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Ratings

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# Talanx Primary Insurance Group

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## Table Of Contents

# Talanx Primary Insurance Group

| Anchor | a+ |
|---|---|
| **Business Risk** | **Strong** |
| Competitive position | Strong |
| IICRA | Intermediate |
| **Financial Risk** | **Very Strong** |
| Capital and earnings | Very strong |
| Risk exposure | Moderately low |
| Funding structure | Neutral |

\+

| Modifiers | 0 |
|---|---|
| Governance | Neutral |
| Liquidity | Exceptional |
| Comparable ratings analysis | 0 |

=

| SACP | a+ |
|---|---|

\+

| Support | 0 |
|---|---|
| Group support | 0 |
| Government support | 0 |

=

| Financial strength rating | Holding company ICR |
|---|---|
| A+/Stable/-- | A+/Stable/-- |

IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

## Credit Highlights

### Overview

| Key strengths | Key risks |
|---|---|
| Increasing premiums and earnings diversification by geography and business-line supported by strategic acquisitions and organic growth, complementing the company's domestic market position as one of Germany's largest insurance groups. | Geopolitical and economic risks, capital market volatility, and inflation trends add uncertainty to financial targets. |
| Excellent capital adequacy, based on our internal risk-based capital model, supported by sound earnings and strong reserving. | We view earnings as still dependent on dividends from Hannover Re, although diversification is improving. |
| Improving underwriting performance with sound earnings potential expected in 2023. | |

***S&P Global Ratings expects Talanx Primary Insurance Group (TPG) will continue to diversify its geographic footprint.*** The Talanx group operates mainly in industrial lines, German retail, international retail, and reinsurance. TPG operates in the first three segments. Gross premiums without saving parts from its primary operations increased by 11.7% to €20.9 billion in 2022. The growth was attributable to industrial lines and retail international, whereas premiums in retail Germany declined by 2.8%. For 2023, we expect lower insurance revenues compared with premiums due to the transition from International Financial Reporting Standards (IFRS) 4 to IFRS 17, as investment components are not included in revenues. In May 2023, Talanx acquired the Latin America business from Liberty Mutual, adding some revenue diversification. We expect the transaction to close in 2024.

***TPG disclosed strong results in 2022, despite high natural catastrophe claims and inflation.*** In 2022, the group generated net income of €1.228 million compared with €1.076 million in 2021. The positive development was supported by all segments, although the earnings contribution from German P/C operations was strongly impacted by inflation trends. However, higher interest rates supported German life earnings, offsetting the earnings decline in the German P/C business. Investment results also improved, driven by a strong contribution from inflation-linked bonds, real estate, and dividends from Hannover Re. For 2023 we expect net earnings to be higher than €1.000 million based on IFRS 17 numbers, profiting from stringent underwriting to offset the inflationary environment. Based on half year numbers in 2023, net earnings from the primary operations increased by 16.3% to €426 million. We expect the combined ratio for 2023 to be 94%-97%, reflecting some price increases in loss affected lines, and benefitting from a positive discounting impact in technical liabilities under IFRS 17. Net investment yield is likely to increase, supported by higher recurring investment income due to higher reinvestment rates, as well as a sound performance of inflation-linked bonds.

***Capital and earnings will remain very strong and protected by sound risk controls and conservative reserving.*** We assess TPG's capital adequacy at the 'AAA' level based on our internal risk-based capital model. The strong increase in interest rates has materially affected the consolidated group's shareholder's equity, which declined by 31% from €10.776 million at year-end 2021 to €7.465 million at year-end 2022. However, the group's solvency ratio remained almost stable over the same period at 209% from 208% (excluding transitional measures), despite the repayment of a hybrid bond in the first half of the year of €500 million underlying the group's solid capitalization. The group's ample capital base, successful risk controls, and conservative reserving will likely mitigate capital volatility, enabling TPG to cope with further market volatility, possible large manmade losses or natural catastrophe events, and inflation trends. We expect the €1.4 billion cost of the acquisition--which closes in 2024--to be generated through retained earnings in Talanx AG and the group's mutual parent HDI Haftpflichtverband der Deutschen Industrie V.a.G. (A+/Stable/--). Therefore, TPG's capital adequacy remains at least in the 'AA' range over our forecast horizon of 2023-2025.

## Outlook: Stable

The stable outlook reflects that the group will maintain its competitive strength, based on its strong business and regional diversification over our forecast horizon. We expect annual group earnings of €1.0 billion-€1.3 billion over 2023-2025 that continue to support a very strong capital position, at least.

### Downside scenario

We would consider taking a negative rating action on TPG over the next 24 months if the company's capital and earnings sustainably weakened and we revised our assessment below very strong. This could occur if significantly higher insurance losses led to markedly lower earnings than we anticipate in our base-case scenario, or capital needs increased more than we expect.

### Upside scenario

We do not expect a positive rating action over the next 24 months. However, one could occur if TPG further and significantly diversified its earnings base by geography in its industrial and retail insurance business, potentially supported by successful integration of and synergies from the Latin American acquisition.

## Key Assumptions

- Increase in long-term interest rates in the eurozone to 3.6% in 2023 and 3.7% in 2024, from 3.0% in 2022; and in Germany to 2.9% over the same period from 2.1% in 2022.
- Lower GDP increase in the eurozone in 2023 and 2024 to 0.6% and 0.9% from 3.6% in 2022. In Germany, a GDP decline of 0.1 in 2023 followed by an increase of 0.8% in 2024 from an increase of 1.9% in 2022.
- Stable unemployment development in the eurozone and Germany to 6.7% and 3.1% for 2023, followed by an increase to 6.9% and 3.2% in 2024.
- Decline in average inflation increases in the eurozone and Germany in 2023 to 5.8% and 6.5%, respectively, from 8.4% and 8.7%. For 2024, average inflation to decline to 2.7% and 2.9%, respectively.

**Talanx AG--Key metrics**

| | 2023f+ | 2022 | 2021 | 2020 | 2019 | 2018 |
|---|---|---|---|---|---|---|
| S&P Global Ratings capital adequacy | At least very strong | Extremely strong | Extremely strong | Extremely strong | Extremely strong | Extremely strong |
| Gross premium written (Mil. €)* | > 17,000 | 20,939.8 | 18,747.3 | 17,341.1 | 17,536.3 | 15,269.8 |
| Net income (Mil. €) | >1,000 | 1,227.6 | 1,076.5 | 698.4 | 957.7 | 702.6 |
| Return on shareholders' equity (%) | ~8-10 | 10.2 | 8.1 | 5.5 | 8.3 | 6.6 |
| Financial leverage (%) | ~35 | 34.6 | 25.6 | 22.9 | 23.4 | 24.2 |
| EBITDA fixed charge coverage (x) | ~10-12 | 11.5 | 8.5 | 5.0 | 7.8 | 7.0 |
| Financial obligation / EBITDA | ~2-3 | 2.3 | 2.8 | 3.4 | 2.2 | 2.4 |
| Net investment yield (%) | ~3.3-3.8 | 2.7 | 3.7 | 3.3 | 3.8 | 3.5 |
| P/C net combined ratio (%) | ~94-97 | 96.4 | 96.1 | 98.4 | 97.8 | 100.0 |
| Return on revenue (%) | N.A. | 8.7 | 7.5 | 5.3 | 7.3 | 5.7 |

f--S&P Global Ratings forecast. N.A.--Not available; *Insurance Revenues under IFRS 17 for 2023. + IFRS 17 basis. P/C--Property/casualty.

## Business Risk Profile: Strong

In our view, TPG benefits from its strong market position in Germany and its international business portfolios offering life and P/C insurance through its defined segments. The group benefits from strong premium diversification across segments and regions. Earnings diversification has improved following successful restructuring measures especially in retail Germany and industrial lines. However, overall results still depend on dividends from Hannover Re, with a 57% share of the group's earnings in 2022.

In 2022, gross premiums written (excluding saving parts) from primary operations increased to €20.9 billion from €18.7 billion in 2021. The increase was driven by a strong growth in the industrial business as well as international retail operations, whereas the German retail business declined by 2.8%. The decline in Germany was driven by portfolio restructuring in life products towards unit-linked and biometric policies, as well as lower life single premiums from the banking business. For 2023, we expect insurance revenues to be lower compared with premiums due to the transition from IFRS 4 to IFRS 17, as investment components are not included in revenues.

In May 2023, Talanx acquired the Latin America business from Liberty Mutual, adding some revenue diversification. We believe that the transaction adds scale and enhances TPG's position in the Latin American insurance markets. With this acquisition, TPG's market share in Latin America would improve, in line with the group's strategic goal to achieve top-five positions in its defined core South American markets. We expect this transaction will elevate TPG as a top-three player in the overall Latin America non-life insurance market, making it number two in Brazil, number one in Chile, and number seven in Colombia (number two in Colombian motor). Additionally, the transaction would improve diversification by rebalancing the group's international retail insurance portfolio between Europe and Latin America, and also reducing the share of the group's still dominant industrial lines.

Earnings diversification has improved in recent years mainly because of the successful implementation of restructuring measures in retail Germany and industrial lines. In 2022, all three primary insurance segments contributed positively to after tax results.

Although we believe that the newly acquired operations in Latin America will bring some revenue diversification, and TPG has previously demonstrated a strong track record integrating acquired operations like Warta in Poland and Magallanes in Chile, we don't expect this to translate into higher earnings diversification before 2026. The relatively low profit contribution in the first years after acquisition, as well as some implementation risks, will in our view not materially improve Talanx's overall profit diversification over 2024-2025, nor will it fundamentally contribute to the recovery of capital adequacy in 2024-2025.

The improving diversification and enhancing performance of the primary operations are gradually reducing TPG's dependance on dividends from Hannover Re to reach net income targets. However, reinsurance business still contributed about 57% to the group's net income in 2022 compared with 55% in 2021 and 58% in 2020.

## Financial Risk Profile: Very Strong

At year-end 2022, TPG holds a comfortable capital buffer above the 'AAA' range as per our risk-based capital model. We expect the €1.4 billion cost of the acquisition--which closes in 2024--to be generated through retained earnings in Talanx AG and the group's mutual parent HDI Haftpflichtverband der Deutschen Industrie V.a.G. (A+/Stable/--). Therefore, TPG's capital adequacy remains at least in the 'AA' range over our forecast horizon of 2023-2025. Furthermore, we expect the group's regulatory capital will remain at least securely within the group's target range of 150%-200%. The regulatory solvency ratio was 209% at year-end 2022 without including transitional measures. The group's sound earnings and strong reserving will continue to support our view of its capital position. The solid capital is also visible in the group's half year 2023 regulatory capital ratio of 217%.

Our prospective capital view is based on our estimation of TPG's net profit of more than €1.000 million in 2023. We expect earnings in 2023 might be impacted by geopolitical and economic risks, capital market volatility, and inflation trends. However, the group's strong underwriting and conservative reserving will enable it to maintain a combined ratio of 94%-97% for 2023, based on IFRS 17 figures.

Higher interest rates should support the group's recurring investment income in the medium term. We therefore assume the net investment yield will increase to 3.3%-3.8% in 2023 from 2.7% in 2022.

TPG follows what we view as a balance and conservative investment strategy. Asset allocation is heavily geared toward fixed-income investments, which account for more than 80% of the total. Moreover, its broad geographic business diversification and sound risk controls make the group reasonably resilient to capital and earnings volatility. In our view, potential volatility could result from large losses such as natural catastrophes, but this risk is mitigated by sound reinsurance protection and conservative natural catastrophe and other large-loss budgeting.

TPG has demonstrated its access to ample sources of external funding including equity, reinsurance, and debt markets, and we expect this to continue. However, the decline in shareholder's equity driven by the increase in interest rates negatively affect TPG's leverage. At year-end 2022, the group's financial leverage ratio (debt plus hybrids to shareholders equity, and consolidating the Hannover Re subgroup) was 34.6% compared with 25.6% in 2021, while fixed-charge coverage enhanced to 11.5x compared with 8.5x over the same period following higher results. Based on our capital and earnings forecast and assuming no major change in TPG's capital management approach, we expect leverage to remain at about 35% and the fixed-charge coverage ratio to be 10x-12x in 2023.

## Other Key Credit Considerations

### Governance

We do not foresee any material governance issues that could affect the ratings. We believe the group can implement its management succession plans with internal and external resources, as demonstrated in recent years. We think that the management team has a consistent track record of strategic planning, strong execution, and transparent, demanding, and sophisticated financial management.

### Liquidity

We expect TPG'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 risks, in our view.

### Factors specific to the holding company

The ratings on Talanx AG, the group's operating holding company, are equalized with those on TPG's core entities due to its role within the wider group as internal reinsurer, further enhancing the diversity of its cash flow and its ability to honor its financial obligations. Furthermore, Talanx AG benefits from substantial levels of excess capital and moderate financial leverage.

### 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, while the remainder of its shares are widely held. We understand that Hannover Re's strategy, capital management, and cash flow are independent from Talanx AG.

### Environmental, social, and governance

ESG factors have no material influence on our credit rating analysis of TPG.

### Accounting considerations

We mainly base our assessment of TPG on its annual financial statements, including the mutual parent HDI Haftpflichtverband der Deutschen Industrie V.a.G., where we focus on the three primary insurance segments: German retail, international retail, and industrial lines, supplemented by nonpublic information on the life and P/C operations and a consolidated view on TPG including corporate operations. Our assessment of financial flexibility relies on the consolidated HDI Group figures rather than on TPG data only. In our ratings on domestic and nondomestic subsidiaries of HDI Group, we base our analysis on annual reports under local generally accepted accounting practices and IFRS. The numbers are based on IFRS 4 accounting until 2022. For 2023 we used estimations based on IFRS 17.

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions , March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Insurance | General: Insurers Rating Methodology , July 1, 2019
- General Criteria: Group Rating Methodology , July 1, 2019
- Criteria | Insurance | Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves , Nov. 26, 2013
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011
- 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

## Appendix

**Talanx AG--Credit metrics history**

| Ratio/Metric | 2022 | 2021 | 2020 | 2019 | 2018 |
|---|---|---|---|---|---|
| S&P Global Ratings capital adequacy* | Extremely strong | Extremely strong | Extremely strong | Extremely strong | Extremely strong |
| Total invested assets | 93,047 | 106,006 | 102,292 | 98,899 | 89,739 |
| Total shareholder equity | 10,466 | 13,551 | 13,015 | 12,459 | 10,650 |
| Gross premiums written | 20,940 | 18,747 | 17,341 | 17,536 | 15,270 |
| Net premiums written | 16,072 | 14,176 | 13,075 | 13,736 | 12,662 |
| Net premiums earned | 15,031 | 13,711 | 12,835 | 13,329 | 12,317 |
| Reinsurance utilization (%) | 23.2 | 24.4 | 24.6 | 21.7 | 17.1 |
| EBIT | 1,594 | 1,350 | 883 | 1,242 | 902 |
| Net income (attributable to all shareholders) | 1,228 | 1,076 | 698 | 958 | 703 |
| Return on revenue (%) | 8.7 | 7.5 | 5.3 | 7.3 | 5.7 |

## Talanx AG--Credit metrics history (cont.)

| Ratio/Metric | 2022 | 2021 | 2020 | 2019 | 2018 |
|---|---|---|---|---|---|
| Return on assets (excluding investment gains/losses) (%) | 1.4 | 1.2 | 0.8 | 1.2 | 0.9 |
| Return on shareholders' equity (reported) (%) | 10.2 | 8.1 | 5.5 | 8.3 | 6.6 |
| P/C: net combined ratio (%) | 96.4 | 96.1 | 98.4 | 97.8 | 100.0 |
| P/C: net expense ratio (%) | 25.7 | 25.6 | 26.9 | 28.1 | 27.6 |
| P/C: return on revenue (%) | 5.8 | 6.0 | 4.7 | 5.8 | 3.9 |
| Net investment yield (%) - including all gains | 2.7 | 3.7 | 3.3 | 3.8 | 3.5 |

P/C--Property/casualty.

## Business And Financial Risk Matrix

| Business risk profile | Financial risk profile | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Excellent | **Very Strong** | Strong | Satisfactory | Fair | Marginal | Weak | Vulnerable |
| Excellent | aa+ | aa | aa- | a+ | a- | bbb | bb+ | b+ |
| Very Strong | aa | aa/aa- | aa-/a+ | a+/a | a-/bbb+ | bbb/bbb- | bb+/bb | b+ |
| **Strong** | aa-/a+ | **a+/a** | a/a- | a-/bbb+ | bbb+/bbb | bbb-/bb+ | bb/bb- | b+/b |
| Satisfactory | a | a/a- | a-/bbb+ | bbb+/bbb | bbb/bbb- | bb+/bb | bb-/b+ | b/b- |
| Fair | a- | a-/bbb+ | bbb+/bbb | bbb/bbb- | bbb-/bb+ | bb/bb- | b+/b | b- |
| Weak | bbb+/bbb | bbb/bbb- | bbb-/bb+ | bb+/bb | bb/bb- | bb-/b+ | b/b- | b- |
| Vulnerable | bbb-/bb+ | bb+/bb | bb/bb- | bb-/b+ | b+/b | b/b- | b- | b- |

**Note:** Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

## Ratings Detail (As Of August 16, 2023)*

| | |
|---|---|
| **Talanx AG** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | A+/Stable/-- |
| Senior Unsecured | A+ |
| **Related Entities** | |
| **HDI Global Insurance Co.** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |
| **HDI Global Network AG** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |

| Ratings Detail (As Of August 16, 2023)*(cont.) | |
|---|---|
| **HDI Global SE** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | A+/Stable/-- |
| **HDI Global Specialty SE** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |
| **HDI Haftpflichtverband der Deutschen Industrie V.a.G.** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |
| **HDI Lebensversicherung AG** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | A+/Stable/-- |
| **HDI Versicherung AG (Germany)** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |
| **LPV Lebensversicherung AG** | |
| Financial Strength Rating | |
| *Local Currency* | A/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A/Stable/-- |
| **neue leben Lebensversicherung AG** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |
| **TARGO Lebensversicherung AG** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |
| **Towarzystwo Ubezpieczen i Reasekuracji WARTA S.A.** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |
| **Domicile** | Germany |

## Ratings Detail (As Of August 16, 2023)*(cont.)

*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.