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Research Update:
Insurer Swiss Life's Core Entities Upgraded To 'A-' On Improved Sustainability Of Its Business Model; Outlook Stable

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Overview

- In our opinion, Switzerland-based insurance group Swiss Life has taken significant steps to enhance the sustainability of its business model by improving operational efficiency. Swiss Life also maintained its capital adequacy, according to our criteria, despite difficult market conditions.
- We are therefore raising our long-term ratings on Swiss Life's core operating entities to 'A-' from 'BBB+'.
- The stable outlook reflects our expectation that Swiss Life will be able to improve its operating performance further, maintain at least strong capitalization, and conserve its strong competitive position.

Rating Action

On May 3, 2012, Standard & Poor's Ratings Services raised its long-term counterparty credit and insurer financial strength ratings on Swiss Life's core operating companies to 'A-' from 'BBB+'. We also raised the long-term counterparty credit ratings on Swiss Life Holding to 'BBB' from 'BBB-'. The outlooks are stable.

Rationale

The upgrade of Swiss Life reflects our opinion that Swiss Life has managed to rebuild its financial profile to strong levels, in line with its business profile.

The group has also managed to maintain its capital adequacy according to our criteria in very difficult market conditions, and we expect it to continue to do so in 2012 and 2013. Against our initial base-case assumption, government rates in Switzerland and Germany deteriorated further in 2011. Nonetheless, Swiss Life's bottom-line profitability in 2011 was in line with our expectations because its efforts to improve cost and risk results continued to bear fruit. Prospective profitability, as measured by market-consistent embedded value (MCEV)-based new business margins, was below our initial expectation, mostly because of lower interest rates. We consider that this was offset by the improved operational efficiency.

We see Swiss Life's strong capitalization and strong competitive position, particularly in its domestic market, as strengths to the ratings. These positive factors are partly offset by the company's only good operating performance and its focus on European life insurance markets, which we view as challenging.

Swiss Life's capitalization has remained strong in 2011, in our view, despite the difficult financial market conditions. We note that Swiss Life has substantially decreased its market risk--equity risk in particular, partly based on asset value fluctuations, partly based on active management--throughout 2011. It has also reduced its exposure to peripheral European sovereigns. Based on the outcome of our risk-adjusted capital model, we currently assess Swiss Life's capital adequacy as very strong and quality of capital as strong. Our assessment also takes into account Swiss Life's regulatory solvency position, which we view as healthy. Going forward, we anticipate that Swiss Life will maintain at least strong capitalization in 2012 and 2013.

We continue to assess Swiss Life's operating performance as good. Swiss Life's successful implementation of strategic initiatives led to reduced operating expenses and increased nontraditional new business contribution. Overall, these changes have reduced Swiss Life's dependence on its investment results. Record low interest rates, particularly in Switzerland, however, restricted Swiss Life's profitability on an MCEV basis in 2011. Furthermore, although the percentage of traditional life products in its new business is falling, Swiss Life's business-in-force is still concentrated on traditional life products. We consider that these product lines still pose a threat to Swiss Life's future accounting and MCEV profitability.

Our base-case assumption is that interest rates throughout 2012 and 2013 will increase moderately, at best. Based on that, we expect new business margins to increase moderately as well, to about 1.4%-1.6% in 2012 and 2013 from 1.2% at year-end 2011. Despite our interest rate expectation for 2012 and 2013, we anticipate that Swiss Life's investment result will hold up comparatively well in this time; we expect it to achieve a net investment yield of about 3.5%. As a result, we expect its profit from operations to be higher than Swiss franc (CHF) 800 million in 2012 and 2013, versus CHF699 million in 2011.

Swiss Life's competitive position is strong, in our view. The group benefits from a market-leading position in the Swiss life insurance market, particularly in group life. Furthermore, Swiss Life has built its franchise in other European national life insurance markets, such as France and Germany, and in the international cross-border business. However, we consider the Swiss, French, and German life insurance markets to be difficult operating environments. For 2012 and 2013, we expect only moderately increasing premium volumes. In general, we consider that Swiss Life's key weakness, compared with more-diversified groups in its peer group, is its concentration on life business in Europe.

Outlook

The stable outlook reflects our expectation that Swiss Life will continue to improve its operating performance, in terms of both profit from operations and new business margins. It is also based on our expectation that Swiss Life will maintain its strong capitalization and its strong competitive position.

We would consider a negative rating action if Swiss Life failed to meet the following measures in 2012 or 2013:

- Counteract unfavorable investment conditions by further improving margin management and by reducing interest rate dependence, reflected in increasing risk and cost results and in profit from operations and new business margins similar to those stated above;
- Maintain a healthy spread of about 100 basis points between net investment yield and average guaranteed rates, as well as a weighted-average duration mismatch of below 1;
- Conserve group capital adequacy according to our model at least at strong levels, and maintain a healthy regulatory solvency position (including that under the Swiss Solvency Test (SST) regime), both helped by a conservative asset allocation;
- Maintain the proportion of traditional products below 30% of new business production;
- Leverage financial advisory company AWD Holding AG (not rated) to attain at least stable EBIT margins of above 10% and to moderately increase its new business contribution further.
- Keep group fixed charge coverage higher than 5x and a financial leverage ratio lower than 30%.

Based on our criteria and the information currently available to us, we see no potential for a positive rating action in the next two years.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Assumptions For Quantitative Metrics Used In Rating Insurers Globally, April 14, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Holding Company Analysis, June 11, 2009
- Interactive Ratings Methodology, April 22, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Summary Of Standard & Poor's Enterprise Risk Management Evaluation Process For Insurers, Nov. 26, 2007
- Flexible Gapping Of Ratings Reflects Regional Variations In Structural Subordination As Well As Differing Debt-Servicing Capacities, May 25, 2005

- Counterparty Credit Ratings And The Credit Framework, April 14, 2004

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Swiss Life AG		
Swiss Life AG, Niederlassung fuer Deutschland		
Counterparty Credit Rating	A-/Stable/--	BBB+/Positive/--
Financial Strength Rating	A-/Stable/--	BBB+/Positive/--
Swiss Life Holding		
Counterparty Credit Rating	BBB/Stable/--	BBB-/Positive/--

Upgraded

	To	From
Swiss Life AG		
Subordinated	BBB	BBB-
Junior Subordinated*	BBB	BBB-

*Guaranteed by Swiss Life Holding.

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.