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

Key strengths	**Key risks**
Diversified bancassurance group in Germany with a dual-brand strategy.	Persisting difficult operating environment, with lower-for-longer interest rates affecting the highly sensitive building saving (Bauspar) businesses, as well as life insurance and capital investments.
Diversified product profile offering property and casualty (P/C) insurance, life insurance, and homesavings and other banking products.	Remaining restructuring needs weigh on earnings of both insurance and banking segments.
Favorable strategic risk management capabilities and risk controls.	

Germany-based multiline insurance group W&W continues to maintain a strong competitive position. Ongoing strong performance in P/C insurance, plus the added advantage from the group's dual-brand strategy, support our view. W&W's P/C business has a track record of outperformance, owing to favorable reinsurance protection and superior strategic risk management capabilities that strengthen the group's business risk characteristics.

We believe W&W will generate robust earnings over 2021-2022 after a COVID-19-related decrease in 2020. W&W's strong earnings majorly stems from its P/C underwriting profitability. For the forecast period, we expect W&W will generate annual normalized net income of €200 million-€220 million in 2021-2022, with 2020 net income affected by COVID-19 related losses, reserving needs, and capital market volatility.

We anticipate W&W will maintain its sound capital position-. We expect capital and earnings in 2020 will be impacted due to both claims and investments losses as well an increased credit costs in the banking portfolio as result of COVID-19. However, we believe W&W's capital adequacy will consolidate at the 'A' level over the next two-to-three years, 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 above 200% at the end of 2019.

Outlook: Stable

The stable outlook reflects our assumption that W&W's insurance and banking operations will at least maintain the revenue base, as per our base case, and stable profitability metrics.

Downside scenario

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

- 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 franchise.
- Maintain capital adequacy close to our 'A' level on a consolidated basis. Deterioration could result from a stronger decline in earnings than we currently expect, for example, as a consequence of prevailing low interest rates, or due to an increase in capital requirements for market risks.

Upside scenario

We consider a positive rating action to be 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 the banking businesses.

Key Assumptions

- We expect GDP will fall to about -6% due to economic fallout from the pandemic, with negative effects on unemployment rates, which we forecast will increase to 4.5%, and a drop in inflation to below 0% in 2020. However, we expect recovery in 2021 with GDP growth forecast at 2.6%.
- Low interest rates remain a key risk to European insurers, with German 10-year government bond yields of about -0.4% in 2020 and -0.3% in 2021, based on our economic estimates.
- For the housing market, we foresee a dip in 2020 to -1.2% only slowly recovering to -0.4% in 2021 and 3.9% in 2022.

Table 1

W&W Insurance Group--Key Metrics

(mil. €)	2021f	2020f	2019	2018	2017	2016	2015	2014
Gross premiums written	4,000-4,200	4,000-4,200	4,319.65	4,065.40	3,873.36	3,988.82	4,040.49	4,033.29
Net income	200-220	150-200	249.06	215.19	258.04	235.31	274.28	241.97
Return on shareholders equity	>5	~3	5.49	5.25	6.64	6.31	7.50	6.99
P/C Net combined ratio (%)	<95	<95	89.63	88.48	89.09	89.85	91.89	95.71
Life: Net investment yield (%)	>3	2-3	2.84	3.30	2.98	3.28	3.80	3.48

Table 1

W&W Insurance Group--Key Metrics (cont.)								
(mil. €)	**2021f**	**2020f**	**2019**	**2018**	**2017**	**2016**	**2015**	**2014**
S&P Capital Adequacy (indicate rating level of redundancy)	Strong	Strong	Strong	Strong	Moderately Strong	Moderately Strong	Upper Adequate	Moderately Strong
Fixed charge coverage	>10	>10	23.36	20.34	18.01	15.07	14.11	13.29
Financial leverage (%)	~5	~5	6.09	5.71	4.38	5.07	8.45	10.21

f--Forecast. P/C--Property/casualty. S&P Global Ratings forecast.

Table 2

Wuestenrot Bausparkasse AG Key Metrics					
	Fiscal year end Dec. 31				
(mil.€)	**2019**	**2018**	**2017**	**2016**	**2015**
Adjusted assets	28,144	27,398	28,353	20,779	21,897
Customer loans (gross)	20,589	19,653	19,943	13,595	14,039
Return on average common equity	2.74	3.25	3.76	2.55	0.04
Tier 1 capital ratio	16.80	16.40	16.00	14.20	12.80
S&P Global Ratings' RAC ratio before diversification	13.89	14.39	13.71	17.21	N/A
Net interest income/operating revenues	78.51	71.32	60.08	67.24	71.31
Cost to income ratio	90.66	80.88	88.91	84.41	84.05
Gross nonperforming assets/customer loans + other real estate owned	0.76	1.00	1.28	1.34	1.78
Core deposits/funding base	84.28	85.88	82.08	98.02	90.50
Stable funding ratio	101.85	106.45	106.22	106.68	99.45
Broad liquid assets/short-term wholesale funding (x)	2.25	3.99	3.00	11.66	1.91

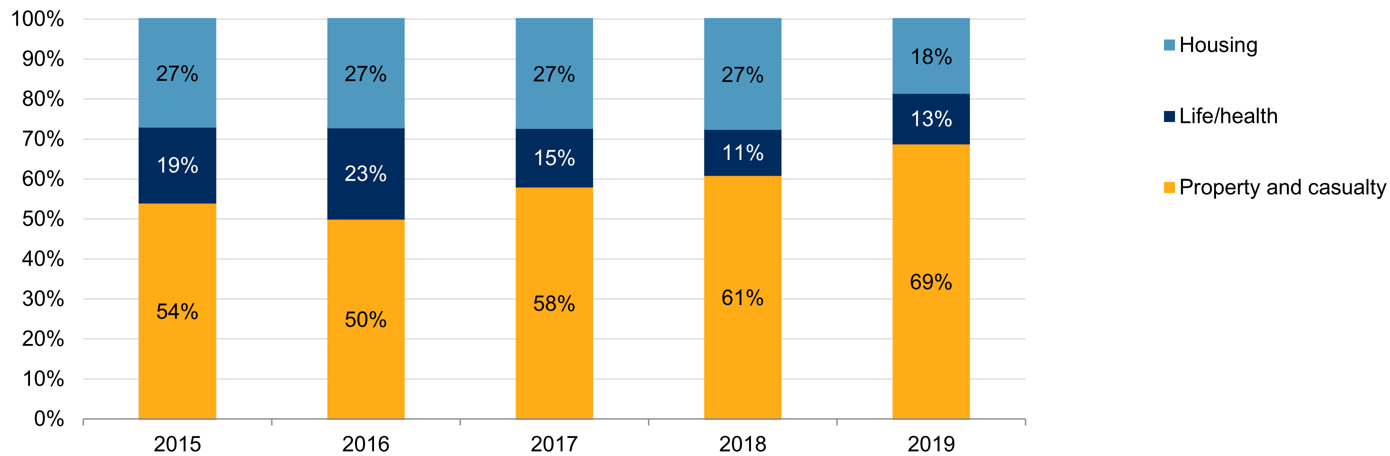
Business Risk Profile: Strong

We believe W&W's competitive advantage stems forms its unique bancassurance structure, sound profitability levels, and product diversification. Additionally, we consider W&W's dual-brand strategy successful based on its strong and diverse tied-agent network, which benefits both insurance and banking segments.

W&W writes 55% of life/health premiums and 45% of nonlife premiums. The group benefits from its earnings diversification with the P/C business segment contributing 69%, followed by the housing segment contributing 18%, and 13% from its life segment. We believe P/C business will remain the major earnings contributor in the forecast period.

Chart 1

W&W Benefits From Diversified Income Streams



Source: W&W annual reports.

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W&W's nonlife carrier Wuerttembergische Versicherung AG (WV) demonstrates resilient earnings, with favorable combined ratios owing to sound claims and cost management. The five-year average gross combined ratio for this segment stands at about 91.8% and was 87.4% in first-quarter 2020, and although we expect slight weaker underwriting margins in 2020 considering uncertain claims and additional reserving needs due to spread of COVID-19, we believe overall P/C segment profitability will remain robust.

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.

Then 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 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-2019) 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

In our view, W&W's financial risk profile will continue to benefit from the further improvement of group's capital adequacy at 'A' level according to our risk-based capital model, its conservative-but-diversified investment portfolio, and favorable financial leverage ratios.

In first-quarter 2020, despite COVID-19 impact, the group reported net profit of €25 million (€78 million in first-quarter 2019). However, we expect capital market volatility, COVID-19-related insurance claims, additional reserving needs, and still-low interest rates will put pressure on profitability in 2020, but we expect recovery to about €200 million-€220 million net income in 2021 and 2022.

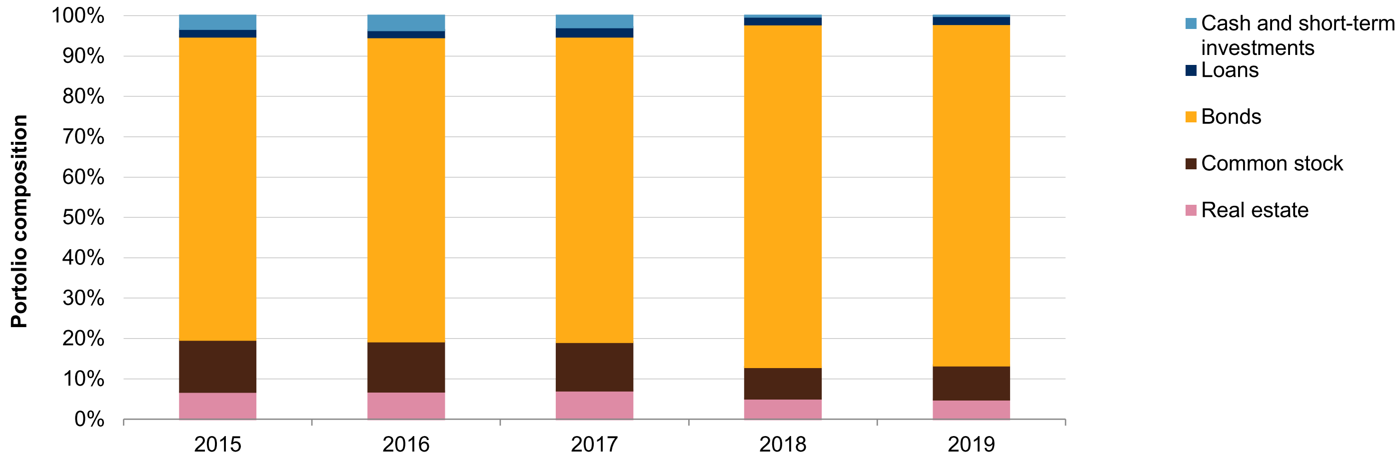
The pressure on investment income and new business margins in life insurance will likely prevail, considering the low-interest-rate environment, and because WL's portfolio is still dominated by traditional products with an average guaranteed interest rate slightly below 3% (excluding Zinszusatzreserve; additional reserving requirements). 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. Also, we acknowledge WL's new business strategy, which should gradually support and strengthen its capitalization under Solvency II requirements.

We expect this will result in risk capital requirements exceeding the consolidated group's total adjusted capital, with capital adequacy remaining in the 'A' range of our model in 2020-2022.

We see no material change in W&W's investment portfolio, where over 70% of the instruments are fixed-income securities. The insurance subgroup displays favorable leverage and coverage ratios.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 2

W&W's Investment Portfolio



In 2018, W&W changed reporting from IAS to IFRS. Source: S&P Global Ratings.
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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 13.9% at year-end 2019. Here, we anticipate a material increase in loan loss provisioning in light of COVID-19, and in our risk-weighted assets metric because of increased NPL recognition and, in particular, because of the Aachener Bausparkasse (ABAG) acquisition in January 2020. However, this is 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 that 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 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 forecast WBSK's cost of risk will increase materially from historically low levels observed over the past years. However, we think WBSK's focus on collateralized residential mortgage lending will limit risk compared with peers with a higher focus on corporate banking in the wake of COVID-19 pandemic. 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.

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, mainly sourced from the building-savings business. We forecast our stable funding ratio will remain comfortably above 100%, with a ratio of 102% as of year-end 2019. We continue to observe sound coverage of short-term wholesale funding by broad liquid assets (2.3x as of year-end 2019), 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.

However, despite very high liquidity ratios, 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 management and governance based on established record of sound strategic planning, focusing on improving operational efficiencies, as well as 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, favorable liability profile, and a very liquid asset portfolio. We do not foresee any refinancing concerns.

Factors specific to the holding company

We rate holding company W&W AG 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.

Environmental, social, and governance

We believe W&W's exposure to environmental and social risks are in line with the German insurance industry and its peers. Since 70% of operating profit comes from P/C business, W&W's exposure to environmental factors stems from natural-catastrophe exposure. For example, climate change could cause an increase in the frequency and severity of claims from extreme weather events. With less than 20% of operating profit generated from life business, we view W&W as less exposed than other life insurers to social risk factors such as changes in demographic trends; for example, the trend toward greater longevity, which could increase insurance liabilities, which is a common problem for life insurers in Germany.

Enterprise risk management

W&W's strong strategic risk management capabilities enhance the ratings of 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-'.

Competitive dynamics in the German banking sector remain under pressure due to poor cost efficiency, rising risks from tech disruption, and expectations of a prolonged low-interest-rate environment. As a result, we revised industry and economic risk trends for German banks under our Banking Industry and Country Risk Assessment (BICRA) to negative already on Sept. 18, 2019. We also see that macroeconomic risk now have further increased as a result of the COVID-19 pandemic. In our assessment of WBSK's stand-alone creditworthiness, we view as positive the business stability and 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-rate environment. If German industry risk increases, we could revise downward our assessment of WBSK's SACP by one notch to 'bbb'. However, we expect that increasing earnings contribution from W&W's stronger insurance subgroup over the long term could help to 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

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, 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 | Insurance | Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- 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
- 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

- Government Job Support Will Stem European Housing Market Price Falls, May 15, 2020

- Negative Rating Actions Taken On Multiple German Banks On Deepening COVID-19 Downside Risks, April 23, 2020

Appendix

Table 3

W&W Insurance Group--Credit Metrics History

Ratio/Metric	**2019**	**2018**
S&P Global Ratings capital adequacy*	Strong	Strong
Total invested assets	47,471.9	43,983.6
Total shareholder equity	4,835.1	4,236.3
Gross premiums written	4,319.7	4,065.4
Net premiums written	4,183.6	3,944.6
Net premiums earned	4,184.8	3,946.9
Reinsurance utilization (%)	0.0	0.0
EBIT	374.0	341.5
Net income (attributable to all shareholders)	249.1	215.2
Return on assets (excluding investment gains/losses) (%)	0.5	0.5
Return on shareholders' equity (reported) (%)	5.5	5.2
P/C: net combined ratio (%)	89.6	88.5
P/C: net expense ratio (%)	26.2	26.3
P/C: return on revenue (%)	5.9	9.7
EBITDA fixed-charge coverage (x)	23.4	20.3
EBIT fixed-charge coverage (x)	18.3	17.1
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	23.4	20.3
Financial obligations / EBITDA adjusted	0.2	0.1
Financial leverage including pension deficit as debt (%)	6.1	5.7
Net investment yield (%)	2.8	3.3
Net investment yield including investment gains/(losses) (%)	4.2	4.8

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-/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 11, 2020)*

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

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