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Hannover Rueck SE

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Table Of Contents

Credit Highlights

Outlook

Key Assumptions

Business Risk Profile

Financial Risk Profile

Other Key Credit Considerations

Ratings Score Snapshot

Related Criteria

Appendix

Hannover Rueck SE

Credit Highlights

Operating Company Covered
By This Report

Financial Strength Rating

Local Currency

AA-/Stable/--

Overview

Strengths

A market leader in global reinsurance, its very strong diversification by product and geography, low cost base, and selective and stringent underwriting caused it to outperform most peers despite severe catastrophe losses in 2017 and 2018.

Capital is very strong under both our risk-based capital model and solvency requirements and, and it has well-defined risk controls.

Risks

Potential volatility in capital and earnings because Hannover Re covers large risks such as natural catastrophes and pandemics.

It relies more on retrocession than some of its peers.

S&P Global Ratings expects Hannover Re to maintain its position as one of the leading global reinsurers due to its very strong diversification and low cost base. The group has a Top 3 position in the global reinsurance market and a strong brand image, supported by its strong underwriting and claim-settlement expertise. It also enjoys long-standing relationships with brokers and key clients and has leading positions in some of the reinsurance treaties it underwrites globally.

Hannover Re has demonstrated a resilient and strong operating performance compared with its peers and we anticipate that the group will continue to perform strongly. Difficult market conditions resulted in high natural catastrophe losses for the reinsurance industry in 2017 and 2018. Despite these conditions, the group reported a combined (loss and expense) ratio of 96.9% and a net income of €1.1 million in 2018. It achieved this through its strong underwriting capabilities, superior cost base compared with peers, cautious reserving, and sound retrocession strategy. By building on these strengths, we expect the group to generate net income of €1.0 billion-€1.2 billion, a combined ratio of about 96%-98% and a return on equity (ROE) of 10%-12% in 2019-2020.

Capitalization remains very strong, protected by strong risk controls and retrocession capacity. Hannover Re has maintained very strong capitalization; it has a 'AA' level of capital adequacy, measured using S&P Global Ratings' risk-based capital model, and its Solvency II ratio for 2018 was 246%. We anticipate that the group will maintain its very strong capitalization at about this level in the future. The group is still exposed to large tail risks, such as natural catastrophes or pandemic risks. These could lead to capital and earnings volatility. In our view, the risk is partly offset by the group's diversified property/casualty and life portfolio, strong risk controls, and sound retrocession cover.

Outlook

The stable outlook indicates that we expect the group to maintain its competitive advantage as a well-positioned, leading global reinsurer. The group will also benefit from moderate price increases in global property/casualty (P/C) reinsurance business in 2019 and growth in structured reinsurance products. We also assume sound earnings in 2019-2021, which should enable the group to maintain capital securely above the 'AA' level.

Downside scenario

We regard the possibility of a downgrade as remote over the next 12-24 months. However, we might consider lowering the ratings if capital adequacy fell significantly below the 'AA' level in our capital model. This could occur because of large unexpected losses, higher risk capital charges than we currently expect, or a material erosion of underlying earnings. We may also take a negative rating action if Hannover Re's underwriting controls deteriorated, or if it assumed a riskier profile overall through heightened underwriting or investment risks.

Upside scenario

We assess the likelihood of an upgrade as remote over the next 12-24 months. This reflects the difficult business conditions in the global P/C reinsurance market, despite the 2019 rate increases that followed the large natural catastrophe events in 2018 and 2017.

Key Assumptions

- GDP growth in the U.S. of 2.5% in 2019 and 1.8% in 2020, and in the eurozone of 1.1% in 2019 and 1.3% in 2020.
- Long-term interest rates of 2.4% in 2019 and 2.6% in 2020 in the U.S., and 0.8% in 2019 and 1.2% in 2020 in the eurozone.

Key Metrics

	2020f	2019f	2018	2017	2016	2015	2014
S&P Global Ratings capital adequacy	Very strong	Very strong	Very strong	Very strong	Very strong	Extremely strong	Extremely strong
Gross premium written (mil. €)	>19,000	>19,000	19,176	17,791	16,354	17,069	14,362
Net income (mil. €)	1,000-1,200	1,000-1,200	1,146	1,045	1,226	1,215	1,065
Return on shareholders' equity (%)	10-12	10-12	12.2	11.0	13.2	14.3	14.4
Net investment yield (%)	3.0-3.2	3.0-3.2	3.5	3.5	3.4	4.2	4.0
P/C: Net combined ratio (%)	96-98	96-98	96.9	100.0	94.0	94.7	95.0
Reinsurance utilization (%)	N/A	N/A	9.3	9.5	10.7	13.0	12.4
Return on revenue (%)	N/A	N/A	7.5	5.6	9.3	9.9	9.4

f--S&P Global Ratings forecast. N/A--Not applicable.

Business Risk Profile

Hannover Re has a broad business portfolio offering P/C and life/health reinsurance across the globe. Within P/C reinsurance, we believe that Hannover Re is exposed to product risk, especially because of the unpredictable nature of natural catastrophes. We saw the risk demonstrated in 2018 and 2017, when there were large natural catastrophe market losses.

That said, the group outperformed the global reinsurance sector--its combined ratio of 96.9% in 2018 and 100% in 2017 compared well with peers. We consider that Hannover Re benefited from a well-diversified product portfolio and sound retrocession cover. In the group's life reinsurance operations, the barriers to entry are higher, in our view, because the market is dominated by only a handful of reinsurers.

In life reinsurance, Hannover Re is exposed to risks arising from changes to assumptions regarding mortality and morbidity changes. These have less potential to increase capital and earnings volatility than the product risks in P/C reinsurance.

Hannover Re is one of the global leading reinsurance companies and has a well-established brand, strong underwriting and claims services abilities, and longstanding relationships with brokers and clients. Moreover, Hannover Re has used its competitive strength to access large tailor-made structured reinsurance deals. These bolstered its growth in P/C reinsurance in 2018 and in the first half of 2019. Hannover Re and some larger peers can access such deal, but they are not available to most of its peers in the reinsurance sector. This underlines Hannover Re's competitive advantage.

In our view, Hannover Re benefits from a lower-than-average administration expense ratio, which also bolsters the group's competitive strength. The group's diverse business mix is a further positive factor. The group's retrocession strategy helped it to withstand large natural catastrophes in 2018 and 2017. That said, its reinsurance utilization ratio, which stood at about 9% in 2018, is somewhat higher than some peers, which suggests greater reliance on retrocession capacity.

Financial Risk Profile

Even after large industry losses in 2018 and 2017, Hannover Re's capital adequacy remained redundant above the 'AA' level, according to our capital model. It benefits from strong operating performance and stable dividends of about €600 million per year.

The regulatory solvency ratio has also remained sound in 2018, at 246%. We assume capitalization to remain in the 'AA' range over 2019-2020. Equally, we expect regulatory capital to remain securely above the group target of more than 200%. The group's financial risk profile is supported by very strong and prudent reserves, which we take into account in our assessment of the group's capital. We also view positively Hannover Re's good internal economic capital model.

On a group level, we expect Hannover Re to generate return on equity of 10%-12% in 2019-2020. This is based on our expectation that the group will generate a stable net income of about €1.0 billion-€1.2 billion per year, with a net

combined ratio of 96%-98% over 2019-2020, if net catastrophe losses do not exceed Hannover Re's budget of €875 million. We also assume the net investment yield will decline to 3.0%-3.2% over the forecast period, from 3.5% in 2018.

Hannover Re is exposed to tail risks from severe natural catastrophes, man-made claims, and pandemics, which could cause some volatility of capital and earnings. That said, in our view, Hannover Re has been able to better manage these events than its reinsurance peers, as demonstrated in 2017 and 2018, thanks to its beneficial cost base, diversified portfolio, strong modeling and risk controls, very strong and prudent reserving, and comprehensive retrocession program. Hannover Re also maintains a conservative stance on its investments, via relatively low-risk asset allocation, limits for foreign currency exposure, and prudent diversification by sectors and single obligors.

Other Key Credit Considerations

Governance

We do not foresee any material governance issues that could affect the ratings. The recent change of CEO was cautiously planned well ahead of time, and we consider that the replacement illustrates the group's stability and consistent strategy. We think that the management team has a consistent and successful track record of strategic planning, strong execution, and transparent, demanding, and sophisticated financial management. Hannover Re also has a strong track record of meeting its financial and strategic targets.

Liquidity

We expect Hannover Re's liquidity to remain exceptional over the next two years. The group has ample liquidity sources available, mainly premium income and a highly liquid asset portfolio. Moreover, there are no refinancing concerns, in our view.

Group support

Our assessment of Hannover Re reflects the group's stand-alone characteristics. The group is 50.2%-owned by ultimate parent Talanx AG, and the rest of its shares are widely held. We understand that Hannover Re's strategy, capital management, and cash flows are relatively independent from Talanx AG.

Enterprise risk management

We consider Hannover Re's enterprise risk management (ERM) program as an important consideration in our ratings analysis, particularly given the global diversity of the group's business and the potential volatility to capital and earnings from the exposure to natural catastrophes or pandemics. Hannover Re benefits from stringent risk controls and a well-established ERM framework. We also factor in our assessment of the group's good economic capital model. As such, the ratings factors in our analytical framework relating to ERM, including risk exposure, governance (risk management culture), and risk optimization in profitability are viewed as an essential part of the credit story.

Ratings Score Snapshot

Business Risk Profile	Very strong
Competitive position	Very strong

IICRA	Intermediate risk
Financial Risk Profile	Strong
Capital and earnings	Very strong
Risk exposure	Moderately high
Funding structure	Neutral
Anchor*	aa-
Modifiers	
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Financial strength rating	AA-

*This is influenced by our view of Hannover Re as one of the market leaders in the global reinsurance sector. It has a very strong franchise and sound diversification by line of business and regions compared with its 'A+' rated peers. Additionally, the group has been able to outperform most of its peers in difficult market conditions in 2017 and 2018.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Insurance | Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- Criteria | Insurance | General: A New Level Of Enterprise Risk Management Analysis: Methodology For Assessing Insurers' Economic Capital Models, Jan. 24, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Appendix

Hannover Re Credit Metrics History

Ratio/Metric	2018	2017
S&P Global Ratings capital adequacy	Very strong	Very strong
Total invested assets	42,007	39,969
Total shareholder equity	9,414	9,514
Gross premiums written	19,176	17,791
Net premiums written	17,398	16,094
Net premiums earned	17,289	15,632
Reinsurance utilization (%)	9.3	9.5

Hannover Re Credit Metrics History (cont.)

Ratio/Metric	2018	2017
EBIT	1,597	1,364
Net income (attributable to all shareholders)	1,146	1,045
Return on revenue (%)	7.5	5.6
Return on shareholders' equity (reported) (%)	12.2	11
P/C: net combined ratio (%)	96.9	100
P/C: net expense ratio (%)	30	28.8
P/C: return on revenue (%)	11.2	10.8
EBITDA fixed-charge coverage (x)	14.5	12.3
EBIT fixed-charge coverage (x)	13.7	11.3
Financial obligations / EBITDA adjusted	1.6	1.3
Financial leverage including pension deficit as debt (%)	22.8	17.2
Net investment yield (%)	3.5	3.5
Net investment yield including investment gains/(losses) (%)	3.7	4.3

Ratings Detail (As Of August 29, 2019)***Operating Company Covered By This Report****Hannover Rueck SE**

Financial Strength Rating

Local Currency

AA-/Stable/--

Issuer Credit Rating

AA-/Stable/--

Senior Unsecured

AA-

Related Entities**E+S Rueckversicherung AG**

Financial Strength Rating

Local Currency

AA-/Stable/--

Issuer Credit Rating

Local Currency

AA-/Stable/--

Hannover Life Reassurance Africa Ltd.

Financial Strength Rating

Local Currency

AA-/Stable/--

Hannover Life Reassurance Bermuda Ltd.

Financial Strength Rating

Local Currency

AA-/Stable/--

Issuer Credit Rating

Local Currency

AA-/Stable/--

Hannover Life Reassurance Company of America (Bermuda) Ltd.

Financial Strength Rating

Local Currency

AA-/Stable/--

Hannover Life Reassurance Co. of America

Financial Strength Rating

Local Currency

AA-/Stable/--

Ratings Detail (As Of August 29, 2019)*(cont.)

Issuer Credit Rating	
<i>Local Currency</i>	AA-/Stable/--
Hannover Life Reassurance of Australasia Ltd.	
Financial Strength Rating	
<i>Local Currency</i>	AA-/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	AA-/Stable/--
Hannover Re (Bermuda) Ltd.	
Financial Strength Rating	
<i>Local Currency</i>	AA-/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	AA-/Stable/--
Hannover Reinsurance Africa Ltd.	
Financial Strength Rating	
<i>Local Currency</i>	AA-/Stable/--
Hannover Re (Ireland) DAC	
Financial Strength Rating	
<i>Local Currency</i>	AA-/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	AA-/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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