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Research Update:

# Milli Reasurans T.A.S. Turkey National Scale Rating Lowered To 'trBBB-' From 'trA-'

**September 30, 2022**

(***Editor's Note:*** *This research update was republished on Oct. 4, 2022, to correct a misstatement of the net underwriting losses. A corrected version follows.)*


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## Overview

- Milli Reasurans T.A.S. (Milli Re)'s operating profitability has eroded, weakening its capital position.
- The company is exposed to high inflation and foreign exchange risks in Turkey that have impeded our view of its underlying credit fundamentals.
- Milli Re's balance sheet is predominantly concentrated in Turkish lira and its asset base has failed to keep up with a strong increase in insurance liabilities, resulting in our weakened view of its liquidity position. However, we take note of the mix of foreign-currency-denominated investment on the balance sheet.
- We lowered our Turkey national scale rating on Milli Re to 'trBBB-' from 'trA-'.
- Our national scale ratings do not carry outlooks. That said, the company's capital and liquidity position remain susceptible to underlying credit conditions within the Turkish economy.

## Rating Action

On Sept. 30, 2022, S&P Global Ratings lowered its Turkey national scale rating on Milli Reasurans T.A.S. (Milli Re) to 'trBBB-' from 'trA-'.

## Rationale

Our rating reflects Milli Re's deteriorating and vulnerable capital position with weakened liquidity levels. Turkey has seen rampant inflationary pressures and severe lira (TRY) weakness, which have resulted in additional insurance liability reserve creation on Milli Re's balance sheet. This is due to the company expanding its premium base into inflation-indexed and foreign-currency-denominated original policies over recent quarters. In turn, it posted an operating loss of 170% in first-half 2022 and we have revised our view of its capital position.

Milli Re has seen premium growth and underlying volatility persist in its net underwriting results and is largely ascribed to macroeconomic variables. Gross written premiums expanded 81% to TRY2.3 billion ($136 million) in first-half 2022 compared to a net underwriting loss of TRY1.4 billion ($86 million), resulting from additional reserve adjustments due to inflation and lira weakening, in line with local accounting standards. The company's investment portfolio did provide a buffer, with income of TRY481 million in the first half versus TRY844 million in full-year 2021, but this was not sufficient to prevent an overall net loss for the period and the hit to its capital position.

Therefore, we expect Milli Re's capital adequacy to fall well below the 'BBB' level, measured using our risk-based capital model, in 2022 and over the forecast period to 2024. This has also weakened our view of its financial risk, supporting the downgrade. The reinsurer's exposure to the country's banking system, through its bank deposits and investment portfolio (mostly 'B' range credit quality), further strains our financial profile assessment.

We consider Milli Re's liquidity position to be weaker than earlier this year due to its asset base not keeping up with a strong increase in insurance liabilities. We positively note the active management around ancillary liquidity risks relating to premium collection and receivables management. However, we also recognize the mix of investments not denominated in lira on the balance sheet that support the payment of foreign-currency liabilities.

We view Milli Re as a moderately strategically important subsidiary of Turkiye Is Bankasi AS, which is one of Turkey's leading banks and has near-full ownership of the reinsurer.

ESG credit indicators: E-3, S-2, G-3

## Related Criteria

- 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: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

## Related Research

- Reinsurer Milli Reasurans T.A.S. Turkey National Scale Rating Affirmed At 'trA-', April 25, 2022

## Ratings List

**Downgraded**

| | To | From |
|---|---|---|
| **Milli Reasurans T.A.S.** | | |
| Issuer Credit Rating | | |
| Turkey National Scale | trBBB-/--/-- | trA-/--/-- |

## Regulatory Disclosures

Milli Reasurans T.A.S.

- Primary Credit Analyst: Trevor Barsdorf, Associate Director
- Rating Committee Chairperson: Johannes Bender
- Date initial rating assigned: July 25, 2007
- Date of previous review: April 25, 2022

## Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

This credit rating is solicited. The rated entity did participate in the credit rating process. S&P Global Ratings did have access to the accounts, financial records and other relevant internal, non-public documents of the rated entity or a related third party. S&P Global Ratings has used information from sources believed to be reliable but does not guarantee the accuracy, adequacy, or completeness of any information used.

Materials Used In The Credit Rating Process: Sufficient information in general consists of both (i) financial statements that describe the Issuer's financial condition, results of operations and cash-flows, and (ii) a description of the activities and obligations of the entity including of its governance and legal structure.

This credit rating was disclosed to the rated entity or related third party before being issued.

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Model.

## Glossary

- Anchor: The starting point for rating an insurer, based on S&P Global Ratings' assessments of the business and financial risk profiles.
- Business risk profile (BRP: Assesses the risk inherent in the insurer's operations and therefore the potential sustainable return to be derived from those operations.
- Capital and earnings: Measure of an insurer's ability to absorb losses.
- Competitive position: An assessment based on an insurer's market or niche position, scale or efficiency of operations, brand name recognition or reputation, and strength of distribution.
- Date initial rating assigned: The date S&P Global Rating's assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Rating's last reviewed the credit rating on the entity.
- Earnings before interest (other than interest on nonrecourse or operational leverage) and taxes. We may apply analytical adjustments for items such as nonrecurring events; realized investment gains/losses; or impairments to goodwill.
- ESG credit indicators: ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.
- Financial leverage. Financial obligations/(reported equity + financial obligations). We deduct from reported equity any off-balance-sheet pension deficit, net of tax, and any financial obligations included in reported equity, such as preferred stock. We typically include noncontrolling interests as part of reported equity. We may use net assets rather than reported equity, for example in the case of mutual insurers.
- Financial obligations/EBITDA. Determines the number of years of normalized earnings required to pay back debt and is another measure of the sustainability of the level of debt taken on by an insurer.
- Financial risk profile (FRP): The consequence of decisions that management makes in the context of its business risk profile and its risk tolerances.
- Financial strength rating (FSR): A forward-looking opinion about the financial security characteristics of an insurer with respect to its ability to pay under its insurance policies and contracts, in accordance with their terms.
- Fixed-charge coverage. EBITDA/fixed charges. Fixed-charge coverage represents an insurer's ability to service interest on financial obligations out of EBITDA. Fixed charges include total interest expense including interest expense reported as investment expense, lease expense, and preferred stock dividends (tax-adjusted), minus any interest expense on debt that we consider to be nonrecourse or operational leverage.
- High-risk assets: Volatile or illiquid assets.

- Insurance Industry And Country Risk Assessment (IICRA): Addresses the risks typically faced by insurers operating in specific industries and countries, and is generally determined at a country or regional level.
- Intangibles: The sum of goodwill, intangible assets, deferred acquisition costs (DAC), value of in-force, value of business acquired, and deferred tax assets.
- Issuer credit rating (ICR): A forward-looking opinion about an obligor's overall creditworthiness, focusing on its capacity and willingness to meet its financial obligations in full and as they come due.
- Prebonus pretax earnings are the sum of EBITDA and policyholder dividends.
- Return on assets (ROA): Indicates to us how efficiently management uses its assets to generate earnings by comparing EBIT to the two-year average of total assets adjusted. Total assets adjusted is total assets minus reinsurance assets.
- Return on revenue (ROR): EBIT divided by total revenue. Total revenue is the sum of net premiums earned (or net written premium if net earned premium is not available), net investment income, and other income. We remove the effects of realized and unrealized gains or losses from investments and derivatives to provide a more complete picture of an insurer's revenue-generating abilities.
- Risk exposure: Assesses material risks that the capital and earnings analysis does not incorporate and specific risks that it captures but that could make an insurer's capital and earnings significantly more or less volatile.
- Return on equity (ROE): Reported net income divided by the average of opening and closing reported equity for the year. Reported net income is before remuneration of preferred stock and non-controlling interests. Reported equity includes non-controlling interests and preferred stock.
- Stand-alone credit profile (SACP): S&P Global Ratings' opinion of an insurer's creditworthiness, in the absence of extraordinary intervention from its parent, affiliate, or related government.
- Total adjusted capital (TAC): S&P Global Ratings' measure of the capital an insurer has available to meet capital requirements.
- Total assets are the average of opening and closing total assets (less reinsurance assets) for the year.