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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.

Rationale

Business Risk Profile: Strong

- Leading market position in Austria and Central and Eastern Europe (CEE).
- Sound geographic and business line diversification, with a well-established multichannel distribution strategy, including exclusive distribution with Austrian bank Erste Group.
- Recovery in net income in 2016 to €320 million, after unexpected impairments on intangible assets in 2015, and our expectation that it will exceed €300 million in 2017-2018.

Financial Risk Profile: Very Strong

- Capital adequacy, based on our internal risk-based capital model, at the 'AAA' level in 2016.
- Capital that will likely stay at least very strong in 2017-2019, based on strong earnings to finance growth and dividend expectations.
- Proven access to the equity and bond market, with a conservative investment strategy and comprehensive reinsurance coverage that support the group's capital and earnings.

Other Factors

- S&P Global Ratings' combined view of Vienna Insurance Group AG Wiener Versicherung Gruppe (VIG)'s strong business risk and very strong financial risk profiles leads to an anchor of 'a' or 'a+'. We use the 'a+' anchor to reflect VIG's market leading position in Austria and CEE, as well as its ample access to external funding and strong backing from its owner, mutual insurer Wiener Städtische Wechselseitiger Versicherungsverein – Vermögensverwaltung– Vienna Insurance Group (Wiener SWVV).
- 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 underwriting activities, we equalize the ratings on the holding company with those on the group's core operating subsidiary.

Outlook: Stable

The stable outlook on Austrian multiline insurer VIG reflects S&P Global Ratings' view that the group will sustain its strong competitive position in its home market and its leading market position in CEE. We think VIG will achieve 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 domestic market or in CEE;
- Its operating performance sustainably did not meet our base-case earnings assumptions; or
- Its capital adequacy fell below very strong levels according to the S&P Global Ratings capital model for a prolonged period, possibly as a result of deteriorating credit conditions in CEE.

Upside scenario

We see limited rating upside in the next 18-24 months. However, we could take a positive rating action if:

- VIG significantly and sustainably increased its earnings diversity outside Austria and Czech Republic;
- Operating performance consistently exceeded our expectations; and
- Capital adequacy sustainably exceeded the 'AA' confidence level.

Base-Case Scenario

Macroeconomic Assumptions

- Ten-year government bond yields remaining relatively low in the eurozone, at about 1.3% on average in 2017 and 1.7% in 2018.
- Stable real GDP expansion in the eurozone, with growth at 1.6% in 2017 and 1.5% in 2018.
- Small decline in the unemployment rate in the eurozone to 9.4% in 2017 and 8.9% in 2018, from 10% in 2016.

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Company-Specific Assumptions

- Maintenance of a leading market position in Austria and main CEE markets.
- A net combined (loss and expense) ratio, the industry's main underwriting profitability metric, in the 96%-98% range in 2017-2019.
- A life/health new business margin of 3.5%-4.0%.
- Net income that will likely exceed €300 million per year in 2017-2019.
- Capital adequacy that will likely stay at least in the 'AA' range in 2017-2019.
- A fixed-charge coverage of 5x-8x and financial leverage slightly higher than 20% in 2017-2019.

Key Metrics

	2018f	2017f	2016	2015	2014
Gross premiums written (mil. €)	>9,200	~9,100	9,051	9,020	9,146
Net income (mil. €)	>300	>300	321	(15)	391*
Property/casualty: net combined ratio (%)§	96-98	96-98	96.2	96.1	95.4
Life: new business margin (%)	3.5-4.0	3.5-4.0	3.8	4.0	3.4
S&P Global Ratings' capital adequacy	At least very strong	At least very strong	Extremely strong	Extremely strong	Extremely strong
Fixed-charge coverage (x)	5-8	5-8	5.4	1.6	8.0
Financial leverage (%)	>20.0	>20.0	21.0	20.0	18.5

*Figure as reported in 2014. §Combined ratio calculation according to S&P Global Ratings' definition; might deviate from the group's reported figures.

Company Description

VIG holds a market leading position in the Austrian insurance sector. It also holds leading positions in CEE, notably in Czech Republic, Slovakia, Poland, and Romania, writing life, non-life, and health business using different brands for different regions. In 2016 and 2017, the group further strengthened its market position in the CEE region by acquiring the Romanian and Serbian operations of AXA, as well as the majority shares of BTA Baltic Insurance Company AAS, one of the main insurers in the Baltic region. Overall, the group reported gross premiums written of €9.05 billion in 2016, split between property/casualty (P/C; 53.9%), life (41.5%), and health (4.6%). Austria contributed 46% to total premium income in 2016, with the remaining 54% generated outside Austria, including 18% from Czech Republic, 9% from Poland, and 8% from Slovakia.

VIG's ultimate majority owner is mutual insurer Wiener SWVV (not rated), which currently owns about 70% of VIG. The remaining shares are in free float.

Business Risk Profile: Strong

Insurance industry and country risk: Broad geographic diversification in the CEE region

In our view, VIG faces intermediate industry and country risk, which reflects a blended assessment of the various insurance markets in which the company operates. VIG has built up a diverse business portfolio by sectors and geography, including a leading market position in its domestic Austrian market.

We believe that VIG's insurance operations benefit from Austria's prosperous and competitive economy, as well as its institutional effectiveness, credibility of budgetary policies, and respected rule of law. The Austrian P/C insurance sector has historically shown a track record of resilient and stable performance despite its exposure to natural catastrophe claims. The sector's adequate pricing as well as risk mitigation initiatives, such as reinsurance, limited volatility in the past. In the life market, we see higher pressure on earnings than in P/C, mainly stemming from the ongoing low-interest-rate environment, asset-liability management risk, and comparably high policyholder guarantees in existing inforce policies.

In the CEE markets, VIG faces somewhat higher political, regulatory and economic risks than in Austria. We think our overall industry and country risk assessment for VIG will remain unchanged in 2017-2019.

That said, the uptake of insurance policies will likely remain relatively low in CEE, visibly lagging the Western European average. We therefore expect further growth potential will emanate from CEE rather than the domestic market.

Table 1

Vienna Insurance Group Industry And Country Risk

Insurance sector	IICRA	Business mix (%)
Austria P/C	Low	26
Austria Life	Low	20
Czech Republic P/C	Intermediate	11
Czech Republic Life	Intermediate	7
Poland P/C	Moderate	5
Poland Life	Moderate	4
Turkey P/C	Moderate	2
Germany P/C	Low	1
Germany Life	Intermediate	1
Other markets	Moderate	23
Weighted average IICRA	Intermediate	100

P/C--Property/casualty. IICRA--Insurance Industry Country Risk Assessment.

Competitive position: A leading market position in Austria and CEE

In our view, VIG has a strong competitive position, mainly reflecting the group's market leading position in Austria, Czech Republic, Slovakia, and Romania, as well as its position in the top four in most of its CEE markets, namely including Poland. We think the group's multibrand strategy, multiple distribution capabilities, and broad geographic and business line diversity (P/C, 53.9% of total premiums in 2016; life, 41.5%; and health 4.6%) are strong market credentials. We also believe that VIG's exclusive bancassurance cooperative agreement with Erste Group Bank AG is a competitive advantage.

VIG posted net income of €320 million in 2016, which is an improvement relative to the €15 million loss in 2015. The group had to retroactively restate reported net income of €110 million for 2015, with a €125 million negative impact comprising goodwill impairment of about €91 million and a change in the valuation of its social housing of €34 million.

We think that after unexpected losses at the group's Romanian operation and the Italian P/C business in 2013, and the losses in 2015 from IT impairments and retroactive valuation changes, the group has shown higher volatility in earnings than in the past and needs to restore a track record of sustainable operating performance in line with its objectives and our base-case assumptions. We assume the group will post a combined ratio of 96%-98%, a new business margin in life/health of 3.5%-4.0%, and net income of at least €300 million over the next two years.

We expect VIG will defend its leading position in Austria and CEE in 2017-2019 by leveraging its existing operations and, potentially, strengthening its market share through bolt-on acquisitions in CEE, like the recent examples in Romania, Serbia, and the Baltics.

Table 2

Vienna Insurance Group Competitive Position

	--Year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Gross premiums written	9,051	9,020	9,146	9,219	9,646
Change in gross premiums written (%)	0.3	(1.4)	(0.8)	(4.4)	8.6
Net premiums written	8,240	8,220	8,337	8,445	8,935
Change in net premiums written (%)	0.2	(1.4)	(1.3)	(5.5)	9.7
Total assets under management*	44,645	39,238	38,731	36,387	36,555
Growth in assets under management (%)	13.8	1.3	6.4	(0.5)	7.4
Reinsurance utilization (%)	9.0	8.9	8.8	8.4	7.4
Business segment (% of gross premiums written)					
Life/health	41.5	44.6	45.9	45.6	47.5
Property/casualty	53.9	51.0	49.9	50.1	48.4
Health	4.6	4.4	4.2	4.3	4.1

*Including unit- and index-linked products.

Financial Risk Profile: Very Strong

Capital and earnings: Ample capitalization to finance organic growth and potential bolt-on acquisitions

We regard VIG's capital and earnings as very strong, based on our view of its 'AAA' capital adequacy. We think that the group's past earnings volatility will stabilize, supporting a small increase in capital requirements from modest business growth and a continued conservative investment strategy.

We assume under our base case that VIG will at least maintain capital adequacy in excess of our benchmark for the 'AA' rating in 2017-2019. We forecast VIG's earnings at more than €300 million in 2017-2019, supported by sound technical profitability, as described above, and despite slightly declining investment results because of low interest rates. We forecast that strong retained earnings will continue to support the group's capital adequacy, while financing organic or inorganic growth and expected dividend payouts of about 30%-50%.

Table 3

Vienna Insurance Group Capital

	--Year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Common equity*	5,711	4,414	5,283	4,967	5,689
Change in common equity (%)	29.4	(16.4)	6.4	(12.7)	12.7
Total capital (reported)	9,751	6,023	6,664	7,206	7,952
Change in total capital (reported) (%)	61.9	(9.6)	(7.5)	(9.4)	(4.0)

*2015 figures including restatements from the 2016 annual report. 2012-2014 numbers according to reported figures in the respective financial years.

Table 4

Vienna Insurance Group Earnings

	--Year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Total revenues *	9,410	9,356	9,587	9,806	10,319
EBIT adjusted §	517	32	498	301	525
Net income	321	(15)	391	256	445
Return on shareholders' equity (reported) (%)	6.3	(0.3)	7.6	4.8	8.3
P/C: Net expense ratio (%) †	29.3	29.4	29.6	29.9	28.0
P/C: Net loss ratio (%)	66.9	66.7	65.3	69.0	65.3
P/C: Net combined ratio (%) †	96.2	96.1	95.4	99.3	93.9
P/C: Return on revenue (%)	6.7	(3.1)	6.9	1.3	8.0
Life: Net expense ratio (%) ‡	17.7	17.1	16.9	15.6	14.1
Life: Value of new business	131	148	150	159	204
Life: New business margin (%)	3.8	4.0	3.4	4.1	4.3
Operating earnings by segment					
Life & health	252	196	209	302	233
Non-life	147	(149)	310	54	331
Other	(1)	0	0	0	0

*Reported data, including unit-linked business. §Before (un)-realized capital gains/losses.†Combined ratio and expanse ratio calculated according to S&P Global Ratings' definition; might deviate from company's reported figures. ‡Net premiums earned used for 2015 and 2016, due to a change in the group's segment reporting. P/C--Property/casualty.

Risk position: Diverse investment portfolio and sound reinsurance coverage

In our view, VIG's conservative investment strategy and sufficient reinsurance coverage against natural catastrophe exposure in Austria and CEE are making the group relatively resilient against capital and earnings volatility. About 66% of VIG's investments comprise bonds, with an average rating of 'A'. Moreover, VIG's exposure in equity, including investment funds, and alternative investments of about 7% at year-end 2016, is low compared with peers', in our view. The group's 16% exposure to real estate, including social housing, is high compared with the European average. However, the performance has been historically strong, with comparably low risk and volatility. We regard VIG's investment portfolio as diverse, with no material segment or single obligor concentration.

Although VIG is exposed to natural catastrophes in Austria and CEE, we believe its comprehensive reinsurance coverage significantly reduces the group's net exposure. In order to optimize the reinsurance structure, VIG pools its reinsurance needs within the internal reinsurer VIG Re, taking advantage of diversification effects within its portfolio. Risk exposure that goes beyond the defined risk tolerances are ceded to a broad range of external reinsurers. The group limits its natural catastrophe losses through a comprehensive excess of loss coverage for all exposed lines of business.

Table 5

Vienna Insurance Group Risk Position

	--Year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Total invested assets*	44,645	39,238	38,731	36,387	36,555
Net investment income	1,034	984	1,071	1,139	1,186
Net investment yield (%)	3.1	3.2	3.5	3.8	4.0
Net investment yield including realized capital gains/(losses) (%)	3.3	3.9	4.2	4.5	4.7
Net investment yield including all gains/(losses) (%)	3.0	3.5	3.8	4.2	4.4
Investment portfolio composition (%)					
Cash and short-term investments	5.8	6.2	5.2	6.1	6.6
Bonds	65.6	72.7	72.8	69.4	67.0
Equity investments§	7.0	7.8	6.8	6.6	5.7
Real estate	15.5	6.1	6.0	9.0	10.7
Mortgages	1.2	1.5	1.8	1.4	1.3
Loans	3.3	3.9	3.9	4.5	5.0
Investments in affiliates	1.6	1.8	3.4	2.9	3.7
Other investments	0.0	0.0	0.0	0.0	0.0

*Includes unit-linked and index-linked products. §Includes investment funds.

Financial flexibility: A moderately low increase in indebtedness

VIG has strong financial flexibility, in our view, thanks to the group's proven access to capital markets and sound financial leverage.

We expect majority shareholder Wiener SWVV will maintain a stake of at least 51% in VIG and secure the group's financial independence. In our view, VIG has ample sources of additional funding capacity, including the equity, reinsurance or debt markets. The group issued in 2017 two subordinated bonds totaling €450 million, which it has used in part to refinance two maturing supplementary capital bonds due in January 2017.

We expect that the small additional amount of debt will elevate the financial leverage ratio (debt plus hybrids to economic capital) to slightly more than 20% and fixed-charge coverage will be at about 5x-8x.

Table 6

Vienna Insurance Group Financial Flexibility

	--Year ended Dec. 31--				
(x)	**2016**	**2015**	**2014**	**2013**	**2012**
Fixed-charge coverage	5.4	1.6	8.0	7.0	8.4

Table 6

Vienna Insurance Group Financial Flexibility (cont.)					
	--Year ended Dec. 31--				
(x)	**2016**	**2015**	**2014**	**2013**	**2012**
Financial leverage (%)	21	20	19	17	15

Other Assessments

Enterprise risk management: Adequate, with strong risk controls

We do not expect VIG will experience losses from traditional risk areas outside the normal range. We base our assessment on our view of VIG's embedded risk-management culture and sound risk controls for the group's major risks. Although VIG's partial internal capital model has been among the first that have been approved by the Austrian regulator, 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 and performance assessment, is not yet fully in place.

Management and governance: Strong

We consider that the group has a clear, credible, and consistent strategy focusing on Austria and the CEE market, where it has an overall market leading position. VIG has clear measures, financial and operational goals that are specified for the group and all major lines of business. We see its financial management as conservative. VIG's earnings were hurt in 2015 and 2013 by some unexpected impairments, which we view as onetime earning events. Moreover, we think the group has restructured its underperforming operations in Romania and Italy, which in our view demonstrates the continued execution of its strategy. We anticipate that VIG will continue its expansion in CEE via organic growth and acquisitions within the group's predefined risk tolerances.

Liquidity: Exceptional

Our view of VIG's liquidity as exceptional reflects the strength of the group's available liquidity sources--mainly premium income--and its 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. We think the group is capable of managing any unexpected large claims or an increase in life insurance policy lapses.

Accounting Considerations

VIG prepares its consolidated financial statements according to International Financial Reporting Standards (IFRS). We base our analysis of the group's life profitability and risk exposures mainly on market-consistent embedded value disclosure. The group bases its calculation on year-end swap rates and includes liquidity premiums. 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, parts of the 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 17, 2017)	
Operating Company Covered By This Report	
Vienna Insurance Group AG Wiener Versicherung Gruppe	
Financial Strength Rating	
Local Currency	A+/Stable/--
Counterparty Credit Rating	
Local Currency	A+/Stable/--
Junior Subordinated	A-
Related Entities	
VIG RE zajist'ovna a.s.	
Financial Strength Rating	
Local Currency	A+/Stable/--
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

Ratings Detail (As Of August 17, 2017) (cont.)

debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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