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Mapfre Re, Compañía de Reaseguros, S.A.

Spain

Full Analysis Report

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Contact(s): Angelo Sacca, London (44) 20-7176-7073;
 angelo_sacca@standardandpoors.com
Contact(s): David Laxton, London (44) 20-7176-7079;
 david_laxton@standardandpoors.com
Contact(s): Insurance Ratings Europe;
 InsuranceInteractive_Europe@standardandpoors.com

Operating Company Covered By
 This Report

Financial Strength Rating

Local Currency

AA/Stable/--

Major Rating Factors

Strengths:

- Core to the Mapfre group.
- Strong operating performance.
- Strong competitive position in Spain and Latin America, and increasingly in the international reinsurance market.
- Strong capitalization.

Weaknesses:

- Moderate size in a consolidating global industry.
- High dependence on retrocession capacities arising from its role as the Mapfre group reinsurer.

Rationale

The ratings on Spain-based reinsurer Mapfre Re, Compañía de Reaseguros, S.A. (Mapfre Re) reflect its status as a core subsidiary of Spanish insurance group Mapfre S.A. (the Mapfre group or Mapfre; A+/Stable; main operating entities are rated AA/Stable) which is derived from Mapfre Re's role as the group's exclusive treaty reinsurer, the management's strong links with other parts of the Mapfre group, and the parent's track record of capital management to fund Mapfre Re's growth. Mapfre Re's predominantly proportional book of business is deemed to affect the entire Mapfre group's risk profile only marginally, while bringing valuable diversification in non-Spanish property businesses. Mapfre Re is also regarded as a center of excellence within the group.

On a stand-alone basis, the ratings on Mapfre Re also reflect the company's strong operating performance, strong competitive position, and strong capitalization. The company's modest size in a global, consolidating reinsurance industry, and its relative dependence on retrocession capacities arising from its role as the Mapfre group reinsurer offset these positive factors.

Outlook

The stable outlook on Mapfre Re reflects that on Mapfre S.A. As a core subsidiary of Mapfre S.A., the ratings on Mapfre Re will move in tandem with

those on its majority shareholder.

■ Corporate Profile: Main Reinsurer Of Mapfre Group, And An Increasingly Global Franchise In The Open Market

Mapfre Re was initially established to underwrite the reinsurance needs of the Mapfre group and to act as its international arm. Since becoming autonomous in 1988, Mapfre Re has significantly developed its profile as an international reinsurer and in 2008 it ranked among the 20 largest reinsurers in the world. In 2000, it acquired Chatham Reinsurance Corp. (subsequently renamed Mapfre Reinsurance Corp.; MRC; not rated) in the U.S. However, in 2006, all new and renewal reinsurance business underwritten by this entity was transferred to a U.S. reinsurance trust of Mapfre Re, while the Canadian business was transferred to a newly created branch office in Canada. Mapfre S.A. is the majority 91% shareholder in Mapfre Re, with the remaining stakes held by several international insurers. In 2008, Mapfre Re announced the formation of its new subsidiary Mapfre Re Do Brasil Companhia de Resseguros.

■ Competitive Position: A Strong Presence In Spanish-Speaking Markets, And Leading Provider Of Proportional Capacity

Table 1

Mapfre Re, Compañía de Reaseguros, S.A. /Business Statistics							
	--Year ended Dec. 31--						
(Mil. €)	2008	2007	2006	2005	2004	2003	2002
Non-life gross written premiums	1, 654	1, 478	1, 337	1, 242	1, 060	836	736
Life gross written premiums	124	123	101	96	72	31	24
Total gross written premiums	1778	1, 601	1, 438	1, 337	1, 133	866	760
Non-life: annual change in gross written premiums (%)	12.0	10.6	7.6	17.1	26.9	13.5	11.1
Life: annual change in gross written premiums (%)	0.5	22.0	5.5	32.2	135.5	28.2	(6.3)
Total gross written premiums: annual change (%)	11.1	11.4	7.5	18.1	30.7	14.0	10.5

Mapfre Re has a strong competitive position that is derived from two facets, such as:

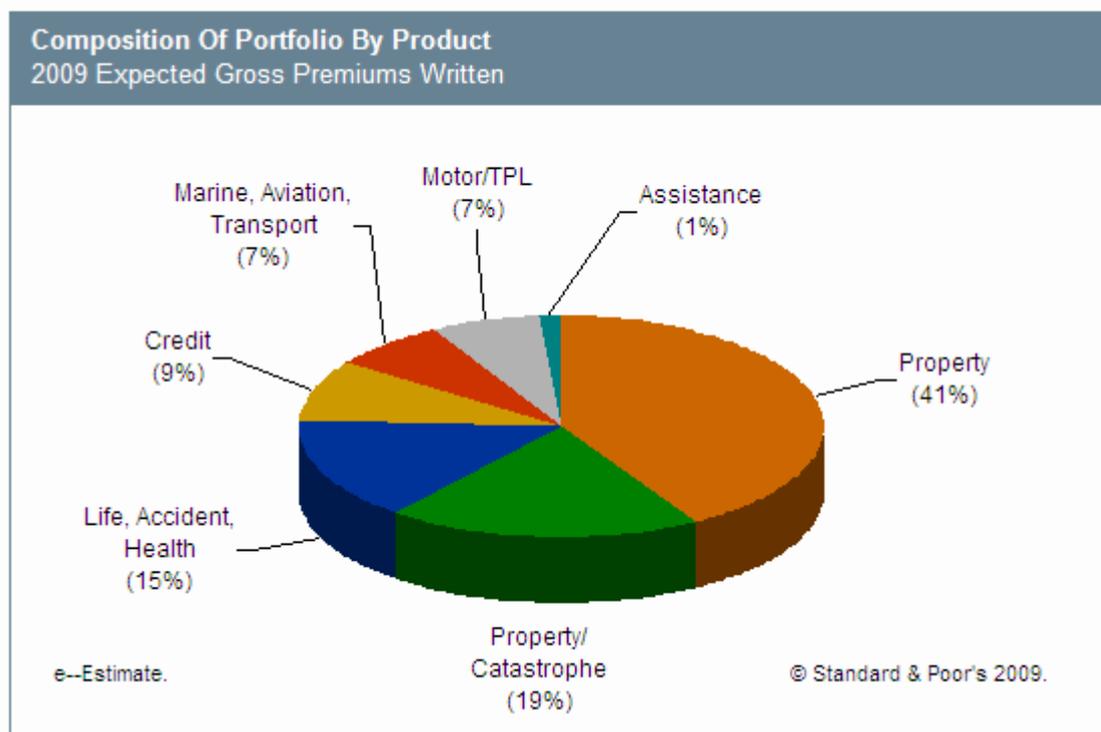
- Its exclusive role as treaty reinsurer to the Mapfre group, which provides a fast-growing and profitable revenue stream and international recognition; and
- A growing and geographically diversified presence in the international reinsurance market, which leverages the financial strength of its parent, but also reflects the strength of its cedent relationships that underpins its mostly proportional-based treaties. This strong competitive position is partly offset by Mapfre Re's relatively modest size in a global, consolidating reinsurance industry.

Historical

From its origins as a writer of mainly Mapfre group reinsurance, Mapfre Re has developed a strong stand-alone competitive position. Nonaffiliated business has been stable at about 64% of total premiums written over several years, as the pace of Mapfre group's international expansion has been matched by Mapfre Re. Premium growth has been exceptional since Mapfre Re started writing open market reinsurance business in 1982. The success of this organic growth is attributable to Mapfre Re's higher international market profile in recent years, particularly in Latin America, and more recently in Europe.

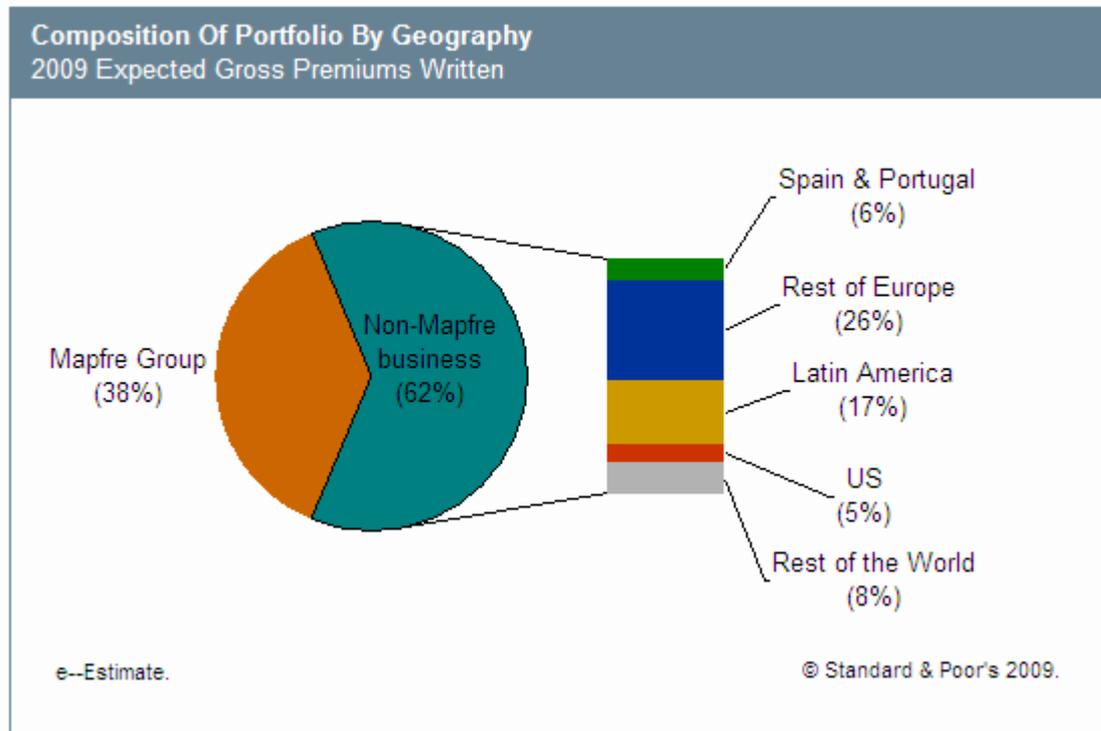
Mapfre Re has a strong relationship with its cedents, reflected in its very high client retention ratio (approximately 90% for the whole portfolio; 83% for the nonaffiliated business), and the fact that 70% of its premiums are written directly (although this figure includes affiliated business). A large number of Mapfre Re's new clients are coming from brokers, however. Contrary to market norms, Mapfre continues to offer coverage mostly on a proportional basis, which makes up 72% of the portfolio in 2008; the remainder is split between XL and

Facultative, 20% and 8%, respectively. This provides Mapfre with a more defensive position in the reinsurance market than some of its peers and reflects both the strength of its cedent relationships and the structure of the reinsurance arrangements with the Mapfre group. This binds Mapfre Re more closely to the pricing discipline of the primary market, however. Property is the dominant class of business overall, representing 61% of total premium in 2008 (including catastrophe business), but motor, accident, health, and credit reinsurance provide a reasonable level of diversification overall (see chart 1).



Including intragroup cessions, Mapfre Re is the market leader in Spain by virtue of Mapfre group's position. Historically, Spain and Portugal had a relative high weight in the overall portfolio. Nevertheless, their significance is reducing in line with the international expansion of Mapfre Re's parent; their share of total premium has decreased from 41% in 2006 to 29% in 2008.

Internationally, Mapfre Re operates in 104 countries, with a strong franchise in Spain, Europe, and Latin America, together with smaller operations in the U.S., Middle East, and Asia. Mapfre Re is able to write specialist products in these markets by utilizing the product expertise of the Mapfre group. The European operations are well spread and a new branch office was opened in Munich in 2007 to develop Mapfre Re's presence in Central and Eastern Europe, including Russia (see chart 2).



Prospective

We believe that Mapfre Re will maintain its strong competitive position in the Iberian and Latin American markets while further increasing its presence in the international reinsurance markets by leveraging the financial strength of the parent, Mapfre group, and its existing strong cedent relationships. Mapfre group is expected to remain a reliable source of revenue growth over the rating horizon. Nevertheless, we expect the proportion of nonaffiliated business to affiliated to remain stable at two-thirds to a third, as Mapfre Re expands its presence and its capacity in the international markets. In our view, Mapfre S.A.'s acquisition of Massachusetts-based insurer Commerce Group Inc. (main operating entities are rated A/Stable/--) will increase the weighting of U.S. risks and motor business in Mapfre Re's portfolio over the long term. The geographic composition of the portfolio (as shown in chart 2) is expected to remain fairly stable over the next two years. As one of only a handful of reinsurers that has applied for local status in the recently liberalized Brazilian market, Mapfre Re will have preferential access to 60% of cessions in the Brazilian market until 2010, reducing to 40% until 2013. The Brazilian regulator Superintendencia de Seguros Privados (SUSEP) estimates that premium income in the Brazilian reinsurance market will exceed €1.3 billion in 2009. Competition in this market is likely to be intense initially. However, we do not expect Mapfre Re to write a large volume of business at the outset.

Overall, we expect strong growth of about 10%-15% in 2009 based on Mapfre Re's January 2009 renewal experience, spread widely across the portfolio. The rate of growth is to be read in the context of a hardening market, but is also reflective of Mapfre Re's financial strength, its growth in emerging markets, its relatively low penetration of the major reinsurance markets globally, and its very low operating expenses, which provide a competitive advantage.

Management And Corporate Strategy: Long Standing And Integrated With The Mapfre Group

Mapfre Re's management and strategy are regarded as strong. The management team is long standing and knowledgeable, and is focused on supporting the strategic and financial objectives of its parent while continuing to grow its own international franchise. Mapfre Re remains a center of excellence within the Mapfre group, and the senior management team has supported the development of the international operations of the parent in recent years. Mapfre Re is also the "test-bed" for the development of economic capital modeling within the Mapfre group.

Operational management

Mapfre Re has a tightly centralized underwriting policy, operating through branches rather than local companies, which is also more cost efficient. There are a few exceptions, notably in Brazil, which brings a higher degree of sovereign-related risk. Local offices are restricted to underwriting only and are permanently linked to a central information technology system in Madrid. This enables a detailed understanding of the make-up of Mapfre Re's business, and facilitates a good balance of the portfolio as viewed by territory, line of business, and type of reinsurance contract. Mapfre Re's strengthening market profile has enabled it to attract high-quality personnel from its competitors to achieve a wider understanding of other markets and practices.

Financial management

Mapfre Re's financial strategy is conservative and focused on long-term goals, particularly with regard to international development. Capital management is strong, with capital allocated and returns measured by profit center, by country, and by line of business. The implementation of an updated version of its economic capital model is expected to further strengthen Mapfre Re's capabilities in this discipline. Capital injections from the parent have been a feature of past years, but in all cases have been made to finance future growth. The main financial targets are a combined ratio of below 100% and return on equity (ROE) of above 12%. Mapfre Re is one of the largest profit centers for the Mapfre group, representing 11% of net income as at half-year 2009. We do not expect Mapfre Re to exhibit the level of earnings volatility of other global reinsurers as the group would not want its consolidated results to be an outlier relative to its insurance peers. Prospectively, we do not believe that the dividend requirement placed on Mapfre Re by its parent will affect its capital base nor limit its growth.

Accounting: Few TAC Adjustments To IFRS Numbers

Mapfre Re reports under International Financial Reporting Standards (IFRS). We have made few adjustments to the reported numbers, and only in respect of calculating total adjusted capital (TAC) and classifying investments according to the appropriate asset class.

In calculating TAC in the Standard & Poor's capital model, we have made adjustments for the discounted value of loss reserves and a charge has been applied for Mapfre Re's estimate of its annual aggregate 1-in-250 year catastrophe loss, which represents almost one-quarter of the total capital requirement.

Operating Performance: Strong, With Less Volatility Than Peer Group

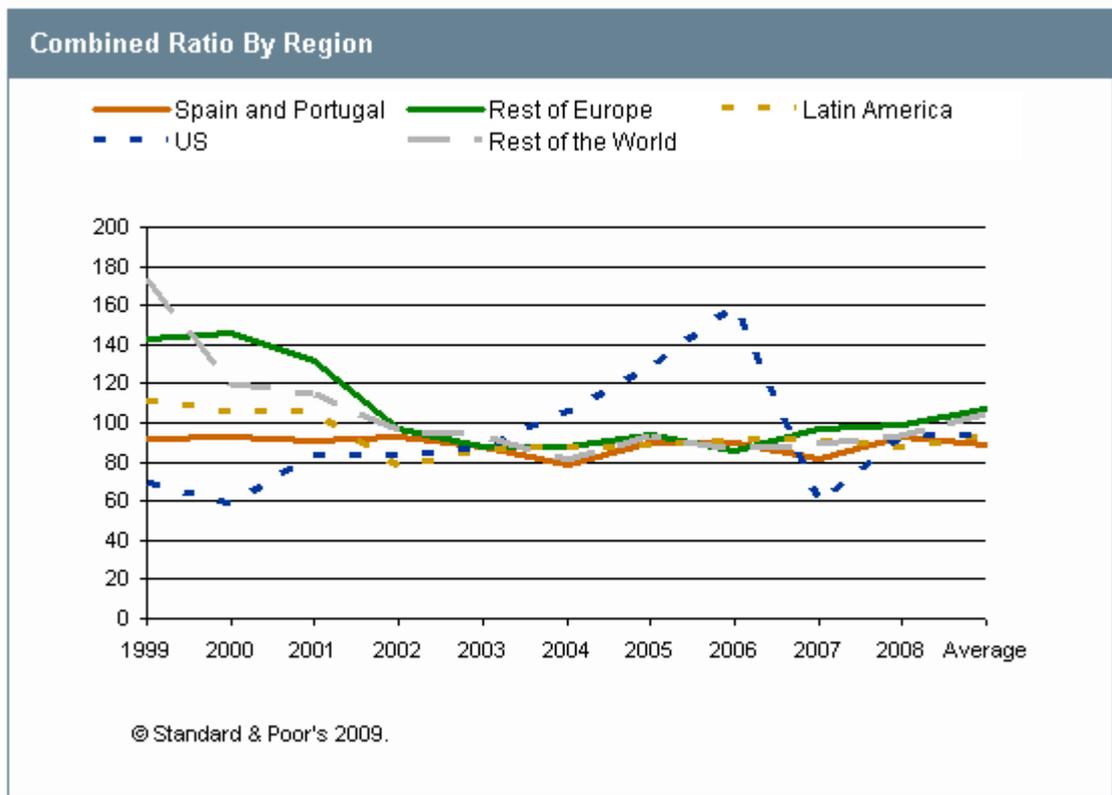
Table 2

Mapfre Re, Compañía de Reaseguros, S.A./Operating Statistics							
	--Year ended Dec. 31--						
(Mil. €)	2008	2007	2006	2005	2004	2003	2002
Non-life underwriting result	46.8	76	61	2	49	36	7
EBITDA	147.6	135	116	54	72	66	38
Net income	104	88	77	32	46	54	31
Gross loss ratio (%)	61.8	53.1	56.9	77.3	52.3	55.2	58.5
Gross combined ratio (%)	89.0	81.5	88.3	77.9	83.7	86.7	90.0
Net loss ratio (%)	65.1	60.0	57.6	67.6	58.5	58.4	60.9
Net expense ratio (%)	30.4	31.6	34.8	32.1	33.2	34.1	37.4
Net combined ratio (%)	95.5	91.6	92.3	99.7	91.7	92.5	98.3
Three year average combined ratio	93.2	94.6	80.4	94.6	94.2	100.7	105.6
Five years standard deviation net combined ratio (%)	3.5	3.5	3.8	8	8.8	9.3	6.3

Reinsurance result	(127)	(178)	(78)	83	(96)	(63)	(58)
Return on revenue (%)	4.5	14.9	7.7	7	12.2	11.5	8.3
Direct yield on invested assets (%)	4.5	3.9	3.6	3.8	3.7	3.9	5.1
Yield (including realized) (%)	5.5	4.1	3.6	4.5	3.3	4.4	6.1
Operating ratio (%)	95.5	85.1	92.3	53.2	87.8	88.5	91.7
Total investment return (including unrealized and realized) (%)	5.5	4.1	3.6	4.5	3.3	4.4	5.5
ROE/adjusted equity (%)	14.1	12.8	12.2	6	10.1	16.5	10.9
Five year average ROE/reported equity (%)	11.0	11.8	11.6	9.2	8.9	6.0	3.4
Return on revenue (%)	10.6	12.4	12.5	5	11.3	11.7	7.9
EBITDA (excluding nonrecurring)/total capitalization (%)	20.1	19.7	18.2	11	15.9	20	13.4
ROE--Return on equity.							

Operating performance is considered strong. Mapfre Re's core business in Spain and Portugal has consistently produced excellent returns, reflected in the average combined ratio of 89.1% between 1999-2008, with a standard deviation of about five during this period. We believe that the gradual change in the composition of the portfolio and the dilution of business in Iberia may weaken the quality of earnings, but not dramatically so. With the exception of the U.S., Mapfre Re's performance in its international book of business has been strong dating back to 2002, with each of the main divisions reporting a five-year average combined ratio below 92%. Before this, performance was weak, but in line with the industry. Overall, Mapfre Re's performance has been more stable than the industry over a 10-year period.

In 2008, net income increased by 18% to €103.6 million, which translated to a ROE of 14%. The improvement in net results reflects a significantly higher income from investments, which increased to €97.9 million in 2008 from €67.2 million in 2007, and a lower expense ratio decreasing to 1.8% from 2.2% over the same period. A weaker underwriting performance offset these factors--with a combined ratio that increased to 95.6% (93.3% in 2007) mainly as a result of a higher loss ratio in Spain. This result, however, has to be viewed in the context of the severe downturn in the Spanish economy and the consequent trend of increasing claims across the whole Spanish insurance industry. Net losses deriving from hurricane Klaus, which hit France and Spain in January 2009, are not expected to be significant partly because of the structure of Mapfre Re's catastrophe retrocession program and also because the Consorcio de Compensación de Seguros (CCS), the government-backed Spanish catastrophe reinsurer, is covering the majority of the claims. In addition, we do not expect material losses from the relatively large book of credit reinsurance, because of Mapfre Re's low retention levels on this line of business.



Mapfre Re appears to have a very low cost operating structure. This pricing advantage appears to have been leveraged by Mapfre Re in paying a high level of commissions (including profit commissions) to its cedents. Mapfre Re has incurred operating expenses of less than 1% of net earned premiums in each of the last four years, but has paid commissions equivalent to 30% of the same figure. This is partly reflective of the proportional business that dominates Mapfre Re's portfolio, which attracts higher commissions than nonproportional contracts.

Prospective

In our view, prospective earnings will remain strong. Performance was improving through the first quarter of 2009 as the trend of numerous midsize claims in 2008 has not continued in 2009. Price hardening is taking place in both proportional and nonproportional markets, typically by between 5%-10%. Mapfre Re's sound underwriting discipline and the proven expertise in its operating markets are expected to result in a combined ratio below 96% in 2009 and 2010. We believe that these factors together with a conservative investment strategy and higher business volumes will flow through to earnings, with an ROE above the 12% target in both years.

The acquisitions by Mapfre S.A. in Turkey and the U.S. could bring additional volatility into Mapfre Re's earnings in future years, principally due to the catastrophe exposure in these markets. Mapfre Re has a trading history with the newly acquired Turkish business, however, while the U.S. business that may be reinsured into Mapfre Re is mostly motor risk, so the downside risk is expected to be limited.

Investments: Low Credit Risk, But Moderate Exposure To Equity Markets

Table 3

Mapfre Re, Compañía de Reaseguros, S.A./Investment Statistics							
	--Year ended Dec. 31--						
(Mil. €)	2008	2007	2006	2005	2004	2003	2002
Total investments	1,899	1,739	1,569	1,463	1,183	812	679
Bonds and other fixed interest securities (%)	75	79	78	82	79	63	66

Equities and other variable interest securities (%)	10	13.6	13.0	7.1	8.9	6.1	7.2
Property (%)	3.2	3.8	4.5	5.1	6.4	9.4	7.7
Cash and bank deposits (%)	1.8	1.8	2.9	4.0	3.3	18.8	15.9
Other investments (%)	10	0.8	1.0	1.1	1.8	1.3	1.2
Insurance and reinsurance receivables/total assets (%)	5.8	6.9	6.9	7.3	6.6	9.3	10.1
Liquid assets/technical reserves (%)	116	131	130	131	135	119	116

Strategy

Standard & Poor's regards Mapfre Re's investments as strong. Credit risk is low. Market risk decreased with the lower allocation to equities in 2008. Active responsibility for all Mapfre group investments is centralized within Mapfre's investment management division. The asset allocation follows Mapfre group's investment policy, which we consider as conservative.

Credit risk

Credit risk is low, with about 80% of the fixed income portfolio rated 'AA' or higher, with the remainder principally held in 'A' rated securities. The corporate bond portfolio is heavily weighted to financial services issuers, but is globally diversified.

Market risk

The bulk (74.0%) of the portfolio remains invested in very high quality bonds. As long as interest rates remain at the current low level, we expect the composition of the bond portfolio to be more weighted toward corporate bonds with yields higher than sovereigns.

Market risk decreased in 2008 due to the group's decision to reduce the equity weighting of its portfolio from 13% to 10%. We do not anticipate this strategy to change over the next 12-24 months, unless equity markets rebound and volatility will be reduced.

The equity portfolio comprises mostly European stocks, with a large weighting (44.0%) in Spanish equities. The remainder is held in property (3.2%) and cash (1.8%). Mapfre Re is exposed to above-average foreign exchange risk, with about 15% of total premiums transacted in five Latin American currencies. With the exception of Chile due to local requirements, Mapfre Re generally holds these assets in U.S. dollars to minimize the sovereign-related risk.

Asset-liability management

The largely short-tail nature of Mapfre Re's portfolio means that asset-liability management is not regarded as a major issue. The currency mismatch is noted above.

■ Liquidity: Very Strong Coverage Of Liabilities, Strong Cashflows

Liquidity is very strong, with 70% of assets held in highly liquid assets, which exceeded net technical reserves by 1.2x in 2008. On a gross basis, the ratio is 0.8x, as approximately 20% of reported assets are recoverable from reinsurers. Net operating cashflow increased to €182.7 million in 2008 from €149.3 million in 2007, reflecting the strong revenue growth and profitability.

■ Capitalization: Strong, Retained Earnings Will Finance Organic Growth

Mapfre Re has strong capitalization. Capital adequacy is strong and is expected to remain so as long as future growth continues to be financed by a high level of earnings retention. The quality of capital is strong, reflecting the absence of financial leverage, the predominantly short-tail book of business, Mapfre Re's favorable reserve development, and the generally conservative risk-retentions. Reinsurance dependence is high, however.

Reserves

Mapfre Re's reserves are regarded as adequate. The mostly short-tail book of business has produced small run-off profits over a long period of time. On new international lines of business with a longer tail, such as motor, tail reserves are calculated based on the yearly estimated ultimate loss ratio until development patterns can be observed over at least five years.

Retrocession

Mapfre group business is protected by a retrocession program down to a low retention level. Nonaffiliated treaty business is underwritten without retrocession, however, except for a single event and aggregate property catastrophe cover, and motor excess of loss protection. This reduced level of spend is consistent with market practice in recent years due to the availability of cover in the retrocession market at an economic price.

Mapfre Re has the advantage of not being heavily exposed to catastrophe risks in Spain, which are covered by the CCS. It is, however, exposed to major perils including hurricanes in Europe, the U.S., and the Caribbean, in addition to earthquakes particularly in Latin America and, more recently, Turkey. The outward catastrophe program is structured so that it would provide protection only up to a one-in-100 year event for certain perils. Mapfre Re was able to place additional sideways cover for 2009, however, to protect it against an accumulation of large events.

The retrocessionnaires used by Mapfre Re are of strong quality; 86% of covers placed in 2009 were with companies rated in the 'A' range or higher. The reinsurance utilization ratio remains higher than peers at 33%, but this reflects the group's role as reinsurer to the Mapfre group, through which risks are passed into the global reinsurance market. Mapfre Re's exposure to amounts outstanding from reinsurers is comparatively low at 21% of reported capital.

Financial Flexibility: Strong History Of Support From Its Parent

Table 4

Mapfre Re, Compañía de Reaseguros, S.A./Financial Statistics							
	--Year ended Dec. 31--						
(Mil. €)	2008	2007	2006	2005	2004	2003	2002
Total assets	2,494	2,328	2,135	2,002	1,620	1,184	1,018
Total adjusted equity	743	725	647	623	537	368	285
Change in adjusted equity (%)	2.4	12.1	3.9	15.9	46	29	1.8
Reinsurance exposure ratio (%)	37.6	28.5	37.4	50.7	24.5	36.1	59.0
Reinsurance utilization ratio (%)	32.8	33.4	33.1	33.1	33.0	34.3	38.5
Investment leverage (including all quasi capital) (%)	35.1	43.5	44.1	30.8	35.6	36.9	39.5
Net technical reserves/gross technical reserves (%)	70.3	69.5	65.8	62.9	70.8	68.5	63.7
Loss reserves/NWP (%)	60.5	54.1	52.3	57.9	47.6	47.9	59.2
Net claims reserves/net claims incurred (%)	98.2	95.8	102.1	92.8	97.7	93.7	111.6
NWP--Net written premiums.							

Mapfre Re's financial flexibility (defined as the ability to source capital relative to requirements) is strong, reflecting its core status within the Mapfre group. Organic growth is expected to be financed through retained earnings. Should it be required, the parent group's commitment to funding growth at Mapfre Re has been demonstrated over recent years.

Ratings Detail (As Of 27-Aug-2009)***Operating Company Covered By This Report****Mapfre Re, Compania de Reaseguros, S.A.**

Financial Strength Rating

Local Currency

AA/Stable/--

Counterparty Credit Rating

Local Currency

AA/Stable/--

Domicile

Spain

*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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