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Ratings

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Gothaer Group

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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	
Moderately 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

- Predominantly domestic German multiline insurance group with a small presence in Poland and Romania.
- Strong competitive position stemming from a well-diversified product portfolio and distribution channel diversity.
- Profit-oriented strategy with a business mix that is actively steered toward more profitable products.
- Profitability challenged by low interest rates as well as strong competition in the non-life commercial lines.

Financial Risk Profile: Moderately Strong

- Sound retained earnings and a moderate increase in capital requirements warrant a strong capital and earnings assessment.
- Moderate risk position mainly stemming from still somewhat higher credit risk compared with some peers' and life asset-liability mismatch (ALM) risk, although improving.
- Leverage and coverage ratios overstated in 2015 as a result of a one-year debt overlap.

Other Factors

- Enterprise risk management (ERM) capabilities enable the group to continue optimizing capital allocation and earnings, enhancing its risk-return profile and mitigating its investment risks.
- Value-oriented management approach.

Outlook: Stable

The stable outlook reflects S&P Global Ratings' expectation that German multiline insurer Gothaer Group (Gothaer) will continue to focus on a profit-oriented strategy to be able to cope with the low interest rates and the strong competition in the German insurance market. We also expect that the group's capital and earnings will remain at least strong over 2016-2018.

Downside scenario

We could lower the rating if the group underperforms relative to its peers and our capital and earnings benchmarks or if heightened concerns from its investment exposures emerge.

Upside scenario

We could raise the rating if Gothaer consistently demonstrates capital adequacy that is at least very strong and at the same time materially improves its risk position, which could follow if Gothaer further reduced risk in its investment portfolio in terms of credit risk, or if it reduced interest rate sensitivity risks in the life in-force book.

Base-Case Scenario

Macroeconomic Assumptions

- German 10-year government bond yields declining to 0.1% in 2016 but recovering to 0.5% in 2017 and 0.9% in 2018.
- Real German GDP growth of 1.8% in 2016 declining to 1.4% in 2018.
- A small decline in Germany's unemployment rate to 4.4% in 2018 from 4.6% in 2015.

Company-Specific Assumptions

- Premium decline of about 3% in 2016 and a modest premium increase of about 1%-3% in 2017–2018, mainly due to property-casualty (P/C) premiums.
- At least strong capital adequacy.
- Prudent investment strategy after a decrease of investment risks over recent years. Slight increase of illiquid investments.
- Net income of approximately €100 million-€120 million in 2016-2018.
- Reported combined ratios of about 96%-99% in 2016-2018.
- Life earnings remaining under pressure due to prevailing low yields and additional reserving requirements.
- Increasing supplementary health not fully offsetting reducing full health cover.
- Financial leverage below 20% and fixed charge coverage of about 10x.

Key Metrics

Table 1

Gothaer Group -- Key Metrics	2017F	2016F	2015	2014	2013
Gross premiums written (mil. €)	4,400-4,500	4,300-4,400	4,517	4,511	4,301
Net income (mil. €)	100-120	100-120	136.8	113.8	104.4
Return on shareholders' equity (reported) (%)	~ 6	~ 6	7.4	6.7	6.9
Non-life: Net combined ratio (%)	96-99	96-99	97.6	99.5	101.4
Net investment yield (%)	>3.3	>3.3	3.7	3.5	4.1
S&P capital adequacy	Very Strong	Very Strong	Extremely Strong	Very Strong	Strong
Fixed-charge coverage (x)	~10	~10	11.5	7.0	8.3
Financial leverage (%)	<20	<20	22.3	19.1	15.9

F--S&P Global Ratings forecast.

Company Description: A Midsize Player With Mutual Roots

Gothaer is a midsize mutual insurer in the German primary insurance market with total consolidated gross premiums written (GPW) of €4.5 billion in 2015. Since the merger of Asstel Leben into Gothaer Leben at the start of 2014, the group has been operating mainly through two brands in Germany:

- The traditional Gothaer brand (more than 90% of group's GPW); and
- Janitos Versicherung AG (Janitos) for operating non-life broker-linked business (about 3%).

The direct insurer Asstel Sach, which will be merged into Gothaer Allgemeine in 2017, complements the companies within Gothaer Group in the domestic market.

In Poland, the group gained full ownership of the small non-life insurer Polskie Towarzystow Ubezpieczen, whose integration into the group was completed in 2012 with the rebranding to Gothaer Towarzystwo Ubezpieczen S.A. In Romania, Gothaer holds the majority of non-life insurer Platinum, which was renamed S.C. Gothaer Asigurari Reasigurari S.A. in 2013.

The operating insurance companies are owned by Gothaer Finanzholding AG (not rated). The group's ultimate mutual parent is Gothaer Versicherungsbank VVaG (not rated).

Business Risk Profile: Strong

We regard Gothaer's business risk profile as strong, operating mainly in the German insurance market. The group's strong competitive position is built on a diverse product and distribution portfolio, striving for profitable business generation.

Insurance industry and country risk: Exposed to heightened industry risk in life and health, partly offset by more beneficial P/C business

Gothaer faces intermediate industry and country risk, in our view. Our assessment is based on the group's exposures to the German life, health, and P/C sector. All three sectors benefit from very low country risk, thanks predominantly to Germany's strongly performing economy. However, we consider that industry risks vary between insurance sectors. We recognize heightened industry risk for life insurers because of high ALM risks and significant pressure on earnings due to the prevailing low-yield environment. Low yields also pressure earnings of P/C and health insurers but not to the same extent as for life insurers. For health insurers, however, we think the sector's dependence on decisions by policymakers results in heightened product risk. Relative to life and health, P/C insurers benefit from stronger earnings and lower product risk. All three sectors are mature and highly competitive, offering limited growth prospects. The group has also some P/C business in Poland and Romania, but it has only a negligible impact on Gothaer's industry and country risk profile, in our view. We do not expect material shifts in Gothaer's insurance sector mix over 2016-2018.

Table 2

Gothaer Group -- Industry And Country Risk		
Insurance sector	**IICRA**	**Business mix (%)**
Germany P&C	Low Risk	43
Germany Life	Intermediate Risk	32
Germany Health	Intermediate Risk	21
Poland P&C	Moderate Risk	3
Romania P&C	High Risk	1
Weighted average IICRA	Intermediate Risk	100

Competitive position: Strong, thanks to a well-diversified portfolio

Gothaer has a strong competitive position, in our view, mainly thanks to its product and distribution channel diversity. It offers life insurance (about 32% of group premiums), P/C insurance (47%), health insurance (21%), and has broad product offerings in these segments.

The group actively steers its business mix toward more-profitable products. For example, it shifted its P/C business away from the cyclical motor business, which is exposed to intense price competition. However, the group is also active in the small and midsize commercial business where competition is high and the performance in some business lines is under pressure. Gothaer is actively undertaking measures to promote cross-selling, which we consider to be vital in a saturated market. The group has maintained strong market positions in the engineering industry, liability business, and alternative-energy industries, gaining expertise in these selective business lines.

In life, Gothaer's premium volume decreased by 6% in 2015, mainly due to a decrease in traditional life policies. However, the group was able to increase volumes in its target segments, which are biometric and less interest-sensitive products. We believe that Gothaer will further decrease premiums in the traditional life business, continuing to switch from traditional capital-intensive products with guarantees toward unit-linked and biometric products, which will help it cope with low interest rates.

In health, the group increasingly focuses on supplementary health care instead of comprehensive health care, which is more exposed to political intervention. GPW increased by 4.0% year on year in 2015. The premium increase is mainly due to premium adjustments in comprehensive health care insurance. In view of the challenging political environment in Germany, we consider that Gothaer's success in supplementary cover is positive. Moreover, the group has been successful in expanding its group health business through partnerships with statutory health insurers, which is adding diversity to Gothaer's health portfolio. Overall, we believe that premium volumes will remain under pressure in the health segment for 2016, with further reduction in the comprehensive health business, largely offset by strong development in the supplementary and group health sector.

Gothaer also benefits from having access to its preferred customer segment through a blend of tied agents, brokers, and direct insurance. Janitos' broker-focused non-life operations provide additional diversity. We think this diverse distribution mix provides management with the flexibility to adapt to changing market fundamentals.

We regard the group's small-scale acquisitions in Poland and Romania as neutral to the ratings at this stage, but they may add to the group's growth and diversity in the longer term.

In view of Gothaer's profit-oriented strategy and the competitive and demanding markets it operates in, our base-case forecast is for group premiums to decline in 2016 by about 3% and moderately increase by 1%-3% in 2017-2018.

Table 3

Gothaer Group -- Competitive Position					
	--Year ended Dec. 31--				
(Mil. EUR)	**2015**	**2014**	**2013**	**2012**	**2011**
Gross premiums written	4,517	4,511	4,301	4,181	4,050
Change in gross premiums written (%)	0.1	4.9	2.9	3.2	1.2
Net premiums written	4,074	4,110	3,925	3,823	3,688
Change in net premiums written (%)	(0.9)	4.7	2.7	3.7	0.9
Total assets under management	30,136	29,659	27,237	26,198	24,186
Growth in assets under management (%)	1.6	8.9	4.0	8.3	(1.1)
Reinsurance utilization (%)	9.8	8.9	8.7	8.6	8.9
Business Segment (% of GPW)					
Life/health	52.4	53.8	55.8	57.1	57.0
Non-life	47.6	46.2	44.2	42.9	43.0

Financial Risk Profile: Moderately Strong

We regard Gothaer's financial risk profile as moderately strong, particularly reflecting our view of the group's moderate risk position due to higher credit risk compared with peers and heightened ALM risk in the life back book.

Capital and earnings: Strong, but vulnerable to high interest-rate sensitivity of life insurance business

We consider Gothaer's capital position to be strong and expect this will continue over the next few years, despite pressure from low interest rates and the group's somewhat higher credit risk exposure compared with some peers. This is largely because of our view that Gothaer will be able to further build capital at least commensurate with the 'A' capital adequacy level through stable profits. We expect policyholder bonus reserves will slightly decrease due to maturing life contracts and a lower amount of allocation. Our view is based on the assumption that the group will not further increase its risks in the investment portfolio. We include in our 2015 capital assessment a hybrid of €440 million, €190 million of which was repaid in 2016. In October 2015, Gothaer issued a second hybrid bond amounting to €250 million to refinance the one that was repaid.

Quality of capital is good, in our view. Core shareholders' funds accounted for 29% of the group's total adjusted capital in 2015 and 50% of policyholders' capital.

The regulatory solvency ratio based on Solvency I figures declined slightly to 194% in 2015 following 196% in 2014. The change is driven by a higher increase in capital requirements to €1.08 billion (2014: €1.04 billion) in relation to the increase in own funds to €2.08 billion (2014: €2.04 billion). For 2016, we expect the group to report Solvency II figures that are comfortably above the regulatory solvency requirements.

Table 4

Gothaer Group -- Capitalization						
	--Year ended Dec. 31--					
(Mil. EUR)	**2015**	**2014**	**2013**	**2012**	**2011**	**2010**
Common equity	1,883	1,812	1,572	1,463	1,184	1,223
Change in common equity (%)	4.0	15.2	7.5	23.5	(3.2)	11.2
Total capital (reported)	2,564	2,318	2,037	1,927	1,696	1,710
Change in total capital (reported) (%)	10.6	13.8	5.7	13.7	(0.8)	7.8
Total reported capital	2,564	2,318	2,037	1,927	1,696	1,710
Total shareholders' equity	1,883	1,812	1,572	1,463	1,184	1,223
Total debt as reported	681	507	465	465	512	487

We assume net income to be approximately €100 million–€120 million in 2016–2018 (compared with €137 million in 2015). We anticipate that earnings from non-life insurance will be fueled by combined (loss and expense) ratios of about 96%-99% (barring extraordinary natural catastrophe claims). This mainly reflects the group's focus on underwriting profitable lines of business and reducing its activities in the highly competitive German motor market. However, the competition in the midsize commercial business is high and might offset some positive developments from the retail business. Although still above market average, the overall sound expense ratio reflects the group's cost-reduction initiatives. We expect Gothaer's non-life business will remain the key earnings contributor, with sound underwriting performance.

We expect that earnings in life insurance, in particular investment income and new business margins, will remain under pressure, given the prevailing low yields and additional reserving requirements in the German life insurance market. Underwriting performance in the life business remained nearly stable in 2015, benefiting from higher risk and more balanced cost results. We expect the life segment's gross surplus will continue to benefit from the mortality/morbidity surplus, which will likely stay stable at about 0.8% of the actuarial reserves. This, in our view, is thanks to the group's focus on selling unit-linked and biometrical risk products. However, because of the higher exposure of the back book to traditional German life business with high guarantees, additional reserving requirements weigh on Gothaer's gross surplus. In our view, these factors underpin Gothaer's medium vulnerability to a prolonged period of low interest rates.

Due to Gothaer's focus on supplementary health business, we expect the company will report technical results in line with previous years. Technical results well exceeded the market average in previous years, which should support future premium stability, in our view.

Table 5

Gothaer Group -- Earnings					
	--Year ended Dec. 31--				
(Mil. EUR)	**2015**	**2014**	**2013**	**2012**	**2011**
Total revenues	4,963	4,802	4,736	4,541	4,429
EBIT adjusted	87	(18)	24	2	222
Net income	137	114	104	107	85
Return on shareholders' equity (reported) (%)	7.4	6.7	6.9	8.1	7.1
Non-life: Net expense ratio (%)	30.9	30.2	31.5	29.9	29.4
Non-life: Net loss ratio (%)	66.5	69.2	69.7	66.5	68.9
Non-life: Net combined ratio (%)	97.6	99.5	101.4	96.6	98.4
Non-life: Return on Revenue (%)	1.2	0.5	(1.6)	(3.2)	(1.5)
Life: Net expense ratio (%)	11.8	11.6	11.9	11.5	12.3
Operating earnings by segment					
Life & Health	84	88	64	87	42
Non-life	143	99	38	88	141
Other	0	0	0	0	0

Risk position: Moderate, due to high credit risk

In our view, Gothaer's risk position reflects moderate risks stemming from a diversified investment portfolio in which higher credit and life ALM risks are partly offset by relatively low underwriting risks. About 64% of the portfolio comprises fixed-income securities that have a rating of 'A-' or higher. However, about 36% of this bond portfolio is invested in bonds rated 'BBB+' or lower; therefore, Gothaer's exposure to credit risk is somewhat higher than that of peers. In addition, Gothaer's above-market-average duration mismatch poses higher ALM risks than some peers'. The group has taken some actions during 2014 and in 2016 year-to-date to reduce its exposure to high-risk assets, such as selling its structured bonds and hedge bonds portfolio. Additionally, the group managed to reduce its ALM mismatch by strongly increasing the duration of its assets. However, the portfolio is concentrated, to a degree, in the financial services sector through investments in bonds and equity stakes. Equity exposure remains low, accounting for only 0.3% of the portfolio.

Table 6

Gothaer Group -- Risk Position						
	--Year ended Dec. 31--					
(Mil. EUR)	**2015**	**2014**	**2013**	**2012**	**2011**	**2010**
Total invested assets	30,136	29,659	27,237	26,198	24,186	24,450
Net investment income	1,026	940	1,024	915	962	851
Net investment yield (%)	3.7	3.5	4.1	3.8	4.2	3.7
Net investment yield including realized capital gains/(losses) (%)	4.5	4.0	5.2	4.9	4.8	3.9
Net investment yield including all gains/(losses) (%)	4.3	4.1	4.6	4.9	3.9	3.6

Table 6

Gothaer Group -- Risk Position (cont.)						
	--Year ended Dec. 31--					
(Mil. EUR)	**2015**	**2014**	**2013**	**2012**	**2011**	**2010**
Investment portfolio composition (%)						
Cash and short-term investments	3.2	2.0	5.6	4.1	3.9	5.0
Bonds	82.8	85.4	79.3	80.7	80.2	77.2
Equity investments	3.5	2.9	5.4	5.2	5.8	6.9
Real estate	1.4	0.5	0.3	0.3	0.4	0.4
Mortgages	0.7	0.8	1.0	1.2	1.4	1.6
Loans	0.4	0.4	0.9	0.9	0.6	0.6
Investments in affiliates	8.0	7.9	7.4	7.5	7.6	8.2
Other investments	0.1	0.1	0.1	0.1	0.1	0.1

Financial flexibility: Adequate, supported by favorable leverage and coverage

Gothaer has adequate financial flexibility, in our view. Its financial leverage (debt plus hybrids to economic capital available) was slightly above 20% in 2015, driven by the two outstanding hybrids, but should fall below 20% after the hybrid call in 2016. We assume that financial leverage will decline in 2016 as a consequence of the lower interest burden, and remain in line with our expectations in 2017-2018. In line with our earnings expectation, we expect fixed-charge coverage will be higher than 9x. Although we recognize that, as a mutual, Gothaer has a track record of issuing member bonds to policyholders that receive regulatory capital credit, we consider that the depth of its access to capital and liquidity may be less substantive in times of stress than for listed insurers or groups that are more regular participants in financial debt markets.

Table 7

Gothaer Group -- Financial Flexibility						
	--Year ended Dec. 31--					
(x)	**2015**	**2014**	**2013**	**2012**	**2011**	**2010**
Fixed-charge coverage	11.5	7.0	8.3	11.3	8.1	6.7
Financial leverage (%)	22.3	19.1	15.9	15.5	17.7	17.8

Other Assessments

We consider Gothaer to have satisfactory management and governance, and we assess Gothaer's enterprise risk management (ERM) as adequate with strong risk controls. We consider these to be neutral rating factors. Liquidity is exceptional.

Enterprise risk management: Adequate with strong risk controls

We view Gothaer's ERM program as adequate with strong risk controls. The overall assessment is supported by our positive assessments for risk management culture and risk controls for most of the group's risks.

Gothaer's risk management culture is positive, in our view, and the group's top management is highly committed to supporting it.

We assess overall risk controls as positive, influenced by our positive assessment for investment risks as well as credit and non-life underwriting risk. Market risk controls are based on an internal stochastic capital market analysis and consistent stress testing for all entities of the group. Our assessment of credit risk controls is also positive and based on the group's internal comprehensive credit analysis process. We view interest rate risk controls as neutral. Although Gothaer reduced its duration mismatch by progressively increasing the duration on the asset side and lowering exposure to guarantees, the current mismatch is still somewhat higher than that of its peers.

We view strategic risk management as neutral. Gothaer is enhancing its ability to measure risk on a consistent basis group-wide and is building a risk capacity framework to holistically perform risk return analyses.

We view the importance of ERM to the rating as high, considering the diversified nature of Gothaer's operations and the exposure to long-term and guaranteed life business.

Management and governance: Strong commitment to value-based management

We view Gothaer's value-oriented management and corporate strategy as strengths to the ratings. The large changes to the management team in 2014 have not had a bearing on developments in the group's strategy so far, in our view. The current strategy is clearly aligned with the group's financial resources. Furthermore, management has continuously demonstrated successful execution in taking up market opportunities. In our view, management still faces the challenge of improving Gothaer's financial profile in a low-yield environment and pursuing sustained profitable growth in a difficult operating environment.

We observe that, in light of the ongoing fierce competition in commodity-type products, the group is strengthening its position in the midsize commercial business and selected non-life business niches. We understand that the group is aiming to selectively expand in these markets, where competition has increased strongly as a result of higher insurance capacity, especially in the commercial business. We also note Gothaer's new business focus on risk, unit-linked, and corporate pension business, which is gradually improving its risk profile.

Management's risk appetite and risk tolerance framework are appropriately aligned with its risk-bearing capacity at the group and entity level. Risk tolerance levels take into account the group's capital requirements resulting from internal economic models, as well as regulatory and rating considerations. They also reflect the group's earnings targets, liquidity requirements, and debt-usage restrictions.

We have not identified any governance deficiencies in our assessment.

Liquidity: Exceptional

We regard Gothaer's liquidity as exceptional, owing to the strength of available liquidity sources, mainly premium income, and an asset portfolio that is more than 85% liquid assets.

Accounting Considerations

Gothaer uses International Financial Reporting Standards (IFRS) for group reporting. In addition, it continues to report the results of its operating insurance companies under German generally accepted accounting principles (GAAP) for compliance, tax, and bonus policy purposes. Our analysis focuses primarily on the group's IFRS results, but may include German GAAP results.

Gothaer prepares traditional embedded value calculations for its life portfolio. In calculating the group's capital base, we recognize the value in force (VIF) on the group's life portfolio, off-balance-sheet unrealized gains other than life bonds, 67% of the non-life loss reserve discount not included in the balance sheet, and parts of life and health policyholder capital.

Ratings Detail (As Of November 10, 2016)	
Operating Companies Covered By This Report	
Gothaer Allgemeine Versicherung AG	
Financial Strength Rating	
Local Currency	A-/Stable/--
Counterparty Credit Rating	
Local Currency	A-/Stable/--
Junior Subordinated	BBB
Gothaer Krankenversicherung AG	
Financial Strength Rating	
Local Currency	A-/Stable/--
Issuer Credit Rating	
Local Currency	A-/Stable/--
Gothaer Lebensversicherung 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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