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UNIQA Insurance Group

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UNIQA Insurance Group

Please note that the ratings covered by this full analysis apply only to core entities of the group, which are listed below. These ratings do not apply to any noncore or nonrated entities of the group. Ratings assigned to noncore entities of the group are published individually.

Major Rating Factors

Strengths:

- Strong competitive position.
- Sound operational management.

Weaknesses:

- Cautious capital management requirement.
- Substantial earnings volatility.

Holding Company: UNIQA Versicherungen AG
Counterparty Credit Rating
Local Currency
A-/Stable/--
Operating Companies Covered By This Report
Financial Strength Rating
Local Currency
A/Stable/--

Rationale

The ratings on UNIQA Personenversicherung AG (UPV), UNIQA Sachversicherung AG (USV), and UNIQA Re AG (UNIQA Re) reflect their core status within the Austria-based UNIQA Insurance Group (UNIQA). UPV and USV form integral parts of UNIQA and contribute significantly to the group's strong competitive position and sound operational management. These strengths, however, are partly offset by earnings volatility largely due to weak capital market conditions and UNIQA's exposure in Central and Eastern Europe (CEE) and the need to manage capital cautiously against its somewhat aggressive expansion strategy. We consider UNIQA Re fundamental to the group's risk-management strategy.

UNIQA maintains a strong competitive position as one of the market leaders in Austria and has strong distribution capabilities including a strong bancassurance distribution channel via the Raiffeisen cooperative banks and shareholder Raiffeisen Zentralbank Oesterreich (RZB, A/Negative/A-1). In addition, it has successfully achieved above-market-average organic growth in CEE.

UNIQA has successfully executed efficiency programs, which we recognize as a major impetus for further improvement in operating performance. The group is successfully pursuing a further program that is expected to improve bottom-line earnings.

Although we view UNIQA's capitalization as strong and the group has increased its capital base through issuance of new shares worth about €150 million in December 2009 and plans a further increase in 2010, we see capitalization as a relative weakness to the rating in light of the group's funding needs to support its somewhat aggressive expansion strategy and to recover from the effects of the recent financial market downturn.

Earnings, in our view, are strong but have experienced significant volatility in 2008 and 2009, mainly as a result of weak capital market conditions, resulting in a 68% year-on-year drop in net income in the first three quarters of 2009 to €35 million, following a fall of 75% to €66.7 million in full year in 2008. We also believe that UNIQA's exposure in CEE in the currently challenging economic conditions will continue to create volatility in earnings. However, we expect UNIQA's earnings to improve significantly in 2010, moving more closely into line with group targets announced before the recent economic downturn.

Outlook

The stable outlook reflects our expectation that UNIQA will defend its strong competitive position in Austria and will continue its growth in CEE to improve diversification. We expect UNIQA to significantly improve its earnings in 2010 with net income of about €200 million, a return on equity of about 7%, and a combined ratio of well below 100%. Life and health new-business margins should exceed 2% (based on the present value of future premiums). The fixed charge coverage for the group is expected to recover strongly in 2010 to about 5x. Capitalization is expected to remain strong, benefiting from announced capital increases at the end of 2009 and in 2010.

Downward rating pressure could emerge if UNIQA's operating performance does not significantly recover in 2010. This is necessary to strengthen the group's financial profile. It could also emerge if the group fails to meet the operating performance targets mentioned above. We see no upside rating potential in the current market conditions.

Corporate Profile: A Market Leader In Austria

UNIQA, with €5.8 billion in gross premiums written in 2008, enjoys leading positions in all segments of the Austrian insurance market and has market shares of about 49% in health, 21% in life, and 17% in nonlife insurance. It operates through various brands that are well established in Austria. The nondomestic business accounts for about 40% of premium income, reflecting UNIQA's strategy of remaining a diversified composite player in CEE. The group follows a niche strategy in some Western European markets.

UNIQA's ultimate main shareholders include the mutual organization Austria Versicherungsverein AG (not rated) and RZB, each with a shareholding of more than one-third in the group's holding company, UNIQA Versicherungen AG. UNIQA's core operations benefit from their long-standing distribution cooperation with the network of the Raiffeisen cooperative banks in Austria and in CEE via RZB's subsidiary Raiffeisen International Bank Holding AG (not rated).

Competitive Position: Strong Domestic Profile With Increasing International Diversification

Table 1

UNIQA Insurance Group--Business Statistics

	--Year-ended Dec. 31--				
(Mil. €)	**2008**	**2007**	**2006**	**2005**	**2004**
Total gross premiums written (including unit-linked)	5,825	5,276	5,091	4,730	3,778
Non-life (%)	41.2	41.7	40.0	40.9	43.8
Life (%)	42.5	41.1	42.5	41.3	36.5
Health (%)	16.3	17.2	17.5	17.9	19.7
Non-life gross premiums written by line of business (%)					
Accident and health--other	10.8	11.0	11.0	10.9	11.2

Table 1

UNIQA Insurance Group--Business Statistics (cont.)					
Motor	43.4	42.2	41.6	40.5	41.5
Marine, aviation, and transport	4.6	4.8	5.1	5.4	4.2
Property	25.0	25.0	25.1	25.2	24.5
Liability	9.5	10.0	10.3	10.3	9.6
Legal expenses	2.3	2.3	2.2	2.1	2.1
Other	4.4	4.7	4.7	5.7	6.7

We regard UNIQA's competitive position as strong, particularly in its domestic market, while CEE is expected to become the group's main location of growth. With the expansion of the CEE operations, the strategic importance of the group's Western European niches is gradually declining. We believe that the group may face lower demand and reduced savings power in CEE given the current economic environment. In addition, currency losses due to sharp declines in some CEE currencies against the euro are putting pressure on UNIQA's consolidated revenues. In our view, UNIQA will find it difficult to demonstrate sustained success of recent investments in this region and achieve increased organic growth, which is likely to be highly dependent upon the success of the continued cooperation of its strategic partnership with the cooperative Raiffeisen banking group. UNIQA's competitive advantages in the domestic market include strong distribution capabilities and its well-diversified portfolio by line of business.

Domestic competitive position

UNIQA has a strong position in the Austrian insurance market in all lines of business with strong distribution capabilities; it benefits from its exclusive access to the broad network of the Raiffeisen cooperative banks, which we view as a strong competitive advantage.

The group's life insurance segment benefits materially from its exclusive access to the broad network of the Raiffeisen cooperative banks through its subsidiary Raiffeisen Versicherung AG (not rated), as banks remain the most important distribution channel for life insurance products in Austria. Overall, UNIQA's domestic life premiums are expected to increase by about 1% in 2009 driven mainly by strong growth in single premium business of about 11%, while current premium business is thought to have declined by about 1%. The group's brand for unit-linked products, Finance Life Versicherung AG (not rated), continues to develop favorably as reflected by an increase of unit-linked business for the group of about 3.5% in 2009.

In health insurance, we believe that UNIQA has a significant competitive advantage as a result of its dominant franchise in this sector, where it benefits from excellent brand recognition, very strong market expertise, and excellent service to policyholders. We expect the group's domestic health premiums to increase by 3% in 2009.

In nonlife insurance, we expect softening in some business lines that may put pressure on business volumes and profitability. UNIQA aims to alleviate this pressure through product innovation. We expect the group's domestic nonlife premiums to increase by about 2% in 2009, which would mean a small gain in market share.

Geographic diversification

In our view, UNIQA's increasing geographic diversification is vital to expanding the business and achieving greater scale and earnings diversity. UNIQA has been successful in expanding in CEE, which we believe is the group's most important growth location. UNIQA benefits from its status as the preferred partner of the Raiffeisen banks, which fuels its business expansion in CEE and facilitates easier market entry through strong distribution channels. In Western Europe, UNIQA focuses on niche positions in Germany, Italy, Switzerland, and Liechtenstein.

Prospective

UNIQA is well placed to maintain its strong competitive position in Austria and further expand in CEE using its proven distribution power and sound prospects for the life insurance market to support its domestic franchise. We expect its operations in CEE to expand more strongly than those in the domestic market, gradually increasing business and earnings diversification. However, UNIQA will have to respond to weakening economic conditions in CEE with potential pressure on revenues and will need to demonstrate ability to compete effectively with larger players in individual markets.

Management And Corporate Strategy: Sound Operational Management

Management has made further progress in improving UNIQA's geographic diversity and the quality of its operations, in particular, its nondomestic franchise. Nevertheless, in our view, the group is finding it difficult in the current economic conditions to maintain its competitive strength and growth while maintaining adequate earnings levels. We are concerned about the competitive strength of UNIQA's foreign subsidiaries and the group's somewhat aggressive growth strategy. The group's operational and financial management skills are, in our view, sound and essential to maintaining a geographically diversified insurance portfolio.

Group strategy

Management's main focus is on diversifying the group's geographic profile while maintaining strong profitability. Profits from the Austrian businesses provide a platform for investment in foreign expansion. Internationally, UNIQA follows a composite strategy in Central Europe with a strategic focus on bank partnerships, and in addition maintains a strategy of niche positions in Western Europe.

We regard CEE as UNIQA's strongest business opportunity. We expect the group to make further acquisitions and investments in local businesses in this region to reach its target of a market share of at least 5% in nonlife and 3% in life insurance in all the countries in which it has a presence.

Operational management

We consider UNIQA's operational management to be sound because efficient operational controls are in place. We view these capabilities as crucial, particularly in light of the increasing complexity of the group. A balanced-score-card approach is used as an effective tool to monitor and distribute profit responsibility across the organization. UNIQA can also draw on its strong record of integrating newly acquired companies. A groupwide information technology platform, the assignment of responsibility to the holding company's management board members to oversee operations in each individual country, a groupwide risk-management framework, and competence centers should help streamline the group's operations. In our view, a strong customer-segmentation platform and improving risk-management concepts will support operational decision making.

Financial management

UNIQA's groupwide financial targets before the financial downturn included the achievement of a pretax return on equity of at least 20%, which the group did not meet in 2008 and will probably not achieve in 2009 or 2010 because of weak financial markets and economic conditions. As a result, the group has lowered its return on equity expectations to 4%-12%. Regulatory group solvency is targeted to remain in excess of 120%. This capital policy, however, is considered tight compared with the capital policies of the group's peers, and UNIQA's capitalization is a relative weakness for the rating. With regard to foreign acquisitions, UNIQA has clear business plans. It will consider exiting individual CEE markets if it fails to achieve desired profitability levels within five years.

Enterprise Risk Management: Adequate And Set To Improve Through Defined Enhancements

We consider UNIQA's enterprise risk management (ERM) to be adequate. Risk-control processes are mostly strong and based on a detailed set of risk exposures from 12 risk areas, allowing the group to estimate its potential exposure to each individual risk. A "traffic light" system triggers alerts based on deviations from experience. The group has implemented Prophet risk models to analyze European Embedded Value (EEV) in life insurance and traditional embedded value in health insurance. It has also enhanced risk-capital modeling in nonlife using a dynamic financial analytical tool. Full integration of these models into a groupwide economic model and consistent use of risk capital in business planning and pricing should, over time, enhance strategic risk management. A sound governance structure, clear risk policies, and regular risk reporting that broadens the awareness of risk across the organization support the group's risk-management culture. Nevertheless, UNIQA is still faced with the challenge of instilling a consistent ERM culture across the group. We regard this as essential for this complex group, given that it operates in many lines of business (mostly private and small and midsize enterprises) and geographic areas. We expect the group to continue improving its ERM systems, risk models, and strategic risk management.

Accounting: An Early IFRS Adopter

UNIQA has applied International Financial Reporting Standards (IFRS) on a consolidated basis since 2000, although the group's operating entities primarily report under Austrian generally accepted accounting principles. The group published embedded-value information for the first time in 2006. In our capital analysis, we recognize the group's hybrid capital, unrealized gains/losses on investments, 50% of the value of policies in force on the life and health portfolios, and the free part of policyholder bonus reserves.

Operating Performance: High Volatility Due To Investment Results And CEE Exposure

Table 2

UNIQA Insurance Group--Operating Statistics

	--Year-ended Dec. 31--				
(Mil. €)	**2008**	**2007**	**2006**	**2005**	**2004**
Net income	67	269	175	133	102
Posttax return on reported equity (%)	4.48	18.8	14.5	13.4	13.5
Total gross expense ratio (%)	26.9	26.8	25.3	24.9	26.8
Non-life					
Non-life revenue	2,295	2,151	1,846	1,770	1,497
Non-life operating result	122	274	114	89	84
Return on revenue (%)	5.3	12.7	6.2	5.0	5.6
Gross loss ratio (%)	61.1	66.8	63.0	65.0	62.9
Net loss ratio (%)	62.4	65.9	64.3	66.3	64.1
Net expense ratio including other technical expenses (%)	35.7	35.1	36.6	36.9	37.3
Net combined ratio (%)	98.1	101.0	100.9	103.2	101.4
Life/Health					
New-business margin (%, based on present value of new business premiums)	2.0	2.9	2.2	N.A.	N.A.

Table 2

UNIQA Insurance Group--Operating Statistics (cont.)					
New-business margin (%, based on annual premium equivalent)	17.2	25.2	20.2	20.0	N.A.
Life surplus available for distribution	(183.5)	365	377	407	349
Return on assets (before bonus allocation) (bps)	(104.5)	211.0	230.4	279.5	275.1
Administrative expense ratio (%)	6.7	6.7	6.8	7.8	8.4
Acquisition expense ratio (%)	14.6	15.0	11.4	9.9	11.2

bps--basis points. N.A.--Not available.

UNIQA has been substantially affected by investment losses in 2008 and 2009, creating high volatility in its earnings. The group's moderate investment performance is the main reason for the drop in net income in the period. For the first three quarters of 2009, however, net investment earnings increased significantly year on year to €564 million as a result of improved equity markets and lower impairments. However, these investment earnings have been mostly used to increase policyholder bonuses, which act as a risk buffer and which suffered significantly in 2008 and in the first six months in 2009. Consequently net income in 2008 stood at €67 million, while for full-year 2009 we expect a figure of about €50 million. If a more stable investment environment emerges in 2010, we believe UNIQA's net income will recover to about €200 million with a return on equity of about 7%.

Nonlife

The group's nonlife underwriting result worsened in the first three quarters of 2009, with a reported net combined ratio of 102.7%, compared with 96.5% for the corresponding period of 2008. This reflects increased claims as a result of storm events in Austria, but also extraordinary reserve strengthening measures in UNIQA's recently acquired operation in Romania. A strict underwriting policy implemented under a groupwide restructuring program and continued cost efficiency measures should, however, in our view, enable the group to achieve a combined ratio of well below 100% in 2010. In addition, the group needs to continue its cost focus to bring its technical performance sustainably into line with the performances of its peers and to reach its long-term target of 97%.

Life and health

The combined life and health business reported a new-business margin of 2% for 2008 after 2.9% in 2007 (on a present-value-of-future-premiums basis). We expect sound new-business profitability to feed through to future bottom-line results, although adverse investment experience has put pressure on the value-in-force and bottom-line earnings of the life segment.

The performance of the health insurance segment demonstrates that UNIQA's profitability initiatives, including the pruning of unprofitable group contracts, price adjustments, and cost reductions continue to have a positive effect. This segment continued to show promising results, reporting strong profits of €76 million for the first three quarters of 2009. We believe health remains a solid earnings driver within the group.

Foreign business

The contribution of the group's foreign operations to scale and earnings diversity are still relatively limited and we believe the group will continue to derive the majority of its earnings from the domestic market over the next few years. In addition, we believe UNIQA will face increasing earnings volatility in CEE at least in the near future given the uncertain economic conditions in some markets in the region.

Investments: Appropriate Investment Strategy But Comparably High Credit Risk

Table 3

UNIQA Insurance Group--Investment Statistics					
	--Year-ended Dec. 31--				
(Mil. €)	**2008**	**2007**	**2006**	**2005**	**2004**
Net investment income	871	727	700	638	728
Direct yield on invested assets (%)	4.4	3.6	3.6	3.8	5.0
Total return (including unrealized and realized) (%)	1.1	5.0	4.6	5.9	5.3
Nonlinked portfolio composition (%)					
Investment in affiliates	4.4	2.7	2.0	1.3	1.2
Bonds and other fixed-interest securities	54.3	53.4	57.2	62.2	64.0
Mortgages	0.7	0.9	0.9	1.0	1.0
Equities and other variable-interest securities	16.1	24.4	22.4	18.8	12.3
Property	10.6	9.2	8.4	6.1	6.6
Cash and bank deposits	10.3	6.4	5.4	5.8	9.0
Loans and private placements	3.3	2.7	3.2	4.5	4.9
Derivatives	0.1	0.3	0.5	0.3	0.9

We consider UNIQA's investment strategy to be appropriate relative to its risk-bearing capacity, but that its credit risk exposure is comparably high.

The bulk of UNIQA's investments are in fixed-income securities. The group cut its exposure to equities to about 3.4% in the first three quarters of 2009 from 8.5% in 2007, thereby avoiding even greater volatility in its results. UNIQA holds a long-standing domestic property portfolio, representing 8% of total investments.

Credit risk

Credit risk exposure is high compared with that of key competitors; although 80% of the investment portfolio is comprised of bonds rated 'A' or higher, 13% is comprised of bonds in the 'BBB' category. However, in UNIQA's quest for yield, about 7% of portfolio is comprised of speculative-grade bonds. This exposure resulted in material write-downs on subprime bonds in 2007 and further, though limited, writedowns on bonds from other issuers in 2008 and 2009. We have detected rising asset risk resulting from the group's CEE subsidiaries.

Market risk

Interest rate risk is the key risk exposure according to EEV sensitivities, which the group manages through a duration-based approach, including structured investments and swaps. Hedging strategies are in place for equities.

Asset liability management

We consider UNIQA's asset-liability management to be appropriate for managing key risk factors, interest rate changes, and duration mismatches. The group uses a relatively new stochastic model to manage its assets and liabilities.

Liquidity: Highly Liquid Balance Sheet

We consider UNIQA's liquidity to be strong because of the group's available sources of liquidity and highly liquid asset profile. A groupwide liquidity management framework further supports appropriate cash management.

Capitalization: Strong, Backed By Capital Increase But Still A Relative Rating Weakness

We expect UNIQA's capitalization to remain strong through 2009, supported by equity issuance of €150 million in December 2009, mostly via the group's two main shareholders. However, capitalization still represents a relative weakness for the rating. In our view, the group needs to manage its capitalization cautiously, through a combination of earnings retention and external funding measures, given its continued aggressive expansion strategy in CEE. Nevertheless, if additional significant capital were needed, we believe that UNIQA has the long-term option of issuing new shares, which could reduce the stake of its two main shareholders, but to not less than a combined 51%.

Capital adequacy

We expect the group's risk-based capitalization to remain strong through 2009, mainly as a result of the capital increase, offsetting a lower annual result and ongoing financing of the group's expansion. We believe that further capital strengthening measures will be pursued if deemed necessary in 2010 to finance organic and acquisitive expansion.

Quality of capital

The quality of UNIQA's capital is assessed as sound and improved as a result of the capital increase in December 2009, raising the proportion of shareholders' funds in the group's total adjusted capital. The use of debt and hybrid instruments, however, is high in our view and close to our threshold for 'A' rated companies, with the group's financial leverage expected to be about 22% for full-year 2009. In addition, a significant proportion of capital resides in rather illiquid property investments.

Reserves

UNIQA uses a conservative reserving policy for its nonlife operations, applying a 10% surcharge to required reserves at a 90% confidence level. Reserve ratios and runoff profits have remained stable in recent years. Given the composition of the group's portfolio, the major part of its claims development is fairly short term, and its claims reserves are therefore not generally subject to any major deterioration.

Reinsurance

The group, in our consideration, employs a conservative reinsurance policy, both at the holding and the operating level; it had an overall reinsurance utilization ratio of 5% in 2008. We believe the reinsurance program contains conservative retention levels for the operating companies. Retrocession (the practice of transferring underlying risk to another reinsurer) continues to be bundled within the group and placed with reinsurers rated at least 'A'. UNIQA Re, the group's Switzerland-based internal reinsurer, handles most of the reinsurance cover for its foreign subsidiaries. We continue to consider UNIQA Re a core element of the group's risk-management strategy.

Financial Flexibility: Sound, But Constrained In Volatile Capital Market Environment

Table 4

UNIQA Insurance Group--Financial Statistics					
	--Year-ended Dec. 31--				
(Mil. €)	2008	2007	2006	2005	2004
Total assets	24,995	25,072	24,091	22,110	19,370
Total adjusted equity	1,967	2,134	1,763	1,428	1,159
Change in adjusted equity (%)	(7.8)	21.1	23.5	23.2	21.9
Reinsurance utilization ratio (%)	4.6	8.6	8.2	8.1	8.5
Non-life technical reserves/net premiums written (%)	97.7	108.0	106.5	105.0	115.0
Financial leverage (%)	22.5	19.4	19.1	17.3	22.1
Fixed-charge cover (x)	3.3	10.0	10.4	8.2	6.1

UNIQA's financial flexibility is sound, but has weakened since the onset of the recent financial market downturn. It may be tested further by business expansion that is likely to require additional resources. Capital needs will depend on further growth abroad and, to a lesser extent, in Austria.

We consider the group's financial flexibility to be relatively strained in the current capital market conditions as UNIQA's share price has declined and credit spreads have widened, making equity or debt-raising initiatives less attractive. However, we expect continued support from the group's main shareholders to enable it to raise additional equity or hybrid equity in 2010.

UNIQA's relatively high hybrid capital exposure of €575 million as of Sept. 30, 2009, in our view, reduces the group's financial flexibility. We expect fixed-charge coverage to weaken further in 2009 to about 2x after an already low 3x in 2008 as against 10x in 2007, demonstrating currently tightened debt-servicing capabilities.

Ratings Detail (As Of December 21, 2009)*	
Holding Company: UNIQA Versicherungen AG	
Financial Strength Rating	
Local Currency	A-/Stable/--
Issuer Credit Rating	
Local Currency	A-/Stable/--
Operating Companies Covered By This Report	
UNIQA Sachversicherung AG	
Financial Strength Rating	
Local Currency	A/Stable/--
Counterparty Credit Rating	
Local Currency	A/Stable/--
UNIQA Personenversicherung AG	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--

Ratings Detail (As Of December 21, 2009)*(cont.)	
UNIQA Re AG	
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. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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