S&P Global
Ratings

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W&W Group

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W&W Group

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

+

Modifiers	0
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0

=

SACP	a

+

Support	0
Group support	-1
Government support	0

=

A-/Stable/--	Financial strength rating
BBB+/Stable/A-2	Holding company ICR

IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

Credit Highlights

Overview

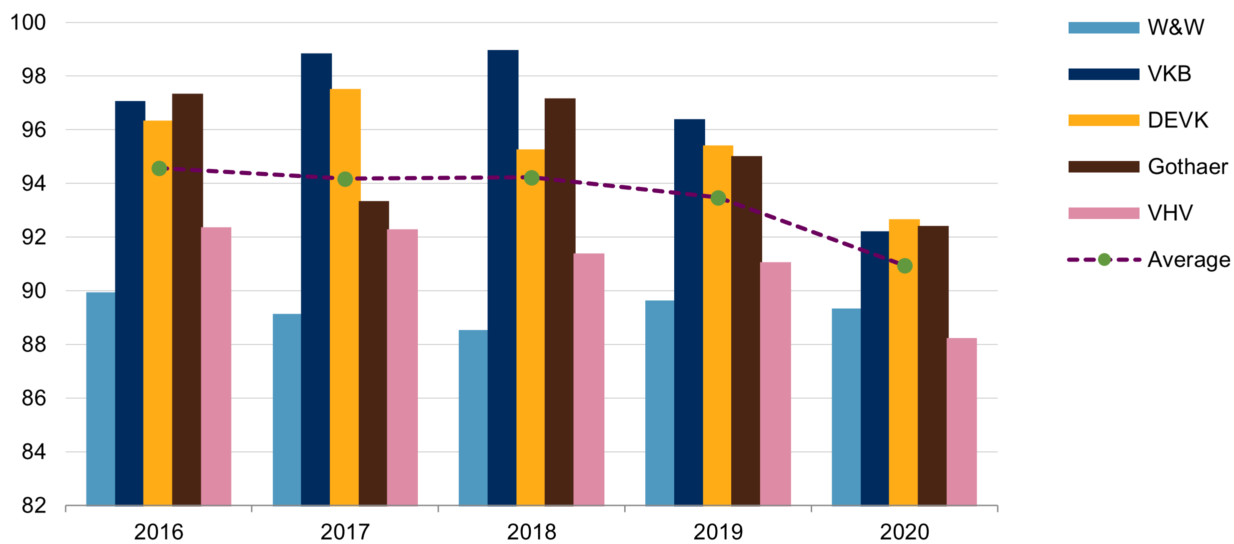
Strengths	Risks
Diversified bancassurance group in Germany with a dual-brand, multi-distribution strategy.	Constraints on earnings and capital from the low-interest-rate environment, mainly affecting highly sensitive building saving (Bauspar) business and life business.
Well-diversified product profile offering property and casualty (P/C) insurance, life insurance, home savings, and other banking products.	Challenging operating environment in the German banking sector weighs on the performance of the housing segment.
Favorable strategic risk management capabilities and risk controls.	Remaining restructuring needs weigh on earnings of both the insurance and banking segments.

S&P Global Ratings expects Germany-based multiline insurance group Wuestenrot & Wuerttembergische AG (W&W) to continue to maintain a strong competitive position. The group's dual-brand strategy, advantage from bancassurance model, slow-but-evolving digital capabilities, and ongoing strong performance in P/C insurance supports our view of W&W's competitiveness. W&W's P/C business has a track record of outperformance, owing to strict underwriting guidelines, favorable reinsurance protection and superior strategic risk management capabilities that strengthen the group's business risk characteristics.

We expect W&W to sustain healthy underwriting profitability and generate robust earnings over 2021-2022. W&W's earnings remained resilient in 2020, despite the impact of pandemic-led losses and financial market volatility. The group's net income slightly dipped to €211 million (€249 million), but remained in line with our expectations. The P/C business continues to generate strong earnings, mostly from its sound underwriting profitability, indicated by combined ratio (loss and expense) of 89% in 2020 and 82.4% in first-half 2021. For the forecast period (2021-2022), we expect W&W will generate annual normalized net income of €220 million-€250 million per year.

Chart 1

W&W's Underwriting Performance Is Its Key Strength



Source: S&P Global Ratings.

We anticipate W&W will maintain its sound capital position. In 2020, W&W capital position benefited from its favorable net income of €210.8 million, driven by a strong combined ratio of 89.3%, despite extraordinary conditions due to COVID-19. Over the next two to three years, we expect W&W to maintain capitalization at the 'A' level as per our risk-based model, owing to the group's capital buffers, prudent dividend payments, and overall conservative investment strategy. Our view is also supported by the group and its subsidiaries' strong Solvency II ratio, which was 239% at the end of first-half 2021.

Outlook: Stable

The stable outlook reflects our view that the group will maintain its strong performance in insurance and cope with pressure on its banking franchise in the low-interest-rate environment through ongoing efficiency measures.

Downside scenario

We might lower the ratings over the next two years if, contrary to our expectations and over a prolonged period, W&W is unable to:

- Further improve the cost structure and efficiency of its banking operations to offset the negative effects of low interest rates on profitability--mainly on its Bauspar and residential real estate lending franchises; or
- Maintain consolidated capital adequacy close to our 'A' level benchmark. Deterioration could result from a stronger decline in earnings than we expect, for example, because of prevailing low interest rates, higher-than-expected growth, or an increase in capital requirements for market risks.

Upside scenario

We consider a positive rating action a remote possibility during the next two years, given the ongoing pressure on capital and earnings from the low-yield environment, both in the life insurance and banking businesses.

Key Assumptions

- Real GDP in Germany of about 3% in 2021, 5% in 2022, 2% in 2023, following the pandemic-induced contraction in 2020.
- Germany's unemployment rate to remain in the 3%-4% range over 2021-2023.
- Average 10-year bond yield of negative 0.3% in 2021, followed by recovery to 0%-0.2% over 2022-2023.

Table 1

Wuestenrot & Wuerttembergische AG -- Key Metrics

	2022f	2021f	2020	2019	2018	2017	2016	2015	2014
Gross premiums written	4,400-4,600	4,400-4,600	4,491.0	4,319.7	4,065.4	3,873.4	3,988.8	4,040.5	4,033.3
Net income	220-250	220-250	210.8	249.1	215.2	258.0	235.3	274.3	242.0
Return on shareholders equity	>4	>4	4.2	5.5	5.2	6.6	6.3	7.5	7.0
P/C net combined ratio (%)	<95	<95	89.3	89.6	88.5	89.1	89.9	91.9	95.7
Life net investment yield (%)	2-3	2-3	2.2	2.8	3.3	3.0	3.3	3.8	3.5
S&P capital adequacy (indicate rating level of redundancy)	Strong	Strong	Strong	Strong	Strong	Moderately strong	Moderately strong	Upper adequate	Moderately strong
Fixed charge coverage	>15	>15	23.4	23.4	20.3	18.0	15.1	14.1	13.3

Table 1

Wuestenrot & Wuerttembergische AG -- Key Metrics (cont.)

	2022f	2021f	2020	2019	2018	2017	2016	2015	2014
Financial leverage (%)	10-13	10-13	5.9	6.1	5.7	4.4	5.1	8.5	10.2

f--S&P Global Ratings forecast.

Table 2

Wuestenrot Bausparkasse AG -- Key Metrics

	Fiscal year ended Dec. 31				
(Mil. €)	**2020**	**2019**	**2018**	**2017**	**2016**
Adjusted assets	29195	28144	27398	28353	20779
Customer loans (gross)	22190	20589	19653	19943	13595
Return on average common equity	2.61	2.74	3.25	3.76	2.55
Tier 1 capital ratio	16.2	16.8	16.4	16	14.2
S&P Global Ratings' RAC ratio before diversification	13.8	13.89	14.39	13.71	17.21
Net interest income/operating revenues	87.52	78.51	71.32	60.08	67.24
Cost to income ratio	92.37	90.66	80.88	88.91	84.41
Gross nonperforming assets/customer loans + other real estate owned	1.02	0.76	1	1.28	1.34
Core deposits/funding base	84.48	84.28	85.88	82.08	98.02
Stable funding ratio	101.39	101.85	106.45	106.22	106.68
Broad liquid assets/short-term wholesale funding (x)	2.63	2.25	3.99	3	11.66

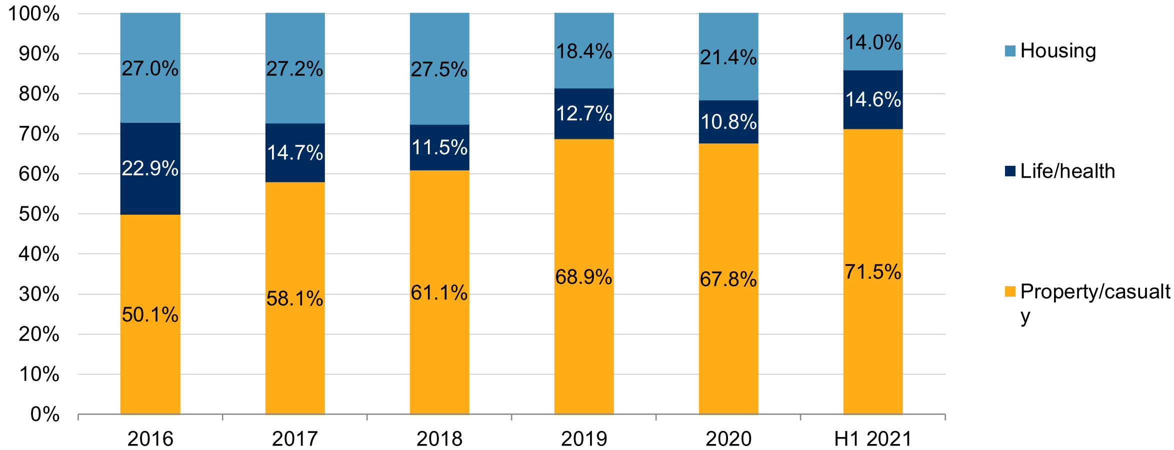
Business Risk Profile: Strong

In our view, W&W's business profile is anchored by the company's unique bancassurance structure, sound profitability levels, and product diversification. We regard W&W's dual-brand, multi-distribution approach as successful, based on its strong and diverse tied-agent network, which benefits both insurance and banking segments and which is supportive of W&W's competitive position.

We believe W&W's competitive position further benefits from its strong earnings and revenue diversification with P/C business contributing 68% to total earnings, followed by the housing segment contributing 21%, and life contributing 11%. Furthermore, in terms of premiums, W&W's insurance business is well-balanced and is composed of 55% of life/health premiums and 45% of nonlife premiums. We believe P/C business will remain the major earnings contributor in the forecast period.

Chart 2

W&W Benefits From Diversified Income Streams



Source: W&W annual/half-year reports.

W&W's P/C carrier Wuerttembergische Versicherung AG (WV), in 2020 witnessed a favorable combined ratio of 89.3% despite some COVID-related claims that were more than offset by lower motor claims. The five-year average net combined ratio for this segment stands at about 89.3%, which further improved to 82.4%. In the first half of 2021, the segment witnessed some claims from storms in Germany, but this was offset by continued lower motor claims, which resulted in a net combined ratio of 82.4%. We note W&W's exposure has the quality to absorb higher natural catastrophe losses thanks to efficient reinsurance protection and a sound equalization reserve. For the coming period, we believe the P/C segment profitability will remain solid, supported by favorable combined ratios stemming from sound claims and cost management.

Wuerttembergische Lebensversicherung AG (WL), W&W's life carrier, offers a broad product portfolio whereby its back book is dominated by traditional annuities and endowment products. However, the group has already shifted its new business product portfolio toward less capital-intensive products. As a result, more than 80% of new business includes unit-linked, disability, and risk-term products, and more flexible guarantees.

The banking franchise of Wuestenrot Bausparkasse AG (WBSK), the group's banking entity, continues to show little diversification and an above-average reliance on interest income, given its focus on Bauspar and residential mortgage products. The sustained low-interest-rate environment drags on its profitability, amplified by still-costly legacy Bauspar deposits. In our assessment we consider ongoing support by its membership in a diversified bank assurance group, which we believe provides stability and allows WBSK to bridge the period until its asset liability profile and the external environment improves.

We expect the bank will continue to mitigate pressure on its net interest income via ongoing cost-cutting measures and the realization of reserves on its security portfolio. We also expect WBSK will continue to draw remaining funds from the reserve fund "Fonds zur bauspartechnischen Absicherung" (FbtA, balance of €52 million as of end-2020) in order to offset constraints on income.

In our view, earnings will remain moderate for the coming years, particularly as long as the share of legacy Bauspar contracts with high deposit rates and bonus commitments remains material.

Financial Risk Profile: Strong

We expect W&W's robust earnings, conservative-but-diversified investment portfolio and recent hybrid issuance of €300 million will enable the group to maintain capital adequacy above the 'A' benchmark in our risk-based capital model. Furthermore, the Solvency II ratio of the group and its subsidiaries remains resilient, as reflected in solid Solvency II ratios of 233% of the group, 421% (with transitionals) for WL and 201% for WV, at year-end 2020.

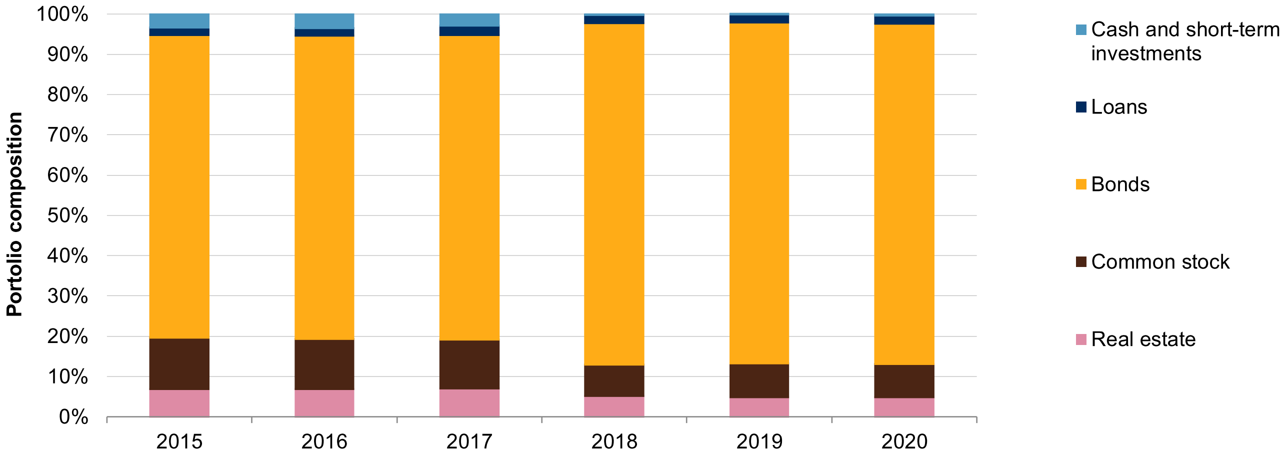
In first-half 2021, the group reported net profit of €196 million (€107 million in first-half 2020). This was driven by an improved combined ratio, premium growth of 8.7%, and a recovery of investment returns due to recovery in capital markets. We expect net income to be about €220 million-€250 million in 2021 and 2022.

With 54% premiums generated from its life business, WL's portfolio is still dominated by traditional products with an average guaranteed interest rate slightly below 3% (excluding Zinszusatzreserve; additional reserving requirements). As a result, we expect the pressure on investment income and new business margins in life insurance will likely prevail, given the low-interest-rate environment. However, we expect that low interest rates will also entail ongoing additional reserving requirements, which will reduce the average guarantee in the back book but squeeze the gross surplus. WL benefits from a cautious bonus policy, but we assume that a further reduction in bonuses will have only a marginal impact.

In our view, W&W holds a diversified investment portfolio, with over 70% of the instruments being fixed-income securities with credit quality of 'AA'. The insurance subgroup displays favorable leverage and coverage ratios including the latest issuance of €300 million in Aug 2021. We anticipate W&W will maintain financial leverage below our threshold of 40% over the next two years and that its fixed-charge coverage will remain very strong, in line with our earnings forecast.

Chart 3

W&W's Conservative But Diversified Investment Portfolio



Source: S&P Global Ratings.In 2018, W&W changed reporting from IAS to IFRS.

We consider market risk to be the group's key risk, particularly regarding the life insurance and Bauspar operations, which are highly exposed to interest-rate fluctuations.

WBSK's capitalization levels remain a rating strength, mainly mirroring our expectation that our risk-adjusted capital (RAC) ratio will remain comfortably above 10%. We expect our RAC ratio will stay at 13%-14% over the next two years, following 13.8% at year-end 2020. Last year's increase in our risk-weighted assets metric, following a material increase in loan loss provisioning in light of COVID-19, and in particular, because of the Aachener Bausparkasse (ABAG) acquisition in January 2020, was offset by ongoing retention of full net income and a positive one-off gain triggered by the ABAG acquisition.

We regard WBSK's risk position as moderate, reflecting its exposure to significant risks not captured by our RAC analysis. Market risk remains key within the group's building-savings operations, which are highly exposed to interest rate fluctuations. This is because of commitments for bonus payments (under tariff schemes and legacy tariff schemes from acquisitions), which have also led to substantially increased provisions and depressed earnings over the past few years. We expect these schemes will continue to limit the bank's profits if interest rates remain permanently at today's levels, but believe the effect of this will lessen slightly over time. Moreover, we envisage reputational risks to the Bauspar product, reflecting ongoing efforts to shrink the portfolio of historical tariff schemes with bonus commitments.

Finally, building-savings products often feature customer options linked to interest rate movements, which we believe constricts earnings, given the low interest rates. W&W has adjusted its tariffs to today's environment, but we still expect only a gradually improvement in its risk profile over the medium term.

In terms of credit risk, we believe that WBSK's focus on collateralized residential mortgage lending will limit risk compared with peers that have a stronger focus on corporate banking or commercial real estate. Overall, we expect the quality of its residential mortgage portfolio will remain sound, also because we forecast a stable performance for the German housing market under our current economic base case (see "Government Job Support Will Stem European Housing Market Price Falls," May 15, 2020). We also note that WBSK is mainly exposed to more rural German areas where the build-up of house-price imbalances has been less pronounced than in larger German cities. Therefore, while we expect cost of risk to increase relative to previous years, it will remain contained when compared to levels implied by our normalized credit losses.

The bank's funding is based on a healthy mix of core deposits and capital market issuance through mainly covered bonds and high amounts of excess liquidity. Most of the funding base comprises relatively stable and granular core customer deposits, sourced mainly from the building-savings business. We forecast our stable funding ratio will remain comfortably above 100%, with a ratio of 101% as of year-end 2020. We continue to observe sound coverage of short-term wholesale funding by broad liquid assets (2.6x as of year-end 2020), which is also a consequence of the low-interest-rate environment, in which customers often decide not to conclude a building-savings loan when allocated.

Despite very high liquidity ratios, however, we do not assess WBSK's liquidity as strong. This is because customer deposits from the building-savings operations and the business model have proven to be more interest-rate sensitive than retail banks' in the past. In particular, we believe that if interest rates were to rise only slightly, building-savings loans would become more attractive again, with negative effects on the bank's liquidity buffers because more customers will accept the loan when allocated.

Other Key Credit Considerations

Governance

We have a favorable view of W&W's very experienced management and governance, based on established record of sound strategic planning, focusing on improving operational efficiencies, and conservative and sophisticated financial management.

Liquidity

The liquidity profile is sound, thanks to the various liquid sources at W&W's disposal, such as premium income, a favorable liability profile, and a very liquid asset portfolio. We do not foresee any refinancing concerns.

Factors specific to the holding company

We rate the holding company, W&W, one notch lower than the group's core operating entities. This reflects the structural subordination of the holding company's creditors to the group's insurance policyholders and bank depositors. Given its diversified earnings streams, low financial leverage, and active internal re-insurance operations, we regard the holding company as an operating holding, and apply a one-notch differential to the operating core subsidiaries.

Enterprise risk management

W&W's strong strategic risk management capabilities enhance the ratings on the insurance subgroup. The group has implemented a robust and consistent risk management culture across all insurance and banking segments and business units. Our view of the group's risk controls is positive. The group has an established record of sound strategic planning, focusing on improving operational efficiencies, as well as conservative and sophisticated financial management. Management still has inroads to make in developing and leveraging an effectively run bancassurance model with efficient processes.

Other considerations

We assess the stand-alone credit profile (SACP) of the insurance subgroup at 'a' and continue to see the SACP of the banking segment as somewhat weaker, at 'bbb+'. We combine the subgroups' SACPs to derive the group credit profile (GCP), reflecting the relative weight of the insurance and banking operations by risk capital, profit contributions, and considering diversification benefits. The GCP for W&W is one notch higher than the SACP of the banking subgroup, reflecting our view that the banking subgroup is core to the overall group. We consider the insurance operations and the banking subgroups to be core parts of the group and assess their overall unsupported GCP at 'a-'.

We revised our assessment of competitive dynamics of the German banking industry to high risk on June 24, 2021, reflecting pressure due to poor cost efficiency, rising risks from tech disruption, and expectations of a prolonged low-interest-rate environment under our Banking Industry and Country Risk Assessment. At the same time, we revised both the economic and the industry risk trends back to stable.

The adjusted competitive dynamics assessment translates into higher overall industry risk assessment and a lower anchor for purely domestic German banks. Therefore, although we revised downward our assessment of WBSK's SACP to 'bbb' from 'bbb+', this was offset by group support from W&W Group. In our assessment of WBSK's stand-alone creditworthiness, we view as positive the business' stability and said ongoing support provided by the group, which includes access to a diversified and stable customer base and moderate return targets. This allows it to weather difficult conditions. However, we see its building loan contracts (Bauspar) business as materially vulnerable to a low-for-longer interest rate environment, because the product's option-like features make it difficult to market in today's environment. We also note a lack evidence regarding WBSK's ability to generate adequate revenue through Bauspar products in a permanent low-interest-rate environment. However, we expect that increasing earnings contribution from W&W's stronger insurance subgroup over the long term could help offset part of the pressure on WBSK and will continue to support W&W's aggregate creditworthiness at current levels.

The short-term rating on WBSK is 'A-1', as we believe the parent's liquidity is exceptional and would be available to the subsidiary in case of distress. We assign a higher short-term rating to the group's core subsidiary to reflect this strength, if the long-term rating on the subsidiary is 'A-'.

Accounting considerations

W&W discloses consolidated financial statements under International Financial Reporting Standards (IFRS). Additionally, all group entities report under German generally accepted accounting principles (GAAP). We used the German GAAP figures to supplement our evaluation of the individual segments. We assess the group's capitalization by combining the capital requirements for both the banking and insurance subgroups, based on our respective criteria, using IFRS data.

We adjust W&W's capital position for the specific insurance and banking components, as follows:

- Crediting 50% of the life insurance value-in-force not included on the balance sheet;
- Crediting 50% of the P/C reserve redundancy;
- Adding the free and unallocated portion of the policyholder bonus reserve in life insurance; and
- Deducting WBSK's FbtA, a reserve fund aimed at protecting the savings/loan collective, which is part of IFRS equity. WBSK does not have full discretion over these funds.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Related Research

- Wuestenrot & Wuerttembergische's Junior Subordinated Callable Fixed-To-Floating Notes Rated 'BBB-', Aug 30, 2021
- Germany-Based Wuestenrot & Wuerttembergische Group Affirmed At 'A-'; Outlook Stable, Jun 24, 2021

Appendix

Wuestenrot & Wuerttembergische AG -- Credit Metrics History

Ratio/Metric	2020	2019	2018
S&P Global Ratings capital adequacy*	Strong	Strong	Strong
Total invested assets	49,250.2	47,471.9	43,983.6

Wuestenrot & Wuerttembergische AG -- Credit Metrics History (cont.)

Ratio/Metric	2020	2019	2018
Total shareholder equity	5,085.2	4,835.1	4,236.3
Gross premiums written	4,491.0	4,319.7	4,065.4
Net premiums written	4,354.9	4,173.4	3,944.6
Net premiums earned	4,345.6	4,184.8	3,946.9
Reinsurance utilization (%)	0.0	0.0	0.0
EBIT	324.9	374.0	341.5
Net income (attributable to all shareholders)	210.8	249.1	215.2
Return on assets (excluding investment gains/losses) (%)	0.4	0.5	0.5
Return on shareholders' equity (reported) (%)	4.2	5.5	5.2
P/C: net combined ratio (%)	89.3	89.6	88.5
P/C: net expense ratio (%)	24.9	26.2	26.3
P/C: return on revenue (%)	9.2	5.9	9.6
EBITDA fixed-charge coverage (x)	23.4	23.4	20.3
EBIT fixed-charge coverage (x)	18.0	18.3	17.1
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	23.4	23.4	20.3
Financial obligations / EBITDA adjusted	0.2	0.2	0.1
Financial leverage including pension deficit as debt (%)	5.9	6.1	5.7
Net investment yield (%)	2.2	2.8	3.3
Net investment yield including investment gains/(losses) (%)	4.2	4.2	4.8

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 30, 2021)*

Holding Company: Wuestenrot & Wuerttembergische AG	
Financial Strength Rating	
Local Currency	BBB+/Stable/--
Issuer Credit Rating	
Local Currency	BBB+/Stable/A-2

Ratings Detail (As Of September 30, 2021)*(cont.)	
Operating Companies Covered By This Report	
Wuerttembergische Lebensversicherung AG	
Financial Strength Rating	
Local Currency	A-/Stable/--
Issuer Credit Rating	
Local Currency	A-/Stable/--
Junior Subordinated	BBB
Wuerttembergische Versicherung AG	
Financial Strength Rating	
Local Currency	A-/Stable/--
Issuer Credit Rating	
Local Currency	A-/Stable/--
Wuestenrot Bausparkasse AG	
Issuer Credit Rating	A-/Stable/A-1
Senior Secured	AAA/Stable
Subordinated	BBB
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.