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## Research Update:

# Iceland-Based Non-Life Insurer Tryggingamidstodin Ratings Affirmed at 'BBB-'; Outlook Stable

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## Research Update:

# Iceland-Based Non-Life Insurer Tryggingamidstodin Ratings Affirmed at 'BBB-'; Outlook Stable

## Overview

- Non-life insurer Tryggingamidstodin hf. (TM) has an adequate competitive position in Iceland, with a 27% market share and strong operating performance in recent years, but it faces moderate insurance industry and country risk.
- TM's very strong capital adequacy is a key rating strength, but its small capital base and concentration in Iceland constrain our view of its financial risk profile.
- Because TM's business and assets are concentrated in Iceland, we cap the ratings on TM at the 'BBB-' long-term foreign currency rating on Iceland.
- We are therefore affirming our 'BBB-' ratings on TM.
- The stable outlook reflects that on Iceland, and our view that TM will sustain moderately strong capital and earnings and maintain or lower its investment risk profile over the next two years.

## Rating Action

On June 20, 2014, Standard & Poor's Ratings Services affirmed its 'BBB-' insurer financial strength and counterparty credit ratings on Iceland-based non-life insurer Tryggingamidstodin hf. (TM). The outlook is stable.

## Rationale

The ratings reflect our view of TM's business risk profile as fair and its financial risk profile as upper adequate. Our assessment of business risk stems from our view of a moderate level of insurance industry and country risk for Icelandic non-life business and TM's adequate competitive position. We derive our assessment of TM's financial risk profile from its moderately strong capital and earnings, moderate risk position, and adequate financial flexibility. Under our criteria, these factors lead to an anchor of 'bbb'. We regard TM's adequate enterprise risk management (ERM) and satisfactory management and governance as supportive factors for the ratings. However, TM's exposure to Iceland, both in terms of business and assets, leads us to cap our long-term ratings on TM at the level of our long-term foreign currency rating on Iceland (BBB-/Stable/A-3), resulting in our 'BBB-' ratings on TM.

TM has a 27% share of Iceland's non-life insurance market and a track record of strong operating performance in recent years. These positives are partly offset by TM's concentration in the very small Icelandic market, which increases its vulnerability to market conditions, as it recently experienced. Heightened price competition, especially for motor business, caused TM to report a 4.5% decline in net earned premiums in the first quarter of 2014 compared with the same period the previous year. We believe the increased competition in the market will dampen growth

over the next few years, compared with TM's five-year average growth rate of 4%. We expect TM's gross written premiums (GWP) to be on par with the level achieved in 2013 and then increase by 2% to 3% annually in 2015-2016.

TM's limited geographic diversity beyond Iceland exposes it to moderate insurance industry and country risk, in our view, and this constrains our view of TM's business risk profile. We consider that risk from Iceland's financial system puts the non-life insurance sector at a disadvantage, and capital controls limit insurers' investment choices and access to external funding. In terms of industry risk, we consider that Iceland's non-life insurance sector carries inherent volatility risk because of its small size, concentrated market structure, high competition, history of volatile returns, and investment concentration in Iceland.

Regarding TM's financial risk profile, we consider capital adequacy commensurate with a 'AA' confidence level, according to our risk-adjusted capital model. However, we limit our capital and earnings assessment to moderately strong, based on the company's small capital base, which leaves it vulnerable to losses from a single event, owing to its concentration in Iceland. TM's combined (loss and expense) ratio deteriorated to 96.0% in 2013 and to 98.5% in the first quarter of 2014, from 89.1% in 2012. This was mainly due to two major marine claims in 2013 and harsh winter conditions in 2013-2014. However, we believe that the group's conscious policy of writing profitable business and reducing costs will result in combined ratios of about 95% in 2014-2016. We assume a limited increase in capital requirements, owing to modest growth in asset risk and premium volumes. Consequently, we expect that TM will maintain its capital adequacy at levels exceeding that in line with a 'AA' confidence level, according to our risk-based capital model, in 2014-2016, despite higher shareholder payouts.

In our view, TM exhibits a moderate risk position. We believe that the company's capital base is exposed to potential volatility, due to its underwriting and investment concentrations in the relatively small and volatile Icelandic insurance and capital markets, limited investment opportunities, and other risks stemming from foreign currency controls.

We consider TM's liquidity to be strong. Liquid assets represented approximately 65% of TM's total invested assets in 2013, but the company has high exposure to unrated bonds (23% of total invested assets), real estate (8%), and private equity (3%). Our base-case assumption is that the proportion of illiquid assets will remain broadly stable; however, a material increase of such assets could, in our view, weaken TM's liquidity profile.

## **Outlook**

The stable outlook on TM reflects that on Iceland. Therefore, a rating action on Iceland will likely trigger a similar action on TM. The outlook also reflects our view that TM's management will continue to successfully implement its strategy, sustain moderately strong capital and earnings, and maintain or lower its investment risk profile over the next two years. We expect that TM's strong earnings will continue supporting its capital and earnings and competitive position.

Downside scenario:

We might lower the ratings on TM over the next 12 to 24 months if, contrary to our expectations:

- Risk in the investment portfolio materially increased;
- Capital adequacy deteriorated to levels significantly below the 'A' confidence level, according to our risk-adjusted capital model, for a prolonged period. This could result from an unexpectedly sharp increase in claims or high investment losses; or
- Liquidity weakened, which could result from an increase in holdings of illiquid or higher-risk assets.

Upside scenario:

Absent an upgrade of the sovereign rating, we do not see any upside potential for the rating over the next 12 to 24 months, considering that the rating on TM is constrained by the long-term foreign currency rating on Iceland.

## Ratings Score Snapshot

Holding Company Rating	Tryggingamidstodin hf.
Financial Strength Rating	BBB-/Stable
Anchor	bbb
Business Risk Profile	Fair
IICRA	Moderate Risk
Competitive Position	Adequate
Financial Risk Profile	Upper Adequate
Capital & Earnings	Moderately Strong
Risk Position	Moderate Risk
Financial Flexibility	Adequate
Modifiers	0
ERM and Management	0
Enterprise Risk Management	Adequate
Management & Governance	Satisfactory
Holistic Analysis	0

## Rating Score Snapshot Continued...

Liquidity Test	0
Sovereign Risk	-1
Support	0

## Related Criteria And Research

### Related Criteria

- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions - November 19, 2013
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management - May 07, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology - May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model - June 07, 2010

### Related Research

- Iceland Property/Casualty Insurance Sector Carries A Moderate Industry And Country Risk Assessment, Feb. 28, 2014
- Republic of Iceland Outlook Revised To Stable From Negative On Receding Fiscal Risk; 'BBB-/A-3' Ratings Affirmed, Jan. 24, 2014

## Ratings List

	Ratings	
	To	From
Tryggingamidstodin hf.		
Counterparty Credit Rating		
Local Currency	BBB-/Stable/--	BBB-/Stable/--
Financial Strength Rating		
Local Currency	BBB-/Stable/--	BBB-/Stable/--

Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [spcapitaliq.com](http://spcapitaliq.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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