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Ratings

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Gothaer Group

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Gothaer Group

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.
- Well diversified product portfolio and distribution channel diversity.
- Profit oriented strategy with a business mix that is actively steered toward more profitable products.
- Private line non-life underwriting performance is strong, commercial lines are facing challenging market conditions.

Financial Risk Profile: Moderately Strong

- Sound bottom-line earnings and reduced asset risk exposure warrant a strong capital and earnings assessment.
- Higher life asset-liability mismatch risk compared with peers', although improving.
- Favorable leverage and coverage.

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 the management of German multiline insurer Gothaer Group will continue to pursue a profit oriented strategy and that the group's capital and earnings will remain strong over 2017-2019.

Downside scenario

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

Upside scenario

We could raise the rating over the next two years if Gothaer strengthens its capital adequacy to at least very strong levels and if the group's risk position materially improves. This could happen if Gothaer further reduces risk in its investment portfolio in terms of credit risk, and if it reduces asset liability mismatch (ALM) risks in the life in-force book.

Base-Case Scenario

Macroeconomic Assumptions

- German 10-year government bond yields increasing to 0.4% in 2017, followed by 0.8% in 2018 and 1.1% in 2019.
- Real German GDP growth of slightly below 2% annually until 2019.
- A decline in Germany's unemployment rate to 3.3% in 2019 from 4.2% in 2016.

Company-Specific Assumptions

- Modest premium increase of about 0.9% in 2017 and a modest premiums increase of about 1%-3% in 2018–2019, mainly due to property/casualty (P/C) premiums.
- At least strong capital adequacy.
- Prudent investment strategy after a decrease of investment risks since 2014.
- Net income of approximately €120 million-€140 million in 2018-2019. In 2017, we expect an extraordinary result of approximately €180 million.
- Reported combined (loss and expense) ratios of about 95%-97% in 2017-2019.
- 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 above 8x.

Key Metrics

Table 1

Gothaer Group -- Key Metrics	2018F	2017F	2016	2015	2014
Gross premiums written (mill. €)	4500-4600	4400-4500	4,411	4,517	4,511
Net income (mill. €)	120-140	~180	164	141	114
Return on shareholders' equity (reported) (%)	>8	>8	8.3	7.6	6.7
Non-life: Net combined ratio (%)	95-97	96-97	97.3	97.4	99.5
Net investment yield (%)	>3	>3	3.1	3.7	3.5
S&P capital adequacy	Strong	Very Strong	Extremely Strong	Extremely Strong	Very Strong
Fixed-charge coverage (x)	>8	>10	10.2	11.7	7.0
Financial leverage (%)	~18	~18	15.5	22.3	19.1

Company Description: A Midsize Player Ultimately Owned By Gothaer Versicherungsbank VVaG

Gothaer is a mutual insurer in the German primary insurance market with total consolidated gross premiums written (GPW) of €4.4 billion in 2016. Since the recent merger of direct insurer Asstel Sach into Gothaer Allgemeine, the group now operates through two brands in Germany:

- The traditional Gothaer brand (more than 95% of group's GPW); and
- Janitos Versicherung AG, operating non-life broker-linked business (about 3%).

In Poland, the group gained full ownership of the small non-life insurer Gothaer Towarzystwo Ubezpieczen S.A. In Romania, Gothaer holds the majority of non-life insurer S.C. Gothaer Asigurari Reasigurari S.A.

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

Gothaer's business risk profile is based on the group's sound competitive position in the German insurance market, which is built on a diverse product and distribution portfolio, striving for profitable business generation.

Insurance industry and country risk: 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 strong 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-interest rate environment. 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 also has some P/C business in Poland and Romania, but this has a negligible effect on Gothaer's industry and country risk profile, in our view. We do not expect material shifts in Gothaer's insurance sector mix over 2017-2019.

Table 2

Gothaer Group -- Industry And Country Risk

Insurance sector	IICRA	Business mix (%)
Germany Health	Intermediate Risk	20.6
Germany Life	Intermediate Risk	30.7
Germany P/C	Low Risk	44.0
Poland P/C	Moderate Risk	4.1
Romania P/C	High Risk	0.6
Weighted average IICRA	Intermediate Risk	100

P/C--Property/casualty.

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

Our view of Gothaer's competitive position mainly reflects its product and distribution channel diversity. It offers life insurance (about 31% of group premiums), P/C insurance (49%), health insurance (20%), 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 5.5% in 2016 mainly due to a decrease in traditional life policies. The group increased 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 over the longer term.

In health, the group increasingly focuses on supplementary health care instead of comprehensive health care, which was more exposed to uncertainty about political intervention in the past. Based on 2016 figures, GPW decreased by 3%. This is mainly due to lower-than-expected premium adjustments and ongoing erosion in the comprehensive health care insurance sector, a common issue in the German health insurance market. We therefore view positively Gothaer's success in supplementary cover. Moreover, the group has been successfully expanding in group health business through partnerships with statutory health insurers, which is adding diversity in Gothaer's health portfolio. Overall, we believe that premium volumes will remain under pressure in the health segment for 2017, with further reduction in the comprehensive health business, largely offset by a strong development in the supplementary and group health sector.

Gothaer also benefits from 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.

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 marginally increase in 2017 by about 1% and moderately increase by 1%-3% in 2016-2018, mainly driven by the non-life business.

Table 3

Gothaer Group -- Competitive Position					
	--Year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Gross premiums written (GPW)	4,411	4,517	4,511	4,301	4,181
Change in gross premiums written (%)	(2.3)	0.1	4.9	2.9	3.2
Net premiums written	4,027	4,074	4,110	3,925	3,823
Change in net premiums written (%)	(1.2)	(0.9)	4.7	2.7	3.7
Total assets under management	31,061	30,136	29,659	27,237	26,198
Growth in assets under management (%)	3.1	1.6	8.9	4.0	8.3
Reinsurance utilization (%)	8.7	9.8	8.9	8.7	8.6
Business Segment (% of GPW)					
Life/health	51.2	52.4	53.8	55.8	57.1
Non-life	48.8	47.6	46.2	44.2	42.9

Financial Risk Profile: Moderately Strong

Gothaer's financial risk profile particularly reflects our view of its slightly higher-than-peers credit risk and heightened ALM risk in the life back book, although actively decreasing.

Capital and earnings: Vulnerable to high interest rate sensitivity of the 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. 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 bottom-line earnings and despite shrinking policyholder bonus reserves due to maturing contracts and a lower allocation amount. Our view is based on the assumption that the group will not further increase its risks in the investment portfolio. We include in our capital assessment a hybrid of €250 million that was issued in 2015.

Quality of capital is good, in our view. Core shareholders' funds accounted for 29% of the group's total adjusted capital in 2016 and 56% of policyholder capital.

The regulatory solvency ratio based on Solvency II figures increased to 220% in 2016 following 149% in 2015 (both including transitionals).

Table 4

Gothaer Group -- Capitalization					
	--Year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Common equity	2061	1889	1812	1572	1463
Change in common equity (%)	9.1	4.3	15.2	7.5	23.5
Total capital (reported)	2,551	2,570	2,318	2,037	1,927
Change in total capital (reported) (%)	(0.7)	10.8	13.8	5.7	13.7

We assume extraordinary net income to be about €180 million in 2017 and approximately €120 million–€140 million in 2018–2019 (€162 million in 2016). We anticipate that earnings from non-life insurance will be fueled by combined (loss and expense) ratios of about 95%-97% (barring extraordinary natural catastrophe claims). This mainly reflects the group's focus on underwriting profitable lines of business and increased profitability in the German commercial market. However, the competition in the midsize commercial business is high and could offset some positive developments from the retail business. Although still above the 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 for traditional business, 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 2016, benefiting from higher risk (that is, mortality/ morbidity) and more balanced cost results. This, in our view, is due to the group's focus on selling unit-linked and biometrical risk products. The introduction of new capital-lite products will further enhance new business margins. 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. Furthermore, Gothaer's pretax return on assets (before bonus distribution) amounted to 3.7% in 2016 compared with 2.7% in 2015. 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. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Total revenues	4,738	4,963	4,802	4,736	4,541
EBIT adjusted	(421)	92	(18)	24	2
Net income	164	141	114	104	107
Return on Shareholders' Equity (reported) (%)	8.3	7.6	6.7	6.9	8.1
Non-life: Net expense ratio (%)	30.2	30.6	30.2	31.5	29.9
Non-life: Net loss ratio (%)	66.9	66.6	69.2	69.7	66.5
Non-life: Net combined ratio (%)	97.3	97.4	99.5	101.4	96.6

Table 5

Gothaer Group -- Earnings (cont.)					
	--Year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Non-life: Return on Revenue (%)	(0.3)	1.3	0.5	(1.6)	(3.2)
Life: Net expense ratio (%)	11.4	11.8	11.6	11.9	11.5
Life: Value of new business					10.6
Life: New business margin (%)					4.2
Operating Earnings by Segment (Mil. €)	2016	2015	2014	2013	2012
Life & Health	118	84	88	64	87
Non-life	96	143	99	38	88
Other	0	0	0	0	0

Risk position: Somewhat higher ALM risk in the life book

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 61% of the portfolio comprises fixed-income securities that have a rating of 'A-' or higher. However, about 39% of this bond portfolio is invested in bonds rated 'BBB+' or lower. Gothaer's exposure to credit risk is therefore somewhat higher than peers'. In addition, Gothaer's above-market average duration mismatch poses higher ALM risk than peers'. The group has taken some actions since 2014 to reduce its exposure to high-risk assets, such as selling its structured bonds and hedge funds portfolio. Additionally, the group managed to reduce its ALM mismatch by strongly increasing the duration of its assets. Still, the ALM mismatch is slightly higher than peers'. Furthermore, 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 3% of the portfolio.

Table 6

Gothaer Group -- Risk Position					
	--Year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Total invested assets	31,061	30,136	29,659	27,237	26,198
Net investment income	887	1,027	940	1,024	915
Net investment yield (%)	3.1	3.7	3.5	4.1	3.8
Net investment yield including realized capital gains/(losses) (%)	6.2	4.5	4.0	5.2	4.9
Net investment yield including all gains/(losses) (%)	5.6	4.3	4.1	4.6	4.9
Investment portfolio composition (%)	2016	2015	2014	2013	2012
Cash and short-term investments	2.4	3.2	2.0	5.6	4.1
Bonds	83.0	82.8	85.4	79.3	80.7
Equity investments	3.7	3.5	2.9	5.4	5.2
Real estate	2.2	1.4	0.5	0.3	0.3
Mortgages	0.5	0.7	0.8	1.0	1.2
Loans	1.9	0.4	0.4	0.9	0.9
Investments in affiliates	6.4	8.0	7.9	7.4	7.5
Other investments	0.0	0.1	0.1	0.1	0.1

Financial flexibility: Supported by favorable leverage and coverage

Gothaer has adequate financial flexibility, in our view. Its financial leverage (debt plus hybrids to economic capital available) is slightly above 15% in 2016, which fell after one hybrid call in 2016. We assume that financial leverage declined in 2016 as a consequence of the lower interest burden, and remain in line with our expectations in 2017-2019. We expect fixed-charge coverage will be at least higher than 8x. 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)	**2016**	**2015**	**2014**	**2013**	**2012**
Fixed-charge coverage	10.2	11.7	7.0	8.3	11.3
Financial leverage (%)	15.5	22.3	19.1	15.9	15.5

Other Assessments

We consider Gothaer to have satisfactory management and governance, and we assess its 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

Our assessment of Gothaer's ERM is supported by our positive assessments for risk management culture and risk controls for the majority of the group's risks. The group's top management is highly committed to supporting Gothaer's risk management culture. 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 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 for the group as a whole as neutral. We view positively that Gothaer is steering toward a consistent risk metric group wide, but economic capital and value-based management focused on risk-adjusted return targets are not yet fully embedded in the management and decision-making processes of the entire group. Major enhancements are in process, including the implementation of a capital allocation that is expected to strengthen the risk-bearing limit system groupwide. We consider emerging risk management as neutral, taking into account that a formalized process for the early identification and evaluation of potential emerging risks was only recently set up.

We view the importance of ERM to the rating as high, since the ability to manage interest rate and ALM risks is also critical considering the long term and guarantee feature of Gothaer's life business exposure and the larger than peers duration gap.

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 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, Gothaer 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

Our view of Gothaer's liquidity takes into account the strength of available liquidity sources, mainly premium income, and an asset portfolio that contains more than 86% of 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 50% of the value in force on the group's life portfolio, off-balance-sheet unrealized gains other than life bonds, and eligible parts of life and health policyholder capital.

Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct.

22, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Criteria - Financial Institutions - General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Criteria - Financial Institutions - Banks: Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings Detail (As Of October 19, 2017)	
Operating Company 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
Related Entities	
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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