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Ratings

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Vienna Insurance Group

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Vienna Insurance 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	
Very 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
• Leading market position in Austria and Central and Eastern Europe (CEE). • Extremely strong capital adequacy according to our risk-based capital model, as well as solid solvency capital. • Proven access to the equity and bond markets.	• Some capital and earnings sensitivity to interest rate movements, mainly from the life business. • Somewhat higher regional earnings concentration compared with higher rated peers, with about 73% of profit before tax stemming from Austrian and Czech Republic operations based on 2017 figures.

Rationale

S&P Global Ratings' issuer credit and financial strength ratings on Vienna Insurance Group's core operating companies (jointly, VIG) reflect our view of the group as the market leader in its domestic Austrian insurance operations. It also reflects its leading position in CEE, notably in Czech Republic, Slovakia, Poland, and Romania. The group further strengthened its position in Poland through the acquisition of Gothaer Towarzystwo Ubezpieczen (Gothaer TU) in 2018, increasing its non-life market share to 7.8% from 6.2%. Furthermore, the group has robust capital adequacy under Solvency II of 220%, which is comfortably within its internal capital target range of 170%-230%. According to our risk-based capital model, the group disclosed capitalization in excess of the 'AAA' level. However, we also consider that capital and earnings are exposed to interest rate sensitivity, stemming mainly from its life insurance business. This is reflected in a 30-percentage-point sensitivity of regulatory solvency in the case of a decline in the interest rate curve or spread increase of about 100 basis points.

VIG's ultimate majority owner is mutual insurer Wiener Städtische Versicherungsverein, which currently owns about 70% of VIG. The remaining shares are in free float.

In 2017, the group reported gross written premiums (GWP) of €9.39 billion, which is an increase of 3.7% from the 2016 result. About 56% of VIG's GWP were from its property and causality (P/C) operations, 39% from life, and 5% from health. Austria contributed about 41% to total premium income in 2017, with the remaining 59% generated outside of Austria, including 17% from Czech Republic, 9% from Poland, and 9% from Slovakia. The share from Poland will increase in 2018 following the acquisition of Gothaer TU, which generated GWP of about €150 million in 2017.

Outlook: Stable

The stable outlook on Austrian multiline insurer VIG reflects our view that the group will sustain its leading market position in its home market and CEE. We think VIG will be able to maintain strong earnings, supporting at least very strong capital adequacy, despite needs arising from organic and external growth and dividend payments.

Downside scenario

We could take a negative rating action in the next 18–24 months if:

- VIG's market position deteriorated in its main domestic and CEE markets;
- Its operating performance did not meet our earnings expectations for a prolonged period; or
- Its capital adequacy fell below very strong levels according to our risk-based capital model for an extended period.

Upside scenario

We see limited rating upside in the next 18-24 months. However, we could raise the ratings if:

- VIG significantly and sustainably increased its earnings diversity outside Austria and Czech Republic;
- Earnings consistently exceeded our base-case assumptions; and
- Capital adequacy sustainably exceeded the 'AA' confidence level.

Macroeconomic Assumptions

- Ten-year government bond yields remaining relatively low in the eurozone, moderately rising to about 1.2% on average in 2018 and 1.9% in 2019, from 1.1% in 2017.
- Real GDP growth in the eurozone declining to 2.1% in 2018 and 1.7% in 2019, from 2.6% in 2017.
- The unemployment rate in the eurozone reducing to 8.4% in 2018 and 7.9% in 2019, from 9.1% in 2017.

Table 1

Vienna Insurance Group -- Key Metrics								
	--Year ended Dec. 31--							
	2020F	**2019F**	**2018F**	**2017**	**2016**	**2015**	**2014**	**2013**
Gross premiums written (mil. €)	> 10.000	>9.700	~9.500	9,386	9,051	9,020	9,146	9,219
Net income (mil. €)*	>400	~400	350-400	373	321	(15)	391	256
Fixed-charge coverage (x)	5-8	5-8	5-8	4.7	5.4	1.6	8	7.0
Financial leverage (%)	~20	~20	~20	20.8	21.0	20.1	18.5	17.3
S&P capital adequacy	At least very strong	At least very strong	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong
P/C: Net combined ratio (%)§	95-97	95-97	95-97	95.6	96.2	96.1	95.4	99.3
P/C: Net expense ratio (%)	N/A	N/A	N/A	29.4	29.3	29.4	29.6	29.9
P/C: Net loss ratio (%)	N/A	N/A	N/A	66.3	66.9	66.7	65.3	69.0
Return on shareholder's equity (%)	>6	>6	>6	6.3	6.3	(0.3)	7.6	4.8
Common equity (mil. $)	N/A	N/A	N/A	6,044	5,711	4,414	5,283	4,967
Reinsurance utilization (%)	N/A	N/A	N/A	8.5	9.0	8.9	8.8	8.4
P/C: Return on revenue (%)	N/A	N/A	N/A	7.9	6.7	(3.1)	6.9	1.3
Net investment yield (%)	2.6-2.9	2.7-3.0	~3.0	3.1	3.1	3.2	3.5	3.8

F--forecast. N/A--Not applicable. *Net income before minorities. §Combined ratio calculation according to S&P Global Ratings' definition; might deviate from the group's reported figures. Source: S&P Global Ratings.

Business Risk Profile: Strong

VIG has a broad portfolio offering P/C, life, and health products in Austria and the CEE markets. In the Austrian P/C sector, the group is exposed to some natural catastrophe events, like heavy snow, storms, and rain. However, the sector has historically shown a track record of resilient and stable performance through adequate pricing, as well as risk-mitigation initiatives, such as reinsurance. In the life market, we see still higher pressure in earnings than in P/C, mainly stemming from the ongoing low-interest-rate environment, asset-liability management, and comparable high policyholder guarantees in existing in-force policies.

In some of its CEE market, VIG faces somewhat higher political, regulatory, and economic risk than in Austria. We think that our overall industry and country risk assessment for VIG will remain unchanged in 2018-2020.

In our view, VIG has a strong competitive position, mainly reflecting the group's market leading position in Austria and the overall CEE region. We think that the group's multi-brand strategy, multiple distribution capabilities, and broad geographic and business line diversity are strong market credentials. The group aims to further enhance its operational effectiveness and further enforce its banking cooperation by merging some entities within the markets it operates. After the merger of the Hungarian, Slovakian, and Croatian entities, VIG is planning to merge its Austrian subsidiaries Sparkassen Versicherung AG and Wiener Stadtische Versicherung. Furthermore, we also believe that VIG's exclusive bancassurance cooperation agreement with Erste Group Bank AG is a competitive advantage, which was extended until 2033 in May 2018.

Financial Risk Profile: Very Strong

Based on the analysis of our risk-based capital model, we assess VIG's capital adequacy in the 'AAA' range in 2017, and we assume that capitalization will remain at least in the 'AA' level over 2018-2020. The group's regulatory solvency ratio is also robust, with a reported Solvency II ratio of 220%, which is comfortably within the group's internal target of 170%-230%. However, we believe that capitalization is somewhat exposed to volatility resulting from interest rate movements.

We forecast VIG's after-tax earnings at about €350 million–€400 million in 2018-2020, supported by sound technical profitability and improving cost efficiency, despite slightly declining investment results because of the low interest rates. We expect that strong retained earnings will continue to support the group's capital adequacy, while financing organic and inorganic growth and expected dividend payouts of about 30%-50% of net income.

We regard VIG's investment strategy as conservative. Based on first-quarter 2018 figures, 65.3% of assets are invested in bonds with an average credit quality of 'A'. The group's exposure to real estate of 15.5%, including social housing, appears to be high compared with the European average. However, the performance has been historically strong with comparably low volatility. Riskier investments in equities are relatively limited at 4.4%. In our view, VIG's investment portfolio is diverse, with no material segment or obligor concentration.

VIG has demonstrated access to capital markets, and we expect it will continue to be able to regularly access different sources of capital via hybrid securities, reinsurance cover, or equities if needed. At year-end 2017, financial leverage was 20.8%, and we assume it will remain at about 20% in 2018-2020. We also assume fixed-charge coverage will improve to 5x-8x over our forecast period 2018-2020, following potentially higher earnings.

Other Assessments

We consider VIG's importance to enterprise risk management as high given the complexity of its business, the exposure to some natural catastrophe risk, and its exposure to the interest-rate-sensitive life business. We base our assessment on our view of VIG's embedded risk-management culture and sound risk controls for its major risks. Nevertheless, we believe that VIG's strategic risk management remains in a development phase. This is because we think that a holistic approach, including economic capital and risk-and–return considerations in operational and strategic decision-making, is not yet fully in place.

We believe that the management team has a consistent and successful track record of planning with clear measures, and financial and operational targets that are specified for the group and all major business lines. We anticipate that

VIG will continue its expansion in CEE via organic growth and acquisitions within the group's preferred risk tolerances.

We expect VIG'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. There are no refinancing concerns, in our opinion, even though the group reports the next first call date for a subordinated bond in 2018.

Table 2

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

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

Other Considerations

Factors specific to the holding company

Vienna Insurance Group AG Wiener Versicherung Gruppe, the ultimate holding company of VIG's operating entities, writes internal reinsurance and international corporate and large customer business. Because we view the company as an operating holding company with sizable excess capital and sound revenues from its own investments and underwriting activities, we equalize the ratings on the holding company with those on the group's core operating subsidiary.

Accounting considerations

VIG prepares its consolidated financial statements according to International Financial Reporting Standards (IFRS). A particular feature of VIG's IFRS accounting is the limited recognition of deferred acquisition costs in its balance sheet. This is because VIG channels most of its commissions directly through its profit-and-loss statement.

We base our assessment of VIG's capital adequacy on its reported shareholders' equity, which we adjust mainly to account for 50% of the life insurance value in force that is not on the balance sheet, hybrid debt classified as carrying equity content according to our criteria, policyholder capital available to absorb losses, and off-balance-sheet asset-value reserves. We deduct the on-balance-sheet goodwill from capital.

Starting in 2016, VIG fully consolidates asset and liabilities from its social housing participations. We do not include the additional minority interest in our capital calculation, because we think that these minorities are not fungible to absorb losses related to its insurance business. The social housing buildings are partly financed through banking loans, which we view as operational debt rather than financial debt. As a consequence, the financial leverage ratio does not include loans from social housing.

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 August 30, 2018)	
Operating Company Covered By This Report	
Vienna Insurance Group AG Wiener Versicherung Gruppe	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
Junior Subordinated	A-
Related Entities	
VIG RE zajist'ovna a.s.	
Financial Strength Rating	
Local Currency	A+/Stable/--

Ratings Detail (As Of August 30, 2018) (cont.)	
Issuer Credit Rating	
Local Currency	A+/Stable/--
Domicile	Austria

*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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