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DEVK Insurance Group

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Table Of Contents

DEVK Insurance Group

Anchor	a+
Business Risk	**Strong**
Competitive position	Strong
IICRA	Low
Financial Risk	**Excellent**
Capital and earnings	Excellent
Risk exposure	Moderately low
Funding structure	Neutral

+

Modifiers	0
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0

=

SACP	a+

+

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

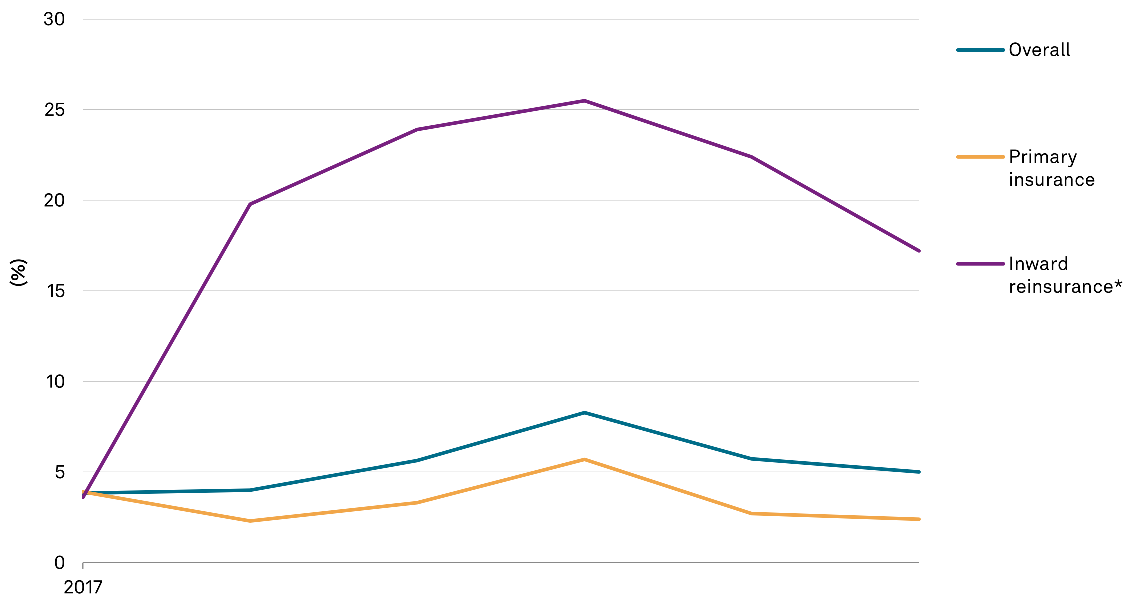
Overview

Key strengths	**Key risks**
A long-established brand in the German insurance market, especially in the railway sector.	Some concentration in the German motor business line, which has experienced margin pressure lately, due to inflation and an increase in claim frequency.
Strong distribution capabilities, supported by an exclusive bancassurance contract with Sparda-Bank.	Elevated volatility in capital markets could weigh on the group's revenue and earnings, especially in the case of its life insurance business.
Very robust capitalization as per our risk-based capital model, coupled with robust regulatory solvency levels and good reinsurance protection.	

Strong premiums growth in 2023 will support underwriting results. We expect premiums growth will accelerate to 7%-10% in 2023, because a spike in reinsurance premiums will enable DEVK Insurance Group's (DEVK's) entities DEVK Re (A+/Stable/--) and Echo Rueckversicherungs-AG (A-/Positive/--) to benefit from material rates hardening in Europe and the U.S. In addition, we believe the group will further expand into some new risk areas within its reinsurance operations. In our view, growth is also supported by DEVK's German non-life business, with DEVK continuing to actively adjust prices to reflect inflation. We now expect the growth rate of DEVK's motor business, which posted weak results in 2022, will be more in line with the group's growth rate. This is because inflation led to an increase in claim costs that was higher than we previously expected. That said, the group is gradually adjusting to higher inflation and a weaker economic environment. We expect an increase in premium volumes of about 4%-7% in 2024 and 2025, considering that inflation will likely remain higher and that prices in the motor business will still need to fully catch up with inflation in 2024-2025. This, in our view, would enable DEVK to protect its established position in the German retail and railway sector.

Chart 1

Strong growth in DEVK's reinsurance segment will continue
Gross written premiums growth over 2017-2022

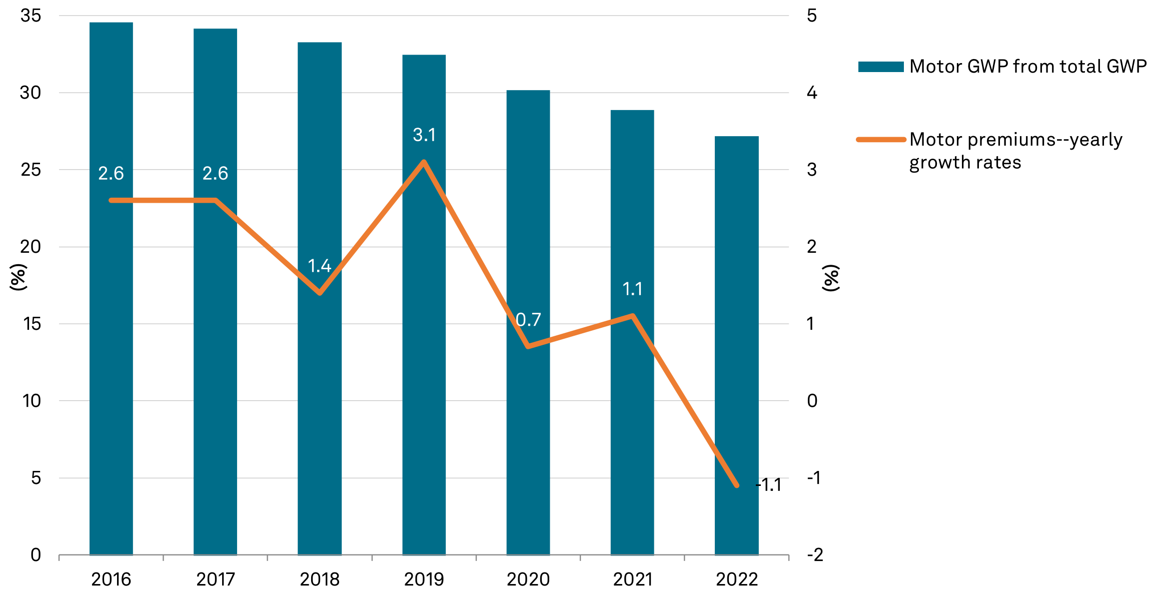


*Includes only reinsurance premiums from outside the DEVK Group. Source: S&P Global Ratings.

In our view, challenges in the German motor business will not derail the overall group performance in 2023-2025. The performance of DEVK's motor business deteriorated in 2022 because of higher inflation, which pushed loss cost trends above DEVK's previous expectations. As a result, the motor business caused significant underwriting losses. In the second half of 2022, the group increased its focus on underwriting profits by launching a comprehensive program that includes motor tariff increases, coverage reductions, the partial cancellation of unprofitable business, and stricter cost controls. All of that should improve the underwriting results of the motor business in 2023 and thereafter. To sustainably reposition its motor business, DEVK also intensified digitalization efforts and improved customer convenience measures. This enables the group to sustain its core strengths of excellent customer service and competitive price quality. We note that the group's generally conservative reserving policy further limits the risks associated with high inflation and provides considerable flexibility for the repositioning of the motor line in the mid-term future.

Chart 2

We expect motor premiums will show strong growth in 2023

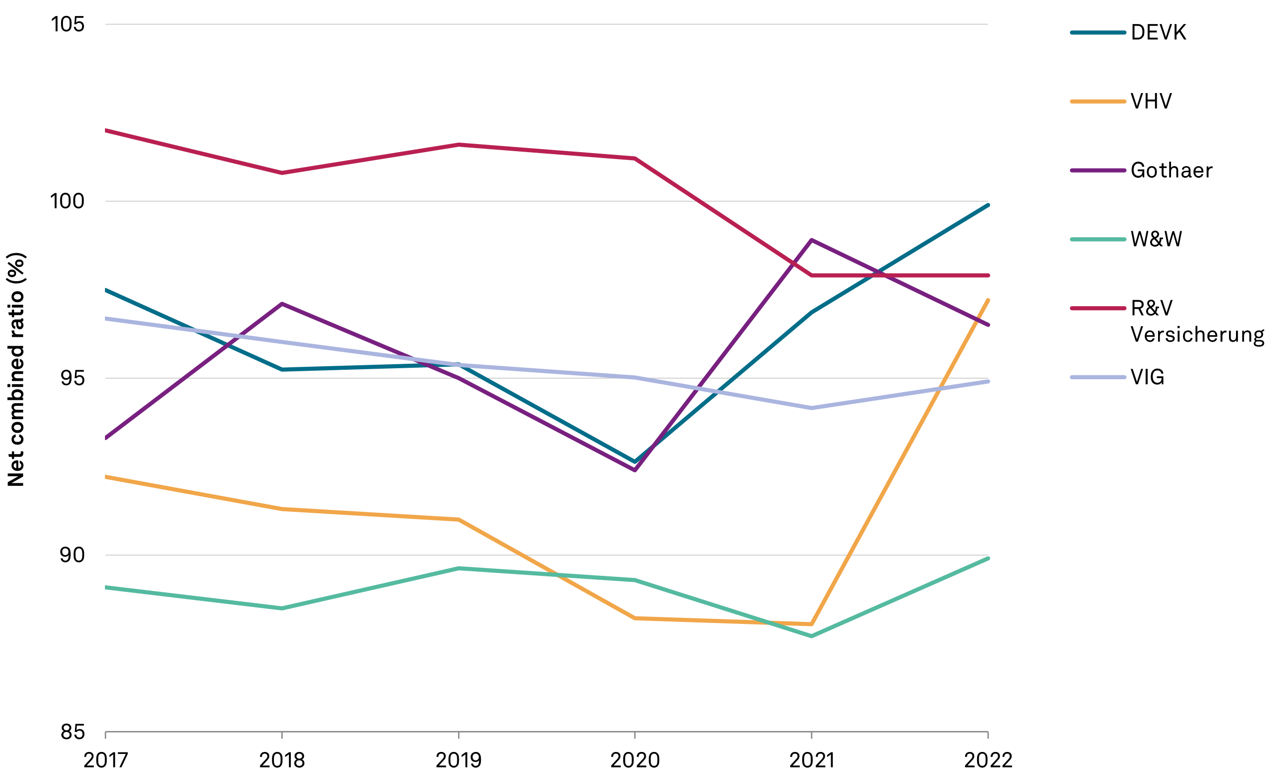


GWP--Gross written premiums. Source: S&P Global Ratings.

The strong reinsurance and property business will offset the weak German motor business. DEVK starts to capitalize on its strategic expansion into the international reinsurance business and the German property business, both of which the group developed in the last decade. The hardening of the international reinsurance and the German property markets in 2022 and 2023 and DEVK's prompt reaction to claim cost trends in the past few years mean that the performance of those two lines is more solid now. We expect that inflation will remain a tailwind for the group's non-motor lines, as it continues to react to evolving claim cost trends in a timely manner. Under our base-case scenario, we believe the group will deliver solid earnings and a stabilized group underwriting performance toward the mid to lower end of our forecast combined ratio of 97%-100%. In addition, higher reinvestment rates due to increased interest rates in Germany and the eurozone will gradually improve investment results. Overall, we expect the group's operating performance will recover, with a net income of €65 million–€100 million. This would correspond to a return on equity of 3%-5% in 2023-2025.

Chart 3

DEVK's property and casualty underwriting performance in 2023 will stabilize at a level that is similar to that of peers



Source: S&P Global Ratings.

Capitalization remains one of DEVK's key rating strengths. Despite the normalization of interest rates in the eurozone, capital market volatility, and DEVK's solid business growth, the group's balance sheet remained strong at the end of 2022, with the capital position remaining solidly above the 'AAA' level, according to our risk-based capital model. That said, the capital buffers slightly reduced in 2022, as capital needs outpaced capital generation. Yet, we think that DEVK's sizable capital buffers still provide sufficient capacity for solid business development in 2023-2025, while cushioning against weaker business conditions and moderate capital market volatility. As a result, we expect the group will maintain capitalization above the 'AAA' level of our insurance capital model over the next two to three years.

Outlook: Stable

The stable outlook reflects our view that DEVK will successfully defend its strong competitive position in the German market and that its earnings will recover, despite current weaker macroeconomic conditions in Germany. This should enable the group to maintain capital adequacy above the 'AAA' level, even with more challenging macroeconomic conditions in Germany and still volatile capital markets.

Downside scenario

A negative rating action on DEVK over the next 12-24 months is unlikely, but we might lower the rating if:

- The group's earnings were consistently weaker than our base-case assumptions, underperforming peers in the German market;
- DEVK's capital reduced below the 'AAA' confidence level of our risk-based capital model, which could happen as a result of aggressive growth or if the group incurred very large losses, for example due to severe financial market stress; or
- We saw higher capital and earnings volatility, for instance if the group significantly increased its international catastrophe exposure through its third-party reinsurance business.

Upside scenario

A positive rating action is unlikely at this time. An upgrade would require an improvement in the competitive position, which could occur if the group significantly diversified its earnings by business line or region. We do not foresee this over the next 12-24 months.

Key Assumptions

- German economy to go through a mild recession in 2023, with real GDP to decline by 0.1%, real growth to improve to 0.8% in 2024 and to 1.6% in 2025.
- Inflation in Germany to remain elevated at 6.5% in 2023 and to decline to 2.9% in 2024. We now expect that inflation will reduce to below 2% only in 2025 but continue to expect that unemployment will remain low at about 3% in 2023-2025.
- Long-term interest rates in Germany to increase to 2.9% in 2023 and 2024.

DEVK Insurance Group--Key metrics

	2024f	2023f	2022	2021	2020	2019
Gross premiums written (mil. €)	> 4,000	> 4,000	3,971.1	3,781.8	3,576.7	3,303.1
Net income (mil. €)	70-100	65-90	35.4	91.6	77.1	113.5
Return on shareholders' equity (%)	3-5	3-5	1.5	3.9	3.5	5.4
P/C: Net combined ratio (%)	97-100	97-100	99.9	96.9	92.6	95.4
S&P Global Ratings capital adequacy	Excellent	Excellent	Excellent	Excellent	Excellent	Excellent

DEVK Insurance Group--Key metrics (cont.)						
	2024f	**2023f**	**2022**	**2021**	**2020**	**2019**
P/C return on revenue (%)	7 - 10	7 - 10	9.1	9.9	10.8	11.0
Net investment yield (%)	2.4 - 3.0	2.3 - 2.9	2.8	2.6	2.7	3.1

f--Forecast. P/C--Property and casualty.

Business Risk Profile: Strong

DEVK is a well-known mutual insurer in the German insurance sector. The group has a long-standing and well-established relationship with the German railway segment and a very good reputation as one of the leading low-cost providers in private lines, in particular motor lines, in Germany. Continuous developments in the past years enabled the group to further evolve its property insurance and to expand its presence in the international reinsurance business, which the group has been active in since 2002. As a result, concentration in German motor lines has gradually reduced to about 27% of gross written premiums at the end of 2022, from about 35% in 2016. Compared with higher-rated peers, DEVK's operations continue to have lower geographical and product diversity. We believe DEVK differentiates itself from other players by offering high service standards and a superior claims management process. While the group follows a multi-distribution channel approach, it still sources most premiums via a network of tied agents, own agents, and a bancassurance partnership with Sparda-Bank.

The group's position remained solid as they continued to expand into domestic property lines and the international reinsurance business in 2022. New risks, some price adjustments due to higher inflation, and material price increases in property lines after the severe floods in Germany in 2021 have resulted in a solid overall premiums growth of 5.0% (5.7% in 2021) to almost €4.0 billion in 2022, despite the rising cost of living and supply chain disruptions. DEVK's property and casualty (P/C) segment recorded a premiums growth of 6.4% in 2022, while life segment premiums remained flat, compared with a 5.9% drop for the German life market. DEVK's overall business mix remains stable, with 79% of premiums from P/C and 21% from the life segment. Unlike its peers in the German market, the group benefited from its stronger focus on the non-life business in the past few years.

Higher inflation, the normalization of interest rates and claims, and capital market volatility affected the group's underwriting and investment performance in 2022. In particular, the group's motor business suffered from the higher cost claim trends in the motor business in Germany, where DEVK recorded underwriting losses in 2022. However, the negative effect in 2022 was largely offset by other non-life lines. As a result, group underwriting results remained marginally positive, with a net combined ratio of 99.9%. But due to a deterioration in underwriting profitability and the weaker performance of some investments (mainly in the equity space) in 2022, the group's overall net income reduced to €35.4 million, which corresponds to a return on equity of 1.5%. We note that the underwriting performance of DEVK's international reinsurance business was at the level of the overall group's combined ratio, as DEVK faced relatively high natural catastrophe claims in 2022.

DEVK has shifted its life focus toward the more profitable biometric business and the capital-light savings business. The group has more life insurance business with guarantees than some of its direct domestic peers. Increases in German interest rates in 2022 and 2023 have reduced pressure on DEVK's traditional life insurance back book. In light of the duration of the asset portfolio, however, it will take time for the life segment to benefit from rising investment yields. We expect the group will continue to focus on the biometric business and the capital-light savings business in 2023-2025. That said, we expect that the group's life business will decline in line with the German life insurance market because of more challenging economic conditions and ongoing capital market volatility.

Financial Risk Profile: Excellent

DEVK's financial profile is supported by an excellent capital position, based on our capital model, and a high Solvency II ratio. We believe that the recovery of the group's operating performance will contribute to capital generation, support growth financing, help DEVK retain its robust capital position, and provide a buffer against investment risks. We consider that the funding structure remains neutral for the group's financial risk profile.

DEVK maintained a robust capital position above the 'AAA' level at year-end 2022, supported by its high Solvency II ratio of 301%. Prior to 2022, DEVK had a strong and growing capital buffer at the 'AAA' level. It cushioned against the negative effect of the aggressive normalization of interest rates in the eurozone and the significant capital market volatility, including widening credit spreads and equity market downturns, in 2022. Given DEVK's current capital buffers, which include large reserving buffers, and the expected recovery of earnings, which are fully retained, we expect that the group's capitalization will remain relatively solid and that it will continue to be a key strength through 2025. Furthermore, we think DEVK's consolidated capital is of good quality, as it mainly stems from sizable shareholder equity. DEVK has very prudent margins on its P/C loss reserves, a sizable equalization reserve, and a comfortable buffer of policyholder bonus reserves.

DEVK managed to source stable and solid reinsurance protection for 2023, despite more challenging reinsurance markets. We believe that DEVK's protection remains in line with its past protection, which proved its effectiveness in 2021--one of the costliest years in terms of natural catastrophes in Germany. We expect that DEVK will continue to safeguard its balance sheet from material capital and earnings volatility with an effective and cost-competitive reinsurance protection.

The pressure on life insurance has slightly reduced, as interest rates have increased. We note that, despite the increase in interest rates in 2022, DEVK's additional life reserves, which the group was building in the past years, remained relatively flat, compared with 2021. In light of currently higher interest rates, we expect the annual amount of additional life reserves DEVK will release until 2025 will be small. The majority of the reserves will remain on DEVK's balance sheet and provide some buffer if needed.

Exposure to less liquid assets, such as property, private debt, and private equity, is mainly concentrated on real estate, which represents about 17% of the group's total invested assets. We expect that the risk of a repricing in real estate markets will remain modest for the group. Most of the real estate investments are in the group's life business, where policyholders have 90% participation in the performance of the assets. DEVK's real estate investments are mainly concentrated in prime residential and commercial areas in Germany. The portfolio remained relatively stable and resilient in 2022. We note that the equity share in DEVK's investments has historically been higher than that of peers. We continue to assess the risk of capital market volatility as relatively elevated in 2023-2025. If material declines in asset prices occurred, DEVK's investment income could come under pressure. That said, most of DEVK's investments remain part of a balanced investment strategy and have limited exposure to credit risk--about 83% of the bonds DEVK invests in are rated at least 'A-'. With higher reinvestment yields on high-quality eurozone debt, we expect investment returns from fixed income will gradually strengthen. Since bonds make up the majority of investments and the investment portfolio is stable, we assume market risk and credit risk will be manageable.

DEVK's funding structure is neutral to the current rating. The group has a debt-free balance sheet and has demonstrated its internal funding capacity through robust capitalization and earnings generation. We believe the group's very robust capital position, good liquidity, and conservative capital structure safeguards its funding capacity in case of need.

Other Key Credit Considerations

Governance: Neutral

DEVK's management team has historically demonstrated that it has a clear strategy for specific client and product segments and that it focuses on efficient and prudent operational management. In our view, DEVK's risk management culture, controls, and strategic and emerging risk management practices are appropriate for the group's overall risk profile and appetite.

Liquidity: Exceptional

In our view, DEVK has sufficient liquidity, despite a decline in its liquidity ratio at year-end 2022, which resulted from capital market volatility and an increase in interest rates. We do not see liquidity at risk or as likely to influence our rating. We expect liquidity will recover in the medium term. In addition, DEVK's expanding operations also provide constant cash inflows. Moreover, larger risks are heavily reinsured, meaning the negative effect of larger claims on the group's cash position is limited.

Factors specific to the holding company

DEVK Re is the intermediate holding company for the group's subsidiaries, operating in reinsurance internally and with external clients. We regard DEVK Re as a regulated operating holding company and equalize our ratings on DEVK Re with those on the group's core operating subsidiaries. This reflects our view of DEVK Re's highly diverse sources of earnings and liquidity and its status as a pool for the majority of the group's excess capital.

Environmental, social, and governance

ESG factors have no material influence on our credit rating analysis of DEVK.

Accounting considerations

DEVK prepares its consolidated financial statements and the accounts for the legal entity under local generally accepted accounting principles. Furthermore, we take into account nonpublic information, such as:

- The composition of the gross surplus in the life business;
- Additional investment-related information for the whole group; and
- Information on reserving in P/C.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- 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

- Swiss Reinsurer Echo Re Outlook Revised To Positive On Improved Operating Performance; 'A-' Ratings Affirmed, Aug. 29, 2023
- Rising Interest Rates Are A Double-Edged Sword For German Life Insurers, May 16, 2023
- Echo Rueckversicherungs-AG, Sept. 15, 2022

Appendix

DEVK Insurance Group--Credit metrics history

Ratio/Metric (mil. €)	2022	2021	2020	2019
S&P Global Ratings capital adequacy*	Excellent	Excellent	Excellent	Excellent
Total shareholder equity	2,448.0	2,389.0	2,284.0	2,169.9
Gross premiums written	3,971.1	3,781.8	3,576.7	3,303.1
Net premiums written	3,717.9	3,562.2	3,391.9	3,130.0
Net premiums earned	3,714.5	3,521.0	3,341.0	3,138.3
Reinsurance utilization (%)	6.4	5.8	5.2	5.2
EBIT	99.7	185.1	107.1	206.6
Net income (attributable to all shareholders)	35.4	91.6	77.1	113.5
Return on revenue (%)	5.8	-0.1	2.8	5.7
Return on shareholders' equity (%)	1.5	3.9	3.5	5.4
P/C: net combined ratio (%)	99.9	96.9	92.6	95.4
P/C: net expense ratio (%)	25.4	25.6	25.3	25.6
P/C: net loss ratio (%)	74.4	70.9	66.7	69.6
P/C: return on revenue (%)	9.1	9.9	10.8	11.0
Net investment yield (%)	2.8	2.6	2.7	3.1
Net investment yield including investment gains/(losses) (%)	1.8	3.9	2.2	4.2

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 September 7, 2023)*

Operating Companies Covered By This Report	
DEVK Deutsche Eisenbahn Versicherung Sach- und HUK-Versicherungsverein a.G. Betriebliche Sozialeinrichtung der Deutschen Bahn	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
DEVK Allgemeine Lebensversicherungs-AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
DEVK Allgemeine Versicherungs-AG	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
DEVK Rueckversicherungs- und Beteiligungs-AG - DEVK RE	
Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
Related Entities	
Echo Rueckversicherungs-AG	
Financial Strength Rating	
Local Currency	A-/Positive/--

Ratings Detail (As Of September 7, 2023)*(cont.)	
Issuer Credit Rating	
Local Currency	A-/Positive/--
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.