Fitch Affirms Munich Re's IFS Rating at 'AA'; Outlook Stable

Fri 24 Apr, 2020 - 04:35 ET

Fitch Ratings - Frankfurt am Main - 24 Apr 2020: Fitch Ratings has affirmed Munich Reinsurance Company’s (Munich Re) Insurer Financial Strength (IFS) Rating at 'AA' (Very Strong) and Long-Term Issuer Default Rating (IDR) at 'AA-'. Fitch has also affirmed the ratings of Munich Re's core operating subsidiaries. The Outlooks are Stable.

KEY RATING DRIVERS

The affirmations are based on Fitch's current assessment of the impact of the coronavirus pandemic, including its economic impact, under a set of ratings assumptions described below. These assumptions were used by Fitch to develop pro-forma financial metrics for Munich Re that Fitch
compared with both ratings guidelines defined in its criteria, and relative
to previously established Rating Sensitivities for Munich Re.

Fitch considers Munich Re's capitalisation and leverage very strong, as
measured by Fitch's Prism Factor-Based Capital Model (Prism FBM).
Prism FBM remained 'Very Strong' based both on reported numbers as of
end-2019 and pro-forma numbers (2018 'Very Strong'). Fitch does not
expect a material weakening of Munich Re's capital strength in the
medium term, assuming a normal level of catastrophe losses.

Financial leverage deteriorated to 18% in 2019 (2018: 15%), which
nevertheless remains low in absolute terms and compared with peers. The
pro-forma financial leverage ratio amounts to 22%, which remains
supportive of Munich Re's ratings.

Munich Re reported a strong set of results for 2019, with a net income
return on equity (ROE) of 9.2% (2018: 8.4%) and a combined ratio of 101%
(2018: 99%) for the property & casualty (P&C) reinsurance segment.
Adjusting for reserve variations and major losses, the underlying
combined ratio improved slightly to 99% (2018: 100%).

Based on our pro-forma assumptions, the ROE drops to 5% and the
underlying combined ratio remains at 99%, partially breaching previously
established Rating Sensitivities. Munich Re is exposed to the pandemic in
particular through its mortality book and event cancellation and business
interruption policies. However, Fitch considers pandemic-related losses to
be one-off in nature and expects an improvement in Munich Re's ROE to
above 6% over the next 12-18 months thanks to rising demand and
improved pricing for reinsurance covers.

Fitch views Munich Re's investment and asset risk as low, due to its
prudent investment strategy and strong liquidity. This has a lower
influence in determining Munich Re's overall ratings. The risky assets ratio
based on reported 2019 numbers was almost unchanged at 75% (2018:
74%) and amounts to 79% on a pro-forma basis. Fitch does not expect any
significant changes in Munich Re's investment and asset risk.
Fitch views Munich Re's asset/liability management risk as low, due to its very strong liquidity and sophisticated asset/liability matching. This has a moderate influence in determining Munich Re's overall ratings. At end-2019, the duration of assets and liabilities at group level were fairly closely matched, with asset duration of 8.4 years and liabilities of 9.0 years.

Assumptions for Coronavirus Impact (Rating Case):

Fitch used the following key assumptions, which are designed to identify areas of vulnerability, in support of the pro-forma ratings analysis discussed above:

--Decline in key stock market indices by 35% relative to 1 January 2020.

--Increase in two-year cumulative high yield bond default rate to 14%, applied to current non-investment grade assets, as well as 12% of 'BBB' assets.

--Both upward and downward pressure on interest rates, with spreads widening (including high yield by 400bp) coupled with notable declines in government rates.

--A COVID-19 infection rate of 5% and a mortality rate (as a percentage of infected) of 1%.

--For the non-life and reinsurance sectors, a negative impact on the industry-level accident year loss ratio from COVID-19-related claims at 3.5pp, partially offset by a favourable impact from the auto line averaging 1.5pp.

**RATING SENSITIVITIES**

The ratings remain sensitive to any material change in Fitch's Rating Case assumptions with respect to the coronavirus pandemic. Periodic updates
to our assumptions are possible given the rapid pace of changes in government actions in response to the pandemic, and the pace with which new information is available on the medical aspects of the outbreak. A discussion of how ratings would be expected to be impacted under a set of Stress Case assumptions is included at the end of this section to help frame sensitivities to a severe downside scenario.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A material adverse change in Fitch's ratings assumptions with respect to the coronavirus impact.

--A sustained material drop in the group's risk-adjusted capital position to below 'Very Strong', as measured by Prism FBM.

--A sustained drop in the group's net income return on equity below 6%.

--A sustained increase in the group's financial leverage ratio to above 25%.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A material positive change in Fitch's ratings assumptions with respect to the coronavirus impact.

--Positive rating action would be prefaced by Fitch's ability to reliably forecast the impact of the coronavirus pandemic on the financial profile of both the reinsurance industry and Munich Re.

--A sustained improvement in the group's capitalisation to 'Extremely Strong' as measured by Prism FBM as well as a sustained improvement in the group's net income return on equity to above 12%.

Stress Case Sensitivity Analysis
--Fitch's Stress Case assumes a 60% stock market decline, two-year cumulative high yield bond default rate of 22%, high yield bond spreads widening by 600bp and more prolonged declines in government rates, heightened pressure on capital markets access, a COVID-19 infection rate of 15% and mortality rate of 0.75%, and an adverse non-life industry-level loss ratio impact of 7pp for COVID-19 claims partially offset by a favorable 2pp for auto.

--The implied rating impact under the Stress Case would be a downgrade of no more than one notch.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.
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RATING ACTIONS

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APPLICABLE CRITERIA
Insurance Rating Criteria (pub. 02 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS
Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Prism Factor-Based Capital Model, v1.7.1 (1)

ADDITIONAL DISCLOSURES
Dodd-Frank Rating Information Disclosure Form  
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Endorsement Policy
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