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Research Update:

Spanish Nacional de Reaseguros Rating Raised To 'A' On Strong Spanish And Growing European Operations; Outlook Stable

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Overview

- Nacional de Reaseguros will continue to generate strong earnings, benefiting from its leading position in the Spanish reinsurance market, the low risk associated with operating in this market, and improved wider economic and growth prospects in Spain.
- We believe that Nacional is showing disciplined execution of its geographic expansion strategy. It is also growing and diversifying its business, widely preserving its risk profile and stable operating performance, and maintaining extremely strong levels of capital adequacy.
- We are therefore raising to 'A' from 'A-' our ratings on Nacional.
- The outlook is stable, signaling our expectation that Nacional will continue to generate strong earnings and preserve sound levels of capital. In addition, we expect it to consolidate its position in the Spanish reinsurance market, and increasingly benefit from its business outside Spain.

Rating Action

On July 24, 2018, S&P Global Ratings raised to 'A' from 'A-' its long-term insurer financial strength and issuer credit ratings on Spanish insurer Nacional de Reaseguros. The outlook is stable.

Rationale

The upgrade reflects our opinion that Nacional will continue to generate sound earnings from its reinsurance operations in Spain, benefiting from its leading position, strong and prudent underwriting, and the low risk associated with operating in the Spanish property/casualty (P/C) insurance market.

We believe that Nacional will continue to benefit from the Spanish P/C market's strong and stable profitability, as demonstrated by its 10-year average combined ratio of just above 93%, with very little volatility, in line with the market.

Spain's system for assessing damages in personal injury claims (Baremo) provides a solid and effective framework to anticipate claims amounts. Meanwhile, the national scheme to cover natural catastrophe events (Consortio)

absorbs losses on all claims arising from such events, which lessens the volatility of the technical results.

We believe that Nacional is also benefiting from Spain's stronger economic growth, as well as the improved credit quality of Spanish investments. Economic growth in Spain is benefiting both Nacional and the wider P/C market (growth of 4.5% in 2016 and almost 4.0% in 2017, stronger than Spanish GDP growth). For more information, see "Spain Long-Term Ratings Raised To 'A-' On Economic Growth And Budgetary Consolidation; Outlook Positive" and "Various Rating Actions Taken On Spanish Insurers Following Sovereign Upgrade").

Nacional is demonstrating disciplined execution of its geographic diversification strategy outside Spain, which is helping to preserve its strong operating performance and extremely strong capital adequacy, according to S&P Global Ratings' risk-adjusted capital adequacy. After many years of consolidating its position in the Spanish reinsurance market, Nacional started to diversify its business outside Spain in 2010. Since then, Nacional's international portfolio has grown, and today contributes a third of the company's total gross written premiums, providing Nacional with volumes and diversification.

Nacional's management and shareholders have committed to slowly and prudently build a niche position outside Spain, leveraging on the company's established and proven expertise as a service-driven coverage provider for small-to-midsize companies. The company is targeting European insurers, particularly in France, Italy, Central European countries, the Nordics, and Portugal. The reinsurer is determined to slowly build profitable, long-term relationships with European insurance companies that have strong underwriting and management, and a local presence.

Nacional's expansion strategy is not without risk, however, mainly due to the challenging competitive dynamics in price-sensitive international reinsurance, as well as the higher reliance on brokers versus its home country. We understand that Nacional is entering new programs by providing a small percentage of coverage and taking new risks, including some catastrophe business. We would expect Nacional's catastrophe and overall risk management to evolve in line with its increasing international profile, which may bring some volatility to its earnings. However, we believe that Nacional's overall risk profile will remain largely unchanged as we do not anticipate that it will take material catastrophe risk in its international business and that catastrophe risk will generally remain absent in its Spanish business.

We expect conservative underwriting and comprehensive reinsurance covers to limit peak risks outside Spain. The majority of Nacional's new portfolio comes from proportional treaties in line with existing ones. In addition, its focus on the EU reduces volatility, as well as regulatory and political risk, owing to its physical and cultural proximity.

We expect Nacional's overall premiums to grow by around 3% in 2018 and 2019, sustained by both its Spanish and, more so, foreign business. We estimate the

net non-life combined ratio will remain below 95%, with little volatility.

We also expect Nacional to maintain risk-adjusted capital adequacy in the 'AAA' level, based on our capital model. It also covers its solvency capital requirements 2.5x under Solvency II. We forecast that Nacional will report stable performance net earnings above €30 million. We expect Nacional to finance capital requirements from the growing business via retained earnings resulting from its stable performance, as well as shareholders' long-term commitment to the company's development. Nacional's dividend payout has historically been conservative, amounting to one-third of net earnings, with no extraordinary dividend payments.

Nacional's exposure to domestic investments has reduced over time to 30% of total invested assets. Our ratings on Nacional are not capped by the sovereign credit rating on Spain, and we could rate Nacional up to four notches higher. Nacional comfortably passes our hypothetical sovereign default stress test under our criteria for rating companies above the sovereign.

Outlook

The stable outlook indicates that we do not expect to change our ratings on Nacional over the next two years. We expect Nacional to maintain its leading and profitable position in Spain while prudently and profitably growing its business position outside Spain. We also expect earnings and capital to remain solid and stable with no material rise in volatility from the increased exposure to catastrophe or other lesser-known risks. We also expect Nacional will increasingly align its enterprise risk management to that of larger peers, with capital adequacy levels further consolidating in the 'AAA' level.

Downside Scenario

We could lower the ratings on Nacional if foreign business growth and related risks were to increase volatility, weaken the company's strong operating performance, or increase its risk profile or capital adequacy below the 'AAA' level.

Upside Scenario

We consider a positive rating action to be remote at this stage.

Ratings Score Snapshot

	To	From
Financial Strength Rating	A/Stable	A-/Positive

Anchor	a	a
Business Risk Profile	Strong	Strong
IICRA	Low	Low
Competitive Position	Strong	Strong
Financial Risk Profile	Very Strong	Very Strong
Capital and Earnings	Very Strong	Very Strong
Risk Position	Intermediate	Intermediate
Financial Flexibility	Adequate	Adequate
Modifiers		
ERM and Management	0	-1
Enterprise Risk Management	Adequate	Adequate
Management and Governance	Satisfactory	Satisfactory
Holistic Analysis	0	-1
Liquidity	Exceptional	Exceptional
Support	0	0
Group Support	0	0
Government Support	0	0

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria

- Criteria - Insurance - Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 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

Ratings List

Upgraded; CreditWatch/Outlook Action

To

From

Research Update: Spanish Nacional de Reaseguros Rating Raised To 'A' On Strong Spanish And Growing European Operations; Outlook Stable

Nacional de Reaseguros S.A.

Issuer Credit Rating

Local Currency

A/Stable/--

A-/Positive/--

Financial Strength Rating

Local Currency

A/Stable/--

A-/Positive/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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