

Nacional de Reaseguros S.A.

Primary Credit Analyst:

Simon Virmaux, CFA, Paris + (33) 1-4075-2519; simon.virmaux@spglobal.com

Secondary Contact:

Jean Paul Huby Klein, Frankfurt (49) 69-33-999-198; jeanpaul.hubyklein@spglobal.com

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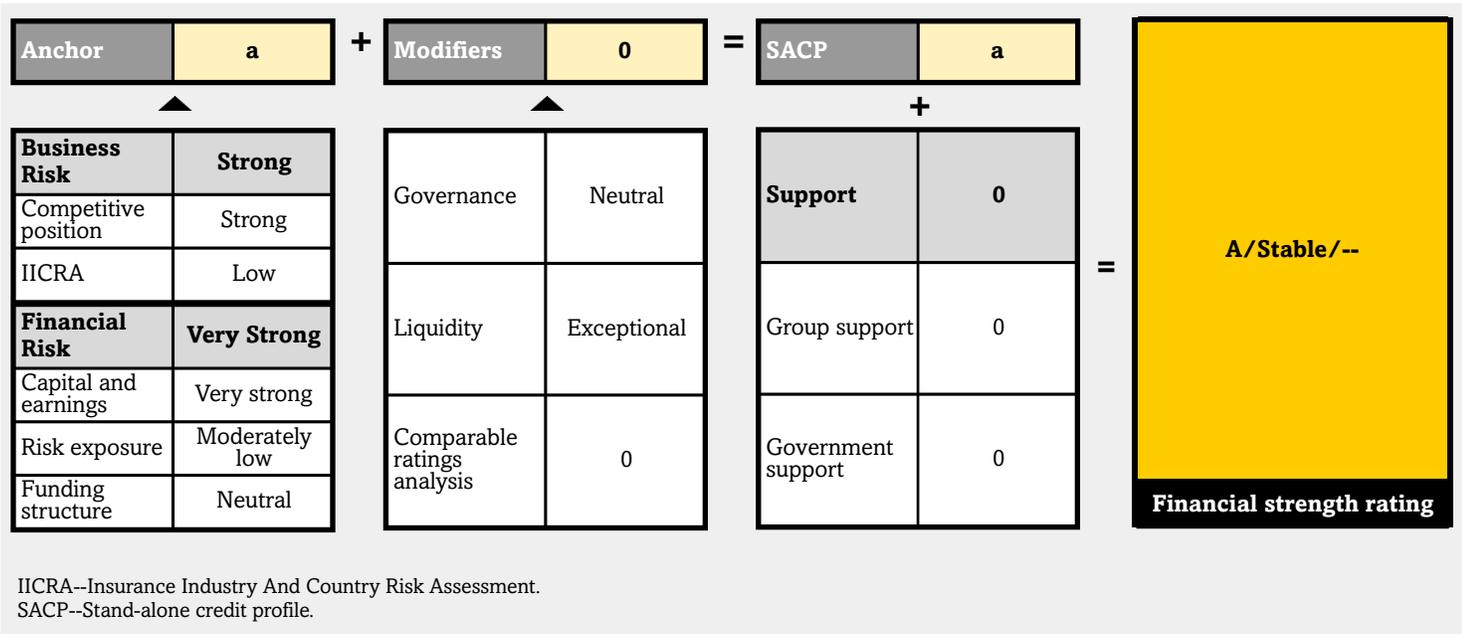
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Nacional de Reaseguros S.A.



Credit Highlights

Overview

Key strengths

Leading position in the Spanish reinsurance market and diversification via foreign business.

Limited earnings volatility from natural catastrophe events.

Resilient earnings generation in the challenging COVID-19-related environment, and excellent risk-adjusted capital adequacy.

Very low expense ratio is a competitive edge.

Key risks

Small absolute size and position in the global reinsurance market.

Relatively short track record of improved earnings from international business.

Limited depth of workforce creates a key-man risk.

Nacional de Reaseguros (NRe) should maintain current capital levels thanks to a limited dent on earnings from the outbreak of COVID-19. The COVID-19 pandemic will dampen NRe's 2020 overall performance, deteriorating a series of years of stable earnings generation that have allowed the reinsurer to build excellent capital adequacy. Nonetheless, we expect NRe to maintain its current capital level over the next two years. Our view is reinforced by its high Solvency II ratio of 260% at year-end 2019.

The company's results will be moderately affected by the challenging environment. We expect NRe's technical and financial performance to continue to be positive, although weaker than previous years. Notably, we expect the combined (loss and expense) ratio to remain below 96%. Sound underwriting and the wider stable claims environment in Spain continue to play a prominent role in NRe's good experience of claims. These led to a five-year average combined ratio of 93%, with little volatility until 2019. The overall return on equity has remained above 10% over the same period.

We expect NRe to maintain its leading position in Spain's reinsurance market. Thanks to long-lasting relationships with insurers and brokers, NRe is a well-recognized brand in Spain, where we expect it will keep its competitive advantage and strong market position. Outside Spain, NRe has progressively expanded its activities over the past decade thanks to a selective distribution approach. Notwithstanding the diversification from this foreign business, the company's scale and geographic footprint remains small in a global context. This influences our view of NRe's competitive position compared with that of most 'A+' rated peers.

We consider that risk exposure will remain moderately low. Some tail property/casualty (P/C) risks underwritten in Spain are mitigated by the Consorcio de Compensacion de Seguros (CCS; a national scheme that will notably cover specific large catastrophe events). Outside Spain, we think that NRe has adopted a prudent approach to its expansion strategy, underwriting a minimal amount of catastrophe risk, as well as continually improving risk management to accompany its expanding international presence.

Outlook: Stable

The stable outlook indicates that we do not expect to take a rating action on NRe over the next two years. NRe has shown resilience against the pandemic. We expect the company will maintain its leading, profitable position in Spain while prudently and profitably expanding its business outside the country. We also expect earnings and capital to remain solid and stable with no material rise in volatility from increased exposure to catastrophes or other lesser-known risks. Furthermore, we expect NRe will increasingly align its enterprise risk management to that of larger peers, with capital adequacy further consolidating at an excellent level.

Downside scenario

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

Upside scenario

We consider a positive rating action to be remote at this stage given the company's lack of global diversification compared with that of higher-rated peers.

Key Assumptions

- Spanish real GDP to contract by 11.3% year-on-year in 2020, follow by a rebound of 8.2% in 2021 and 4.3% in 2022.
- Low long-term Spanish interest rates of 0%-1% for the coming years.
- High unemployment rate in Spain of about 16% in 2020, and 17.5% in 2021. Average inflation in Spain of 1.0% over 2020-2022.

Nacional de Reaseguros S.A.--Key Metrics

| (Mil. €) | 2021f | 2020f | 2019 | 2018 | 2017 | 2016 |
|-------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| S&P Global Ratings capital adequacy | Excellent | Excellent | Excellent | Excellent | Excellent | Excellent |

Nacional de Reaseguros S.A.--Key Metrics (cont.)

| (Mil. €) | 2021f | 2020f | 2019 | 2018 | 2017 | 2016 |
|---|--------------|--------------|-------------|-------------|-------------|-------------|
| Gross premium written | ~555 | ~585 | 590.8 | 567.5 | 556.0 | 532.0 |
| Net income | ~25 | ~25 | 40.2 | 37.0 | 32.1 | 37.7 |
| Return on shareholders' equity (%) | ~6 | ~6 | 10.9 | 10.8 | 9.7 | 12.4 |
| Property/casualty: Net combined ratio (%) | ~95 | ~96 | 92.9 | 92.9 | 96.1 | 90.5 |

f--Forecast.

Business Risk Profile: Strong

NRe is the leading reinsurer in terms of premiums in Spain. It reported €591 million of gross premium at year-end 2019, which represents an estimated market share of almost 10%, excluding intercompany operations in the Spanish reinsurance market. Thanks to solid relationships with both insurers and brokers in Spain, which have been built over the decades, NRe has a leading position on most contracts in its domestic operations.

NRe's expansion across Europe, started in 2010, has borne fruit. The international portfolio now contributes to more than one third of the company's total gross written premium, providing volumes and diversification. However, we believe that its market position internationally is less prominent than in its domestic market. NRe demonstrates disciplined execution of its geographic expansion strategy outside Spain, which helps to preserve its strong operating performance.

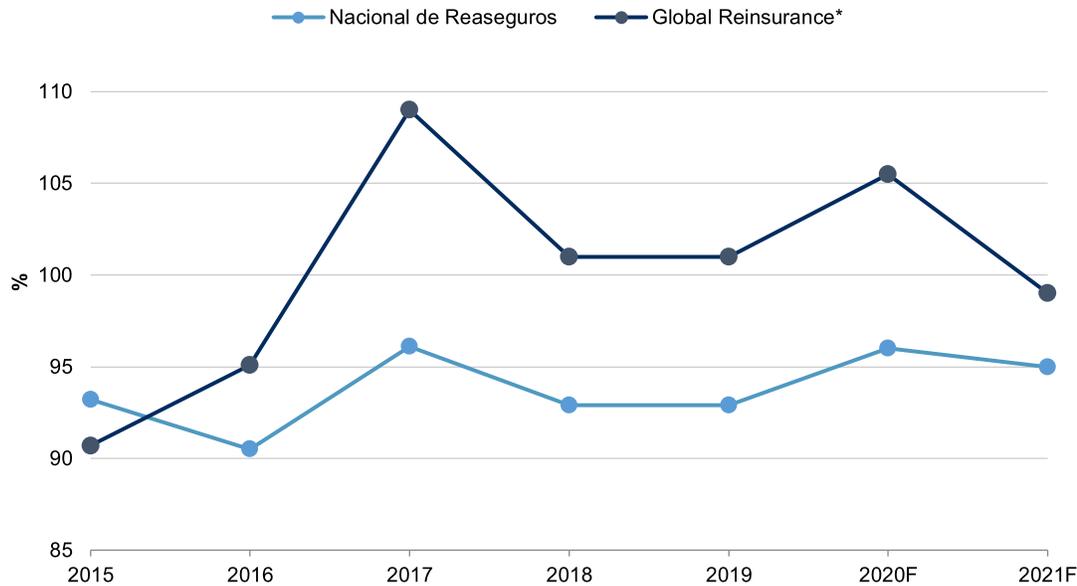
NRe has a diversified insurance business mix, which at year-end 2019 included: fire and multi-risk (43% of gross premiums), life (16%), motor and third-party liability (18%), marine (9%), personal accident and health (6%), and other lines (8%).

We project that NRe's overall premium will decrease by about 1% in 2020 and 5% in 2021, mainly because of the global pandemic. The economic downturn in Spain--we expect a 11.3% GDP contraction for 2020--will hit top line trends in the years to come. We expect that the outbreak of COVID-19 will have a moderate effect on 2020's performance. We forecast that the net non-life combined ratio will remain below 96% over the coming years.

Historically, NRe has shown strong and stable underwriting technical performance, with an average P/C combined ratio of about 93% and return on equity of approximately 10% over the past five years. It benefits from strong and prudent underwriting risk practices, comprehensive reinsurance cover, and a stable claims environment in the Spanish P/C market.

Chart 1

Combined Ratio : Nacional de Reaseguros Versus Global Reinsurance Market
 Nacional de Reaseguros' stable P/C technical results



Source: S&P Global Ratings. *Based on the top 20 global reinsurers: Alleghany, Arch, Aspen, AXIS, China Re, Everest Re, Fairfax, Fidelis, Hannover Re, Hiscox, Lancashire, Lloyd's, Markel, Munich Re, PartnerRe, Qatar Ins., RenaissanceRe, SCOR, Sirius, and Swiss Re. P/C--Property/casualty. F--forecast.
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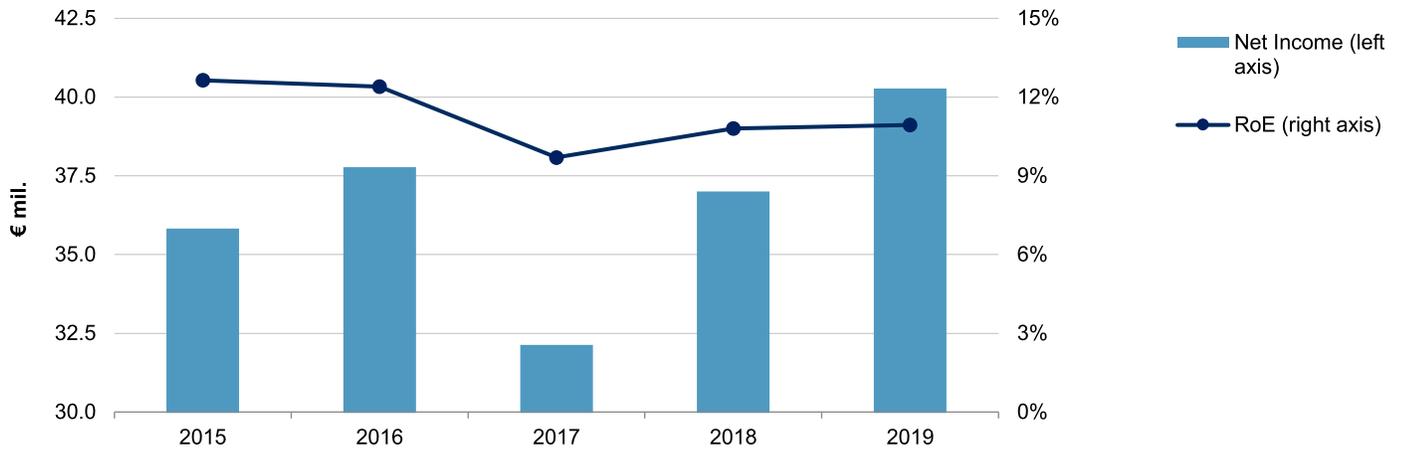
Financial Risk Profile: Very Strong

NRe's reinsurance operations are backed by a solid and protected balance sheet, which is resilient against the current crisis environment. We expect NRe to maintain excellent risk-adjusted capital adequacy according to our model in the years to come. It comfortably covers its solvency capital requirements by about 2.6x under Solvency II at year-end 2019. However, we believe that the small absolute size of its capital remains a risk compared with larger reinsurers, making the company somewhat susceptible to movements in capital and earnings in the event of potential large losses.

NRe's shareholders have a long-term commitment to its development. In spite of the crisis, we forecast that NRe will generate annual net earnings of around €25 million, retaining about 65% of this to finance capital requirements from the expanding business and continually increase its capital base. NRe has no debt and we consider its need for extraordinary additional funds to be modest because of its long-established strategy of self-financing organic growth.

Chart 2

Nacional de Reaseguros' Consistent Profitability
Operating performance



ROE--Return on equity. Source: S&P Global Ratings.
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Proportional treaties account for more than 70% of the business that NRe underwrites, and property reinsurance exposure mostly refers to residential properties. Spain's system for assessing damages in personal injury claims (Baremo) provides a solid and effective framework to anticipate claims amounts. Meanwhile, the CCS scheme to cover natural catastrophes absorbs losses on all claims arising from such events, which lessens the volatility of technical results.

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

NRe's investment strategy focuses on short-duration and liquid assets, consistent with a strict asset-liability management policy. NRe's average credit quality in its fixed-income portfolio is at the 'A' level, supporting the overall financial risk profile. Exposure to equities is relatively high, representing about 19% of total invested assets at market values, although around 9% refers to NRe's long-term investment in Grupo Compañía Española de Crédito y Caución S.L. Net investment yields were 1.1% (2.0% including realized and unrealized gains) in 2019.

NRe's catastrophe and overall risk management is improving to support its increasing international profile. It mitigates the exposure to potentially more volatile earnings. We believe NRe's overall risk profile remains largely unchanged since we do not anticipate that it will take material catastrophe risk in its international business, and that catastrophe risk will generally remain controlled in its Spanish business.

Other Key Credit Considerations

Governance

NRe has an effective governance framework in place, with management and shareholders seamlessly committed to slowly and prudently building a niche position outside Spain, taking advantage of the company's established expertise as a service-led coverage provider for small and midsize companies. Risk management is ingrained in NRe's culture, with continual efforts to embed risk-based decisions at all levels of the organization.

Liquidity

Liquidity is exceptional: NRe maintains a sufficient level of cash or cash equivalents, as well as a high portion of readily realizable assets to face its obligations in the short term.

Ratings above the sovereign

Our ratings are based on NRe's stand-alone credit profile. NRe could be rated above Spain because it passes our capital and liquidity sovereign stress tests thanks to a well-diversified asset portfolio; around two thirds is allocated outside Spain in various geographies. NRe could be rated up to four notches above Spain, reflecting our view of moderate sensitivity to country risk.

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: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- 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

Related Research

- Rated Spanish Insurers To Remain Resilient Despite Challenging Conditions, Sept. 21, 2020

Appendix

| Nacional de Reaseguros S.A.--Credit Metrics History | | |
|---|-----------|-----------|
| Ratio/Metric | 2019 | 2018 |
| S&P Global Ratings capital adequacy* | Excellent | Excellent |
| Total shareholder equity | 390.9 | 345.2 |

Nacional de Reasegueros S.A.--Credit Metrics History (cont.)

| Ratio/Metric | 2019 | 2018 |
|--|-------|-------|
| Gross premiums written | 590.8 | 567.5 |
| Net premiums written | 472.2 | 450.4 |
| Net premiums earned | 467.3 | 449.0 |
| Reinsurance utilization (%) | 20.1 | 20.6 |
| EBIT | 52.0 | 47.7 |
| Net income (attributable to all shareholders) | 40.2 | 37.0 |
| Return on revenue (%) | 9.1 | 9.6 |
| Return on shareholders' equity (reported) (%) | 10.9 | 10.8 |
| P/C: net combined ratio (%) | 92.9 | 92.9 |
| P/C: net expense ratio (%) | 29.7 | 30.5 |
| Net investment yield (%) | 1.1 | 1.1 |
| Net investment yield including investment gains/(losses) (%) | 2.0 | 1.4 |

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-/bbb | 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 November 6, 2020)*

Operating Company Covered By This Report

Nacional de Reasegueros S.A.

Financial Strength Rating

Local Currency

A/Stable/--

Issuer Credit Rating

Local Currency

A/Stable/--

Domicile

Spain

*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.

Additional Contact:

Insurance Ratings Europe; insurance_interactive_europe@spglobal.com

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