

Research Update:

# Echo Rueckversicherungs AG Upgraded To 'A' On Improved Underwriting Performance; Outlook Stable

June 28, 2024

## Overview

- Swiss reinsurer Echo Rueckversicherungs AG (Echo Re) has continued to build a track record of a more solid and sustainable underwriting and operating performance, which was consistent with that of higher-rated peers in 2023.
- We expect the performance will be sustainable and in line with that of global reinsurance peers over 2024-2026.
- We therefore raised our long-term issuer credit and financial strength ratings on Echo Re to 'A' from 'A-'. We also revised Echo Re's business risk profile to satisfactory from fair.
- The stable outlook reflects our expectation that Echo Re will expand its business franchise while preserving satisfactory profitability and solid capital and earnings. It also incorporates our view that the company will remain strategically important to its parent DEVK Insurance Group (DEVK, A+/Stable/--) and benefit from financial and liquidity support if necessary.

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## Rating Action

On June 28, 2024, S&P Global Ratings raised its long-term issuer credit and financial strength ratings on Echo Re to 'A' from 'A-'. The outlook is stable.

## Impact Of Revised Capital Model Criteria

- The implementation of our updated criteria for analyzing insurers' risk-based capital (see "Insurer Risk-Based Capital Adequacy--Methodology And Assumptions," published Nov. 15, 2023) was not the driver for raising the ratings on Echo Re.
- Our revised capital model criteria led to an improvement in Echo Re's capital adequacy. The improvement primarily reflected an increase in total S&P Global Ratings-adjusted capital that resulted from the removal of haircuts to liability adjustments, namely non-life reserve surplus, and because we did not deduct non-life deferred acquisition costs.
- We also captured the benefits of risk diversification more explicitly in our analysis, which

supports capital adequacy.

- The recalibration of our capital charges to higher confidence levels partially offsets these improvements.

## Credit Highlights

### Overview

#### Key strengths

Expanding geographic footprint, with operations in more than 70 countries.

Improved operating performance, now in line with that of global property/casualty (P/C) reinsurance peers.

Track record of parental support, with capital injections ensuring financial stability and underpinning business development.

#### Key risks

Potential for material capital and earnings volatility through substantial exposure to natural catastrophes and human-made disasters, among other significant risks.

Higher vulnerable to adverse developments than peers due to Echo Re's relatively small size.

## Key metrics

### Echo Rueckversicherungs AG--Key metrics

(Mil. CHF)	2026f	2025f	2024f	2023	2022	2021	2020	2019
Gross premiums written	<420.0	<380.0	~350.0	372.7	283.6	241.9	226.7	183.9
Net income	15.0-20.0	15.0-20.0	15.0-20.0	25.1	13.3	5.4	0.6	1.2
Return on shareholders' equity (%)	8.0-12.0	8.0-12.0	8.0-12.0	14.3	8.6	4.0	0.5	1.1
P/C: Net combined ratio (%)	94.0-96.0	94.0-96.0	94.0-96.0	94.6	96.2	99.9	106.0	100.9
S&P Global Ratings' capital adequacy	At least 99.95%	At least 99.95%	At least 99.95%	99.99%	Strong	Very strong	Satisfactory	Excellent
Net investment yield (%)	>2.0	>2.0	>2.0	1.8	1.4	1.0	1.1	1.1

CHF--Swiss franc. f--Forecast. P/C--Property/casualty.

## Outlook

The stable outlook reflects our expectation that Echo Re will expand its business franchise while preserving profitability and solid capital and earnings. The company's stand-alone credit profile (SACP) is 'bbb' and the final rating is further uplifted by its strategic importance to DEVK, which will provide financial and liquidity support if necessary.

## Downside scenario

We could take a negative rating action over the next 12-24 months if:

- Severe losses weaken Echo Re's SACP and lead to a sustainable deterioration in its operating performance such that it falls materially short of the reinsurance sector average; or
- Echo Re's strategic importance to DEVK reduces, potentially triggered by the continued underperformance of group targets or a change in the group strategy.

## Upside scenario

An improvement in Echo Re's SACP would not automatically lead to an upgrade because we cap the ratings on strategically important subsidiaries at one notch below our rating on the parent company.

We could raise our ratings on Echo Re if Echo Re's group status strengthened to "core". Yet we see this as unlikely, given Echo Re's limited business and operational overlap with the rest of the group.

## Rationale

**The upgrade reflects our view that Echo Re's competitive position has strengthened over the past few years.** The company's competitive position benefited from an increase in scale and scope of business, which improved operating performance and portfolio diversification. Thanks to several underwriting measures implemented in the past couple of years to improve business profitability, limiting underwriting risk and strengthening underwriting control, together with a more favorable pricing in the reinsurance sector and the relative absence of large natural catastrophes, further improved Echo Re's operating performance in 2023, with a combined ratio of 94.6% and return on equity (ROE) of 14.3%.

**We expect a combined ratio of 95% or below over 2024-2026, assuming the number and extent of natural catastrophes do not exceed normal levels.** We believe Echo Re's operating performance will benefit from the increased scale and diversification of its reinsurance portfolio. The company continues to control underwriting risk in its portfolio. Relatively favorable pricing in the reinsurance sector will continue to support Echo Re's solid performance. We expect the company will take advantage of organic growth opportunities if they arise.

**Echo Re offers a wide range of P/C inward reinsurance, predominantly as proportional treaties.** Property represented 41% and motor 14% of inward reinsurance premium income in 2023. The remainder comes from agriculture (17%), marine (14%), credit and bond (6%), engineering (4%), and other (7%). The company has progressively added specialty lines, whose premium volume is about Swiss franc (CHF) 160 million, to gain access to more profitable segments and increase its diversification.

**We think the cancellation of overall profitable group-internal cessions with DEVK in January 2024 will temporarily reduce Echo Re's bottom line profits.** Based on the strong and profitable growth and higher investment result, we expect the company can largely offset the reduction in bottom line profits. Overall, we expect Echo Re will be able to deliver CHF15 million–CHF20 million

in net income over 2024-2026. In our view, the company's conservative investment portfolio--with primarily fixed income instruments rated 'AA' on average--will likely benefit from higher reinvestment yields and an increase in investment assets due to business growth. More solid underwriting performance and increasing investment results will support a ROE of 8%-12% over 2024-2026.

**We note that, following the increase in pricing of reinsurance protection, Echo Re adjusted its reinsurance protection and increased the risk retention on its book.** Yet we think this will not derail the company's future performance. Over the past few years, Echo Re has built up capital, which can somewhat protect against large catastrophe events. Considering the still favorable underwriting and claims environment, we expect the company will further build up underwriting buffers for less favorable times.

**Another increase in business scale, which is still small in absolute terms compared with global peers, increases earnings capacity and underwriting diversification, while limiting concentration risk.** Echo Re reported a business growth of 31.4% in 2023, mainly resulting from significant premium increases in 2023 renewals. Asia, where Echo Re generates more than 50% of its gross written premiums (GWP), remains the main growth region. The company benefited significantly from the hardening reinsurance market. We expect GWP will decline in 2024 due to the cancellation of the quota-share agreement with DEVK. This enables Echo Re to focus exclusively on the expansion of the external portfolio. Hence, we expect annual growth levels of 10%-15% over 2025-2026.

**Echo Re occupies a moderate position in the global reinsurance market, with GWP of CHF372.7 million in 2023.** Most GWP come from the nongroup business, while the group business accounts for about 15%. The company's risk profile is spread globally. Echo Re writes about 17% of its GWP in Europe--mainly Germany due to the internal quota-share agreement with DEVK--and 56% in Asia. The Middle East (9%), Africa (4%), Latin America (13%), and Australia (1%) make up the rest. Yet we believe the company's still relatively modest size and low market share make it more vulnerable to adverse operating conditions than larger, more diversified peers.

**As per our risk-based capital model, Echo Re exceeds the capital requirement of an extreme stress scenario in 2023.** The very comfortable regulatory capital position also confirmed our view of Echo Re's capital adequacy, with the Swiss Solvency Test (SST) ratio standing at 228.8% at year-end 2023. In absolute terms, Echo Re's capital position increased substantially in the past decade, mainly due to several capital injections from its parent, DEVK. Given Echo Re's expected rapid business growth, we believe increasing capital requirements from combined underwriting and investments growth will continue to outpace capital generation slightly over the next few years. We therefore expect the company's capital position in our risk-based model will slightly reduce but remain sustainably above the 99.95% confidence level over our forecast horizon. We believe DEVK will provide capital support with capital in the case of large growth opportunities or very severe market stress in underwriting or investments if necessary.

**We continue to consider Echo Re is a strategically important subsidiary for DEVK, particularly in light of DEVK's international expansion plans.** Echo Re remains DEVK's only legal carrier for reinsurance expansion outside Europe and North America. It contributes to DEVK's international business and product diversification. We assume DEVK will continue supporting Echo Re's expansion if necessary. Yet we now believe Echo Re will mainly finance growth through its own solid earnings retention.

## Environmental, Social, And Governance

Environmental factors are a negative consideration in our credit rating analysis of Echo Re. The company's property reinsurance exposure can generate large losses in case of extreme weather events and natural catastrophes. Echo Re's relatively small size makes its capital and earnings sensitive to large claims. Nevertheless, the company has a comprehensive retrocession program that protects it against extreme natural catastrophe events.

## Ratings Score Snapshot

	To	From
<b>Issuer credit rating</b>	<b>A/Stable/--</b>	<b>A-/Positive/--</b>
Anchor*	bbb	bbb-
Business risk	Satisfactory	Fair
IICRA	Intermediate risk	Intermediate risk
Competitive position	Satisfactory	Fair
Financial risk	Fair	Fair
Capital and earnings	Strong	Strong
Risk exposure	High	High
Funding structure	Neutral	Neutral
Modifiers	Neutral	Neutral
Governance	Neutral	Neutral
Liquidity	Adequate	Adequate
Comparable ratings analysis	0	0
Support		
Group support	3	3
Government support	0	0

\*We choose the higher anchor because Echo Re's capital adequacy is redundant at the 99.95% confidence level. IICRA--Insurance Industry And Country Risk Assessment.

## Related Criteria

- Criteria | Insurance | General: Insurer Risk-Based Capital Adequacy--Methodology And Assumptions, Nov. 15, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### Upgraded; Outlook Action

	To	From
<b>Echo Rueckversicherungs AG</b>		
Issuer Credit Rating		
Local Currency	A/Stable/--	A-/Positive/--
Financial Strength Rating		
Local Currency	A/Stable/--	A-/Positive/--

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