

# RatingsDirect®

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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			Holistic Analysis	0		Sovereign Risk	0	Gov't Support	0	
Financial Risk										
Strong										

\*Stand-alone credit profile.  
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

## Major Rating Factors

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>Strong competitiveness supported by a well-diversified product portfolio and distribution channel.</li> <li>Sound bottom-line earnings mainly from the property and casualty (P/C) segment and reduced asset risk exposure.</li> <li>Strong capital base supported by reduced credit and interest risk exposure.</li> </ul>	<ul style="list-style-type: none"> <li>Predominantly low-interest-rate environment, leading to pressurized earnings for the group's life business, which is affected by traditional products with guarantees.</li> <li>Somewhat narrower business profile than higher-rated peers', because of a focus on domestic markets.</li> </ul>

## Rationale

Gothaer is a mutual multiline insurer in the primary insurance market in Germany, writing life, P/C, and health business. Beside the Gothaer brand, the group operates through Janitos. Gothaer also has a small presence in Romania. The presence in Poland was sold in 2018. The ultimate parent is a mutual company Gothaer Versicherungsbank VVaG (not rated).

Gothaer has actively decreased its credit risk and interest risk exposure over the past years, aligning its risk levels with those of its peers in the German insurance market. We anticipate that the group will maintain a reduced appetite for credit and market risk exposure, allowing Gothaer's capital adequacy to remain firmly in the 'A' range of our model. We also expect that Gothaer will continue to prioritize earnings generation over growth and maintain its well-diversified product portfolio and distribution channel as a basis for its sound competitiveness.

**Outlook: Stable**

The stable outlook reflects our expectation that the Gothaer group will continue to prioritize earnings generation over growth, and that the group's capital and earnings will not weaken from the current strong level over 2018-2020.

**Upside scenario**

We could raise the rating over the next two years if Gothaer strengthens its capital adequacy to at least very strong levels, while investment portfolio risks consolidate at current levels.

**Downside scenario**

We consider a downgrade as a remote possibility. That said, 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.

**Macroeconomic Assumptions**

- In Germany over 2018-2020, we anticipate real GDP growth of 1.8% in 2018, 1.7% in 2019, 1.5% in 2020, with unemployment rate in the 3% range.
- We expect the consumer price index to be in the range of 1.8%-2.0% over the next three years.
- Continuation of structurally low, long-term, risk-free rates, with German 10-year government bond yields of 0.4% in 2018, slightly recovering to 0.9% in 2019 and 1.4% in 2020, based on our economic estimates.

**Table 1**

Gothaer Group -- Key Metrics							
	2019f	2018f	2017	2016	2015	2014	2013
Gross premiums (mil. €)	~4,600	~4,500	4,424	4,411	4,517	4,511	4,301
Net premiums (mil. €)	~4,230	~4,150	4,066	4,027	4,074	4,110	3,925
Net income (mill. €)	130-140	130-140	168	158	141	114	104
EBITDA fixed-charge coverage (x)	~9	~9	13.2	10.0	11.7	7.0	8.3
Financial leverage (%)	~12	~12	13.0	15.5	22.3	19.1	15.9
Return on equity (%)	7-8	7-8	7.9	8.0	7.6	6.7	6.9
Net investment yield (%)	2.5-3	2.5-3	2.7	3.1	3.7	3.5	4.1
P/C: Net combined ratio (%)	95-97	95-97	95.9	97.3	97.4	99.5	101.4
P/C: Return on revenue (%)	3-5	3-5	5.2	3.2	5.5	2.0	0.4
Life: Return on assets (%)*	>0.5	>0.5	0.9	0.5	0.7	0.9	1.1

\* Based on German GAAP accounts for Gothaer Lebensversicherung AG. P/C--Property and casualty. f--Forecast.

## Business Risk Profile: Strong

Gothaer, in our view, faces intermediate industry and country risk, which reflects heightened asset liability management (ALM) risks in the German life insurance market, significant pressure on earnings due to prevailing low-interest rate environment, and the health sector's dependence on decisions by policymakers.

Gothaer has built a diverse business portfolio by sectors. It offers P/C insurance (49% of total business written), life insurance (29%), and health insurance (21%). This is supported by the group's well-diversified product portfolio and distribution channels. However, the business profile is somewhat narrower than those of higher-rated peers, because of the focus on domestic markets. The group is active in the small and midsize commercial business where competition is high. Gothaer is also actively undertaking measures to promote cross-selling, which in our opinion is vital when operating in a saturated market like Germany.

We continue to note that the prevailing low-yield environment and additional reserving requirements (Zinszusatzreserve; €1.1 billion at year-end 2017) constrain Gothaer's life subsidiary's earnings and its capacity to strengthen policyholder capital funds in line with peers with similar life exposure. Gothaer posted net income of €165 million in 2017 compared with €156 million in 2016. This improvement was mainly driven by the group's P/C business, which witnessed favorable underwriting results. Life premium volume decreased by around 4% in 2017 mainly due to Gothaer's strategy to shift toward unit-linked and biometrics products. In terms of health insurance, the group focused on supplementary health care instead of comprehensive health care. We assume the group will post a combined ratio of 95%-97% and net income of €130 million-€140 million over the next two years.

## Financial Risk Profile: Strong

Gothaer's prospective capital adequacy is strong thanks to favorable earnings contribution from the P/C segment and sound capital buffers. We estimate that Gothaer's capital requirements slightly outweigh the available capital. Capital requirements may increase gradually on the back of modest business growth and a greater focus on capital-efficient products. This follows the group's strategic decisions regarding business mix and investment policies. However, the life back book, in particular, is still affected by traditional products with guarantees that weigh on interest rate risk, similar to most peers in the German market.

Various management measures--such as the introduction of new capital light products and an increase in asset duration in order to reduce the asset liability mismatch--have helped to contain risks arising from the prolonged low interest rates. The group is reducing its exposure toward risky investments, and more than 90% of their investment portfolio comprises of securities that are rated 'BBB' or higher. We regard Gothaer's investment portfolio as varied, with no substantial segment or single obligor concentration. Equity exposure remains low, accounting for approximately 5% (before hedging) of the portfolio.

Moreover, the group has gradually improved the average credit quality of its portfolio over the past three years, which has reached the upper 'A' range in 2017 and 2018 year to date, with its fixed income portfolio accounting for about 82% of its total investment portfolio. We believe that, following these sustained measures, the group's interest rate and

credit risk exposure is in line with peers' in the German market and that the group remains committed to maintain that prudence in its investment policy.

The group has proven access to capital markets and has sound financial leverage. The group has issued subordinated debt in 2015, that was used to refinance another maturing hybrid issuance, which was callable in 2016.

We expect the financial leverage ratio (debt plus hybrids to economic capital) to be at around 12% and fixed-charge coverage will be at about 8x-9x over the next three years.

## Other Assessments

**Table 2**

Gothaer Group -- Ratings Score Snapshot	
Financial Strength Rating	A-/Stable/--
Anchor	a-
Business Risk Profile	Strong
IICRA	Intermediate
Competitive Position	Strong
Financial Risk Profile	Strong
Capital & Earnings	Strong
Risk Position	Intermediate
Financial Flexibility	Adequate
Modifiers	0
ERM & Management	0
Enterprise Risk Management	Adequate with Strong Risk Controls
Management & Governance	Satisfactory
Holistic Analysis	0
Liquidity	Exceptional
Support	0
Group Support	0

IICRA--Insurance Industry and Country Risk Assessment. ERM--Enterprise Risk Management.

Our assessment of Gothaer's enterprise risk management (ERM) is supported by our positive assessments of its risk-management culture and risk controls for the majority of the group's risks. We view positively the group-wide risk limit system with risk tolerance implemented at entity levels.

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.

We view Gothaer's value-oriented management and corporate strategy as strengths to the ratings. The group's current strategy is aligned with the group's financial resources. Furthermore, the management has repeatedly demonstrated its ability to successfully leverage market opportunities. We however feel that the management still faces the challenge of improving Gothaer's financial profile in a low-yield environment and pursuing sustained profitable growth under difficult operating conditions. We have not identified any governance deficiencies in our assessment.

Gothaer's liquidity position is stable, driven by the strength of its available liquid sources, mainly premium income and its liquid asset portfolio. The group has no refinancing concerns.

## Other Considerations

### Group ratings methodology

We consider Gothaer Lebensversicherung AG, Gothaer Allgemeine Versicherung AG, and Gothaer Krankenversicherung AG as core operating entities of the group.

### Accounting considerations

Gothaer still uses International Financial Reporting Standards (IFRS) for group reporting, but will switch to German generally accepted accounting principles (GAAP) next year. In addition, there is the regulatory requirement to report the results of its operating insurance companies under German GAAP. 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: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, 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 24, 2018)

### Operating Company Covered By This Report

#### Gothaer Allgemeine Versicherung AG

Financial Strength Rating

*Local Currency* A-/Stable/--

Issuer 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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