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Research Update:

Icelandic Insurer Tryggingamidstodin hf. Upgraded To 'BBB-' On Improved Capitalization And Operating Performance

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Overview

- In our view, Iceland-based multiline insurer Tryggingamidstodin hf. (TM) improved its capital adequacy and demonstrated a track record of improved underwriting performance.
- We are therefore raising our ratings on TM by one notch to 'BBB-' from 'BB+'.
- The stable outlook on TM reflects our opinion that it is likely to maintain its good operating performance and maintain risk-based capital adequacy according to our capital model at least at 'BBB' level.

Rating Action

On Feb. 20, 2013, Standard & Poor's Ratings Services raised its long-term counterparty credit and insurer financial strength ratings on Iceland-based multiline insurer Tryggingamidstodin hf. (TM) to 'BBB-' from 'BB+'. The outlook is stable.

Rationale

The upgrade reflects our view of TM's improved capitalization and a track record of good operating performance. It is also supported by improved and good competitive position. These positive factors are partially offset by marginal investments and lack of geographical diversification.

Standard & Poor's considers TM's capitalization to be good and a relative strength for the ratings. According to Standard & Poor's risk-based capital model, TM's capital adequacy improved and we now regard it as good. TM improved its capital adequacy mainly by:

- Lowering the risk in its investment portfolio by reducing equity and concentration exposure, and
- Increasing shareholders' equity through retained earnings.

Our view of capitalization is supported by TM's prudent reserving and high quality reinsurance protection. In our base-case scenario, we expect capital adequacy to remain at least at the 'BBB' level in 2013-2014. We don't expect TM to make a dividend payment for 2012 and anticipate that dividend policy under new ownership will be prudent and protective of TM's capital adequacy.

We view operating performance as good and a relative strength for the ratings. TM has demonstrated a track record of improved operating performance as a result of the successful implementation of management's strategy, enhanced pricing techniques, improved risk selection, and good risk management. This is reflected in a three-year track record of positive underwriting results with a net combined ratio (a measure of profitability for which a result greater than 100% signifies an increasing underwriting loss) at 93% for 2011; we expect a net combined ratio of about 90% for 2012.

In our base-case scenario, we anticipate that the improvements in underwriting will allow TM to maintain good technical performance with net combined ratios below 95% in 2013-2014 and profit before tax of around Icelandic krona (ISK) 2.3 billion in 2013 and ISK2.5 billion in 2014.

We regard TM's competitive position as good. Our view is supported by its high market share (26% in the non-life market), market-leading profitability, and good controlled distribution network. We think TM management has successfully executed its strategy and over the past four years has made significant steps toward strengthening the TM brand, advancing its customer segmentation, pricing, and risk selection.

We think TM has a stable and defensible market share as the third-largest player. It wrote annual premium of ISK11.1 billion in 2011 (around \$91 million). In our view, TM's business concentration in one relatively small country and lack of geographical diversification partially offset these positive factors. In our base-case scenario, we expect TM to grow at around 5% in 2013-2014, which is broadly in line with the market.

Standard & Poor's regards TM's investments as marginal. This reflects its opportunistic approach to investments; reduced, but still high, appetite for risky assets; and a lack of investment opportunities in the local market. At the end of 2012, exposure to risky assets such as equities, alternatives, and real estate was expected to be more than 25% of total investments. The target allocation to this class is around 40%. We consider this high by international standards--it exposes TM's earnings and capital to some volatility. These negative factors are partially offset by the improved investment portfolio mix, reduced concentration, and good quality of its bank deposits and fixed income instruments. In our view, the limited investment opportunities in Iceland caused by its capital controls and high inflation level will be one of TM's key tests. However in our base-case scenario, we expect the investment mix to remain largely the same and that investment income will be above inflation.

Outlook

The stable outlook reflects our view that TM's management will continue to successfully implement its strategy, sustain good operating performance, and produce a net combined ratio under 95% in 2013-2014. We further expect improved retained earnings to contribute to increased capital adequacy, which

we anticipate will be at least in line with the rating or better, as measured by our risk-adjusted capital model.

We do not expect to lower the rating at present. However, we could consider a negative rating action if we see a material deterioration in TM's operating performance, a weakening of capital adequacy according to our capital model below 'BBB' level, or an increase in risk in the investment portfolio composition.

We do not see any potential for positive rating action, as the ratings on TM are at the same level as the sovereign long-term local currency rating on Iceland. We could lower the ratings on TM if we lower the ratings on Iceland.

Ratings List

Upgraded

	To	From
Tryggingamidstodin hf.		
Counterparty Credit Rating	BBB-/Stable/--	BB+/Stable/--
Financial Strength Rating	BBB-/Stable/--	BB+/Stable/--

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