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Insurance Markets

## Research

### Summary:

## Milli Reasurans T.A.S.

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### Rationale

The national scale rating on Turkey-based reinsurer Milli Reasurans T.A.S. (Milli Re) reflects Standard & Poor's Ratings Services' view of the company's leading competitive position in Turkey and its good capitalization. The ratings are constrained by the company's marginal quality of investments from a global perspective, and its concentration in the Turkish market, which exacerbate the potential effect of earthquake-exposure modeling risk. While we assess Milli Re's operating performance as marginal, it is not considered a weakness for the rating.

We consider the quality of investments to be the main constraining factor for the rating. Milli Re invests in instruments and deposits with some of the best credit quality available in the Republic of Turkey (foreign currency BB/Positive/B, local currency BB+/Positive/B, Turkey national scale rating trAA+/-/trA-1). Nonetheless, this constitutes a marginal quality of investments on a global scale. Milli Re invests predominantly in Turkish assets to match its liabilities, approximately 45% of which are treasury bills and government bonds. Most of the balance is held in deposits with Turkey-based T.C. Ziraat Bankasi AS (not rated) and Milli Re's parent, Turkiye Is Bankasi A.S. (Isbank; BB/Positive/B, Turkey national scale rating trAA--/trA-1). Given Milli Re's exposure to local banks and government bonds, an upgrade largely depends on the improvement of the creditworthiness of the aforementioned banks and the Turkish sovereign. Equally, deterioration in creditworthiness of these banks and the sovereign rating would result in a similar rating action on Milli Re.

As with other reinsurers operating in the Turkish market, Milli Re is exposed to earthquake risk. In recognition of this, the company retrocedes almost all of its modeled earthquake risk to highly rated reinsurers. It has also been expanding outside Turkey to mitigate this risk. Even so, it is still exposed to earthquake modeling risk, which remains to be tested. Furthermore the benefits of an international diversification strategy, which in itself created new challenges, have been diluted by Milli Re's increased stake in its affiliate Anadolu Sigorta (Anadolu; not rated). This is now majority owned by Milli Re and is the second-largest insurance company in Turkey in terms of gross premium income. At the current ratings level, we view the impact of Anadolu on Milli Re as neutral because its business and financial profiles largely mirror each others'. Furthermore, Milli Re has only limited influence on Anadolu.

In our view, Milli Re's operating performance is marginal, reflecting its weak underwriting performance largely due to pricing inadequacy. This is particularly the case for the motor and health businesses, which accounted for about 40% of Milli Re's net premium. At March 2011, a technical loss of Turkish lira (TRY) 10 million (TRY14 million loss for the same period in the previous year) coupled with low interest rates on deposit accounts, led to a reduced pretax profit of only TRY1.9 million (pretax profit of TRY9 million at March 2010). Subject to a normal loss experience for the remainder of 2011, we believe that Milli Re is likely to post a high combined ratio of about 110% and a low return on equity in the range 0%- 2%. This reflects the large losses in the first half of 2011 and the reduced interest rate environment in Turkey. Milli Re's technical performance benefits significantly from the earthquake risk-related premium from Turkey due to the absence of major earthquakes. However, it is hindered by the pressure on earthquake premium rates and pricing inadequacy across most of the other lines of business. For these reasons, we believe that Milli Re will find it difficult to post a reasonable technical profit over the medium term.

In our view, Milli Re's competitive position is marginal. Although it has a leading position in the Turkish reinsurance market, it is exposed to severe pricing inadequacy in the local market. International business, which currently represents 20% of Milli Re's total gross premium, is expected to increase to about 25% of the overall premium. This reflects both the withdrawal from poor performing local accounts and the increase in capacity provision to the international business, which is mainly through Lloyd's Market and continental Europe. We expect Milli Re to maintain its leading competitive position in the Turkish reinsurance market over the medium term. Anadolu has increased the company's scale. However, it could potentially reduce local cedants' willingness to do business with Milli Re and bring some operational challenges.

We consider Milli Re's capitalization to be good overall. This is due to its extremely strong capital adequacy, measured using our capital model, and its good-quality retrocession program. In our view, Anadolu is well capitalized. We therefore expect the acquisition to have a neutral effect on Milli Re's risk-based capital. Nonetheless, the company remains highly exposed to natural catastrophe risk. Overall, we believe that capitalization is likely to remain strong, due to Milli Re's relatively low dividend policy and its practice of capitalizing retained profits.

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