Rating Action: Moody's affirms Munich Re's Aa3 IFS rating; subordinated debt at A2(hyb); outlook stable

06 Dec 2018

London, 06 December 2018 -- Moody's Investors Service ("Moody's") has today affirmed the Aa3 insurance financial strength (IFS) ratings of Munich Reinsurance Company (Munich Re) and Munich Reinsurance America, Inc., along with the group's associated debt ratings. The outlook remains stable.

A list of all ratings affected by this rating action is available at the end of this press release.

RATINGS RATIONALE

The rating affirmation reflects Munich Re's excellent business franchise and very strong market position in global reinsurance, its broad diversification across geographies and business lines, strong capital adequacy and moderate asset risk, together with relatively conservative reserving practices. These strengths are partially offset by pressure on profitability due to challenging reinsurance pricing trends, along with the low interest rate environment, and the inherent volatility of the group's catastrophe exposed business. In addition, while the group has made very good progress in repositioning ERGO, there is still some uncertainty and execution risk associated with the ongoing restructuring of that business, which commenced in 2016.

As the largest global reinsurer, Munich Re benefits from its extensive geographic and product diversification and leading reputation for technical expertise and customer service. This franchise strength serves the group well as it navigates the current soft reinsurance cycle by enabling Munich Re to access business that is not always accessible to mid-market reinsurers, generally via large structured transactions which benefit from differentiated terms and/or pricing. Munich Re is at the forefront of innovation and product development, as for example shown by its leading position in cyber insurance, where the group holds a 10% share of this still nascent market, which carries both opportunities and risks.

The group is very well diversified by geography and business line, with leading positions in life and health (re)insurance, as well as in property and casualty (P&C) reinsurance which represented 36% of 2017 gross written premiums, followed by ERGO at 36%, and Life and Health reinsurance at 28%. ERGO is the group's primary insurance operation, which offers life, health and P&C insurance, predominately in Germany, with smaller operations in a number of other countries.

The group's gross written premiums are spread across North America (33%), Europe (52%) and Asia. Latin America and the rest of the world (15%). Strong diversification amongst less correlated business lines and geographic regions provides some protection against cyclical effects, including the P&C (re)insurance pricing cycle. This was highlighted during 2017, when the group remained profitable despite incurring heavy natural catastrophe losses during the highest insured-loss year on record, as well an active catastrophe year thus far in 2018.

Moody's considers Munich Re's profitability to be solid with an average return on capital of 6.2% over the past five years through 2017, although it has been volatile at times given its meaningful cat-exposed property portfolio. Despite the group's excellent franchise, it has not been fully insulated from the impact of softening reinsurance prices, with the group's reported return on equity declining to 9.9% (annualized) for the first nine months of 2018 and 1.3% for 2017, from 12.5% for 2013, largely driven by deterioration in underwriting profitability and lower investment income. That said, improving profitability at ERGO, which reported profits EUR359 million for the first nine months of 2018 (9M2017: EUR224 million), is becoming a more important component of overall group profitability. The group's profitability targets include net income of EUR 2.8 billion by 2020, including EUR 500 million contributed by ERGO.

Capital adequacy is strong, with solid levels of regulatory and economic capital, and moderate modelled natural catastrophe exposures compared to its reinsurance peers. While regulatory capital, as measured by the group's Solvency II ratio, is robust at a level of approximately 260% as at Q3 2018 (244% as at year-end 2017), it is somewhat sensitive to movements in financial markets and interest rates, in part due to the group's significant asset exposure in its ERGO primary life insurance business. For example, as at year-end 2017, the group's Solvency II coverage ratio shows significant sensitivity (decrease by 27% points) in the event of a

100bps widening in government credit spreads or (decrease by 19% points) in the event of a 50bps decrease in interest rates. This in part reflects the group's significant asset exposure in its ERGO primary life insurance business and also the group's decision not to use the volatility adjustment mechanism. The group benefits from a very high quality capital base, with approximately 90% of its eligible own funds being classified as Tier 1 capital.

MUNICH RE AMERICA

Moody's A2 senior unsecured debt rating on Munich Re America Corporation (MRAC) and the Aa3 IFS rating on MRAC's principal operating subsidiary reflect their strategic importance to Munich Re, strong implicit and explicit support from Munich Re, strong franchise in the direct and broker reinsurance market, well diversified product lines, and a high quality investment portfolio. These strengths are somewhat tempered by the company's earnings volatility from property catastrophe reinsurance exposures as well as the cyclical nature and price competitiveness of the reinsurance industry.

MRAC benefits from various forms of group support, including a loss portfolio transfer agreement, an adverse development cover stop loss agreements as well as excess of loss agreements covering catastrophe risks and certain other exposures. US P&C operations (including HSB and AMIG) accounted for about 34% of Munich Re's consolidated gross non-life reinsurance premiums written in 2017.

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WHAT COULD MOVE THE RATINGS UP/DOWN

Moody's said that the ratings could be upgraded in case of: (i) sustained strong core earnings with adjusted return on capital above 10% over the underwriting cycle, while maintaining low volatility in profitability, and/or (ii) financial and total leverage consistently below 20%, together with earnings coverage over 10x through the cycle, and/or (iii) material improvement in the business environment, including P&C reinsurance pricing and interest rates.

Moody's said that Munich Re's ratings could be downgraded in case of (i) return on capital of below 6% over the underwriting cycle, or a sharp increase in volatility of the returns, and/or (ii) financial leverage consistently above 25% and earnings coverage consistently below 6x, and/or (iii) material deterioration in the group's risk profile, for example following rapid growth in volatile or risky business, and/or (iv) meaningful and sustained adverse reserve development, and/or (v) reduction in shareholders' equity of more than 10% over a 12 month period due to catastrophe losses or poor operating results.

Munich Re is the largest global reinsurance group by gross premiums written. It reported gross premiums written of €49 billion in 2017 and shareholders' equity of €27 billion as of 30 September 2018.

The following ratings have been affirmed:

Issuer: Munich Reinsurance Company

Insurance Financial Strength (IFS) rating, affirmed at Aa3

Subordinated debt rating, affirmed at A2(hyb)

..Outlook Action:

The outlook remains stable

Issuer: Munich Reinsurance America Inc.

Insurance Financial Strength (IFS) rating, affirmed at Aa3

..Outlook Action:

The outlook remains stable

Issuer: Munich Re America Corporation

Senior unsecured debt rating, affirmed at A2

..Outlook Action:

The outlook remains stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Reinsurers published in May 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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