S&P Global Ratings

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Talanx Primary Insurance Group

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Table Of Contents

Talanx Primary Insurance Group

Anchor	a+	+	Modifiers	0	=	SACP	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

Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0

+

Support	**0**
Group support	0
Government support	0

=

A+/Stable/--

Financial strength rating

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

Credit Highlights

Overview

Strengths	Risks
Sound geographic and business-line diversification of premiums, complementing the domestic market position as one of the largest insurance groups in Germany.	Uncertain earnings development for 2020 from pandemic-related losses and an active natural catastrophe season, especially for the industrial lines business.
Extremely strong capital adequacy, based on our internal risk-based capital model, supported by Hannover Re's earnings contribution.	Business operations that, while diverse, don't contribute equally to bottom-line results, which benefit from Hannover Re dividends.
Recovering underlying technical profitability (excluding pandemic losses) in industrial lines and retail Germany following restructuring measures.	

S&P Global Ratings expects Talanx Primary Insurance Group (TPG) to maintain its position as one of the largest insurance groups in Germany. The Talanx group operates mainly across the following segments: industrial lines, German retail,, international retail, and reinsurance. TPG operates in the first three segments. Gross premiums from its primary operations were €17.5 billion in 2019, up about 15% compared from 2018 levels. However, we expect that premiums will decline in 2020 by about 4%-6% because of pandemic-related lower economic activity, with a gradual recovery in 2021.

Lower technical and investment returns will have a material impact on 2020 earnings. We believe that pandemic-related claims and an active natural catastrophe season will put pressure on underwriting results, especially in the industrial lines business, where the group is exposed to COVID-19-related claims like business closures. We also believe that investment returns will decline in 2020 due to write-downs on investments like private equities, as well as lower interest rates. We expect this to lead to a return on equity (ROE) decline to 2%-4% in 2020 compared with 8.3% in 2019.

Capitalization remains very strong, and protected by sound risk controls. We assess TPG's capital adequacy at the 'AAA' level, based on our internal risk-based capital model. The group's regulatory solvency ratio was also sound in first-half 2020, at 191% excluding transitional measures. The group's ample capital base and successful risk controls will likely mitigate capital volatility, enabling TPG to cope with further market volatility and possible large man-made losses or natural catastrophe events. We believe that capitalization will remain in 2021 and 2022 at least in the 'AA' range despite exposure to tail risks like natural catastrophes or pandemics.

Outlook: Stable

The outlook is stable because we believe that the group will maintain its competitive strength, based on its strong business and regional diversification over our 2020-2022 forecast horizon. Despite some earnings decline in 2020 related to COVID-19 claims and capital market volatility, we expect TPG will maintain at least very strong capital and earnings.

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 to lower than 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 increase higher than expected.

Upside scenario

We view a positive rating action as a remote possibility over the next 24 months. However, it could occur if TPG further significantly diversifies its earnings base by geography in its industrial and retail insurance business. This would also require a sustainable turnaround of its German retail and industrial lines operations.

Key Assumptions

- Historically low long-term interest rates at negative 0.5% in 2020 and negative 0.4% in 2021 for Germany, and negative 0.1% and positive 0.1%, respectively, in the eurozone.
- German real GDP decline of 5.4% in 2020, with 4.7% growth in 2021; and a decline of 7.4% in 2020, followed by 6.1% growth for the eurozone, respectively.
- Increase in unemployment to 4.3% in 2020 and 4.5% in 2021 in Germany, after 3.1% in 2019. A similar trend in the eurozone, increasing to 8.1% in 2020 and 9.1% in 2021 from 7.6% in 2019.

Talanx Primary Insurance Group--Key Metrics

	2021f	2020f	2019	2018	2017	2016	2015
S&P Global Ratings capital adequacy	Extremely strong	Extremely strong	Extremely strong	Extremely strong	Extremely strong	Extremely strong	Very strong
Gross premium written (mil. €)	~17,500	16,500-16,800	17,536	15,270	14,803	14,225	14,359
Net income (mil. €)	>750	>400	957.7	702.6	728.8	895.0	750.3

Talanx Primary Insurance Group--Key Metrics (cont.)

	2021f	2020f	2019	2018	2017	2016	2015
Return on shareholders' equity (%)	~5-7	~2-4	8.3	6.6	6.9	9.0	8.1
Financial leverage (%)	<40	<40	24.9	25.7	22.8	19.8	20.9
EBITDA Fixed charge coverage (x)	~6-8	~4-7	7.8	7.0	6.6	7.6	7.1
Financial obligation/EBITDA	~2-3	~3-6	2.4	2.6	2.3	1.5	1.4
Net investment yield (%)	~3,0-3,2	~3,1-3,3	3.8	3.5	4.1	3.5	3.7
P/C net combined ratio (%)	~97-99	~98-102	97.8	100.0	101.0	97.7	97.7
Return on revenue (%)	N.A.	N.A.	7.3	5.7	5.9	4.6	5.1

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

Business Risk Profile: Strong

TPG is one of the leading insurance groups in Germany, with a broad business portfolio offering life and P/C insurance

through its defined four segments. Although the group benefits from strong premium diversification across segments and geographies, this has not yet translated into broad earnings' diversity.

The dampening effects from restructuring measures on premium growth are fading, but we believe that the pandemic-related macroeconomic downturn will have a negative impact on the group's 2020 growth aspirations. We estimate a premium decline of 4%-6% in 2020 mainly from the retail international and German retail business. In retail international, we have seen a gross premium decline of 13% in first-half 2020, especially due to a deliberate drop in the Italian single premium life business, as well as lower business activity in Latin America, especially in the motor segment and negative currency effects. The German retail business has mainly been affected in the bancassurance operations due to the mandatory closure of bank branches during the lockdown in Germany. Premiums declined by 5% in the first six months of 2020. For both segments, we believe that this trend will continue in the rest of the year.

The industrial lines sector showed a strong premium increase of 11% in first-half 2020 mainly due to the specialty business and stronger rates. We do not expect such a growth rate by year-end 2020, because some revenue linked contracts will trigger some premium refunds. This is because industrial clients generated lower revenue than estimated due to the economic downturn.

Financial Risk Profile: Very Strong

Based on the analysis of our risk-based capital model, we assess TPG's capital adequacy firmly in the 'AAA' range in 2019 and

assume capitalization will remain at least in the 'AA' range over 2020-2022 despite the group's exposure to large losses such as natural catastrophes and the pandemic. Equally, we expect regulatory capital to remain securely within the group target of 150%-200%. The regulatory solvency ratio was 211% in 2019 and 191% in first-half 2020 without including transitional measures.

Our prospective capital view is based on our expectation that TPG will generate net profit of more than €400 million

in 2020. We expect earnings to decline mainly from large pandemic-related losses in the industrial business, which is partly compensated by a positive claims development in the domestic and international retail operations, for example in the motor business. Large losses from an active natural catastrophe year might further strain 2020 results. We believe that improvements in underlying technical results, reflecting the implementation of restructuring measures in industrial lines and retail Germany, and lower losses from the pandemic will improve net profits to more than €750 million in 2021.

Consequently, we expect the combined ratio to increase to 98%-102% in 2020 and recover to 97%-99% in 2021. Capital market volatility, write-offs in pandemic-affected investments like private equity, and persistently low interest rates will stress investment returns in 2020, where we expect a decline to about 3.1-3.3%. We expect that lower-for-longer yields will continue to erode investment returns, in 2021 leading to an investment yield of 3.0%-3.2%. Consequently, we assume a ROE decline to 2%-4% in 2020, recovering to 5%-7% in 2021 compared with 8.3% in 2019.

In our view, TPG's conservative investment strategy, broad geographic business diversification, and sound risk controls make the group relatively resilient against capital and earnings volatility. In our view, potential volatility might result from large losses, such as natural catastrophe events or the pandemic. However, we believe that the risk is mitigated by a 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 or debt markets, and we expect this to continue. At year-end 2019, TPG's financial leverage ratio (debt plus hybrids to shareholders equity, and consolidating the Hannover Re subgroup) was 24.9%, compared with 25.7% in 2018, while fixed-charge coverage stood at 7.8x in 2019 compared with 7.0x in 2018. Based on our capital and earnings forecast and assuming no major change in TPG's capital management approach, we expect financial leverage to remain below 40%. The fixed-charge coverage ratio will be affected in 2020 by the pandemic, declining to 4x-7x. However, we expect a recovery to 6x-8x in 2021.

Other Key Credit Considerations Governance

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 of 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 financial obligations. Furthermore, Talanx AG benefits from substantial levels of excess capital and a moderate level of 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 is widely held. We understand that Hannover Re's strategy, capital management, and cash flow are independent from Talanx AG. However, we believe there is a strategic alignment between the two groups, indicated by the joint venture in the industrial specialty business.

Environmental, social, and governance

We consider TPG's exposure to environmental and social risks as on par with the insurance sector globally, and with peers such as Mapfre and Allianz. Standards for corporate governance are typically high in Germany and in many of the other countries where TPG has material exposure. The group has three business segments in the primary insurance segment and a majority shareholding in Hannover Re. Much of TPG's exposure to environmental factors stems from its industrial lines sector. For example, climate change could increase the frequency and severity of claims from extreme weather events, including natural catastrophes. However, we believe TPG has contained the risk through sound reinsurance protection and conservative natural catastrophe and other large-loss budgeting--its budget for this was €360 million in 2020. TPG's life operations are exposed to social factors such as demographic trends relating to improved longevity or rising chronic diseases. These trends could increase its liabilities, especially in Germany. Nevertheless, this is a common problem for life insurers. TPG's diversification by business line and the variety of life insurance products it offers mitigates the risks.

We do not foresee any material governance issues that could affect the ratings. The recent changes in the top management were cautiously planned well ahead of time, and we believe the replacements illustrate the group's ability to implement its management succession plans with internal and external resources. We think that the management team has a consistent track record of strategic planning, strong execution, and transparent, demanding, and sophisticated financial management.

Accounting considerations

We mainly base our assessment of TPG on its annual financial statements, including the mutual parent HDI VaG, 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. Our assessment of financial flexibility relies on 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 International Financial Reporting Standards.

Related Criteria

- 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 Primary Insurance Group--Credit Metrics History

Ratio/Metric	2019	2018	2017
S&P Global Ratings capital adequacy*	Extremely strong	Extremely strong	Extremely strong
Total invested assets	98,899	89,739	88,923
Total shareholder equity	12,459	10,650	10,532
Gross premiums written	17,536	15,270	14,803
Net premiums written	13,736	12,662	12,182
Net premiums earned	13,329	12,317	11,843
Reinsurance utilization (%)	21.7	17.1	17.7
EBIT	1,242	902	929
Net income (attributable to all shareholders)	958	703	729
Return on revenue (%)	7.3	5.7	5.9
Return on assets (excluding investment gains/losses) (%)	1.2	0.9	1.0
Return on shareholders' equity (reported) (%)	8.3	6.6	6.9
P/C: net combined ratio (%)	97.8	100.0	101.0
P/C: net expense ratio (%)	28.1	27.6	28.5
P/C: return on revenue (%)	5.8	3.9	4.8
Net investment yield (%) -- including all gains	3.8	3.5	4.1

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 October 28, 2020)*

Holding Company: Talanx AG

Ratings Detail (As Of October 28, 2020)*(cont.)	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	A+/Stable/--
Senior Unsecured	A+
Operating Companies Covered By This Report	
HDI Haftpflichtverband der Deutschen Industrie V.a.G.	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
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/--
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 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/--
neue leben Lebensversicherung AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--

Ratings Detail (As Of October 28, 2020)*(cont.)	
PB 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

*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.