group AG	
Issuer Credit Rating	
Local Currency	A/Positive/--
Munich Re America Corp.	
Issuer Credit Rating	
Local Currency	A-/Positive/--

Ratings Affirmed	
Munich Re Trading LLC	
Temple Insurance Co.	
Issuer Credit Rating	
Local Currency	A+/Positive/--
Temple Insurance Co.	
Financial Strength Rating	
Local Currency	A+/Positive/--
Munich Reinsurance Co.	
Junior Subordinated	A
Munich Re America Corp.	
Senior Unsecured	A-