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## Research Update:

# Euler Hermes Group Core Subsidiaries Affirmed At 'AA-' On Improved Enterprise Risk Management; Outlook Stable

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## Research Update:

# Euler Hermes Group Core Subsidiaries Affirmed At 'AA-' On Improved Enterprise Risk Management; Outlook Stable

## Overview

- We are revising our opinion of trade credit insurer Euler Hermes Group's (EH) enterprise risk management to strong from adequate, but we are maintaining our view of EH's very strong business profile and strong financial risk profile.
- In our view, EH's strategic importance to its parent, Allianz SE, supports the ratings on EH.
- We are therefore affirming our 'AA-' ratings on EH's core subsidiaries.
- The stable outlook on EH mirrors the outlook on Allianz SE and incorporates our expectation that EH will remain strategically important to its parent.

## Rating Action

On Feb. 6, 2014, Standard & Poor's Ratings Services affirmed its 'AA-' long-term counterparty credit and insurer financial strength ratings on Euler Hermes France, Euler Hermes Deutschland AG, Euler Hermes Europe, and Euler Hermes North American Insurance Company, the core subsidiaries of France-based global trade credit insurer Euler Hermes SA (EH). The outlook is stable.

At the same time, we affirmed the 'A-1+' short-term counterparty credit rating on Euler Hermes Deutschland.

## Rationale

We revised EH's enterprise risk management (ERM) to strong from adequate based on our more positive view of EH's risk management culture, risk controls, and strategic risk management. We maintained our stand-alone credit profile (SACP) assessment at 'a+', reflecting the group's very strong business risk profile and strong financial risk profile. Our reassessment of the group's ERM reinforces our view of the group's ability to manage its risk within tolerances. Under our criteria, these factors could lead to an anchor of either 'aa-' or 'a+'. We chose the lower of these because we think that EH's business risk profile is at the lower end of our very strong category due to EH's relatively narrow business focus on global trade credit and high sensitivity to the economic cycle.

The 'AA-' ratings on EH's core subsidiaries benefit from one notch of support,

reflecting EH's strategic importance to Germany-based global insurer Allianz SE.

We regard EH's ERM as highly important for the ratings, given the group's large exposures to multiple economies. In our opinion, the extensive degree of risk monitoring, the role of risk management within EH, and the well-defined risk appetite highlight EH's conservative risk management culture. EH has developed an extensive internal model for its trade credit underwriting risks. It is based on a global grading methodology and supplemented by regular sector and country portfolio reviews. We also view positively EH's capacity to strategically manage the risk-adjusted return of its credit insurance exposure, optimize its asset allocation, and calibrate the cost and protection of reinsurance.

We consider the trade credit's insurance industry and country risk to be intermediate. This reflects the low country risk and an intermediate industry risk, mainly based on highly volatile loss ratios. In our opinion, EH's competitive position remains very strong. The group has a leading position and solid geographic diversity in the trade credit insurance market, with about 34% of market share. EH's average through-the-cycle combined (loss and expense) ratio is stronger than its peers.

We continue to view EH's capitalization as strong according to our risk-based capital model. Nevertheless, the high dividend payout ratio of 60% constrains internal capital retention. We also consider that our estimates of capital requirements, based on historical loss levels, may underestimate the sensitivity of EH's gross exposure to future economic shocks. Gross exposure has risen relatively rapidly by 39% between end-2009 and end-September 2013.

We think that capital adequacy will remain strong in the next three years as we expect exposure to grow at the same pace as premiums. We also assume a combined ratio of between 80% and 85%--slightly worse than the past three years--as positive run-offs of prior reserves reduce. Profitability is also likely to contract due to low investment returns, in our view. We therefore expect net income of €270 million-€300 million in the next three years.

In our opinion, EH exhibits an intermediate risk position, strong financial flexibility, and strong liquidity. We also regard EH's management and governance as satisfactory.

Allianz SE owns 68.2% of EH. We consider EH as strategically important to the Allianz group because of its sizable earnings contribution to the group. EH also enlarges Allianz SE's product offering and strengthens its reach. Although EH operates as a stand-alone unit due to the nature and specificities of its activities, there is some integration with its parent. For example, EH uses Allianz SE's internal capital model and has adopted its risk management practices. As a strategically important subsidiary of Allianz SE, EH's ratings are capped at one notch below that of the parent.

## Outlook

The stable outlook on EH mirrors the outlook on Allianz SE and incorporates our expectation that EH will remain strategically important to its parent company.

We could lower EH's SACP if our assessment of the group's capital and earnings materially dropped below our current projections of strong capital. A protracted decline in operating performance beyond our expectations of a combined ratio of 80%-85% could also put negative pressure on our assessment of the group's business risk profile. However, the SACP could deteriorate by up to three notches and, as long as we view EH as strategically important to Allianz SE and its ERM as strong, the deterioration would not automatically result in a downgrade, all other things remaining equal. EH benefits from up to three notches of parental support above its SACP, according to our criteria. The strong ERM could also support the SACP if the latter fell below the current level of 'a+'.

A positive rating action would depend on a similar rating action on Allianz SE. We currently consider this a remote possibility.

## Ratings Score Snapshot

Financial Strength Rating	AA-/Stable
SACP	a+
Anchor	a+
Business Risk Profile	Very Strong
IICRA	Intermediate Risk
Competitive Position	Very Strong
Financial Risk Profile	Strong
Capital and Earnings	Moderately Strong
Risk Position	Intermediate Risk
Financial Flexibility	Strong
Modifiers	0
ERM and Management	0
Enterprise Risk Management	Strong
Management and Governance	Satisfactory
Comparative Analysis	0
Liquidity	Strong
Support	+1
Group Support	+1

Government Support

0

IICRA—Insurance Industry And Country Risk Assessment.

## Related Criteria And Research

- Group Rating Methodology, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Trade Credit Insurance Capital Requirements Under Standard & Poor's Capital Adequacy Model, Dec. 6, 2013
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

## Ratings List

Ratings Affirmed

Euler Hermes Deutschland AG  
Counterparty Credit Rating  
Local Currency AA-/Stable/A-1+

Euler Hermes Deutschland AG  
Euler Hermes North America Insurance Company  
Euler Hermes France  
Euler Hermes Europe  
Financial Strength Rating  
Local Currency AA-/Stable/--

Euler Hermes Europe  
Euler Hermes North America Insurance Company  
Euler Hermes France  
Counterparty Credit Rating  
Local Currency AA-/Stable/--

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