

# RatingsDirect®

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## BMO Reinsurance Ltd.

**Primary Credit Analyst:**

Anika Getubig, CFA, New York + 1 (212) 438 3233; [anika.getubig@spglobal.com](mailto:anika.getubig@spglobal.com)

**Secondary Contact:**

Peggy H Poon, CFA, New York (1) 212-438-8617; [peggy.poon@spglobal.com](mailto:peggy.poon@spglobal.com)

**Research Assistant:**

Harshit Maheshwari, Pune

### Table Of Contents

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Major Rating Factors

Rationale

Outlook

Macroeconomic Assumptions

Business Risk Profile

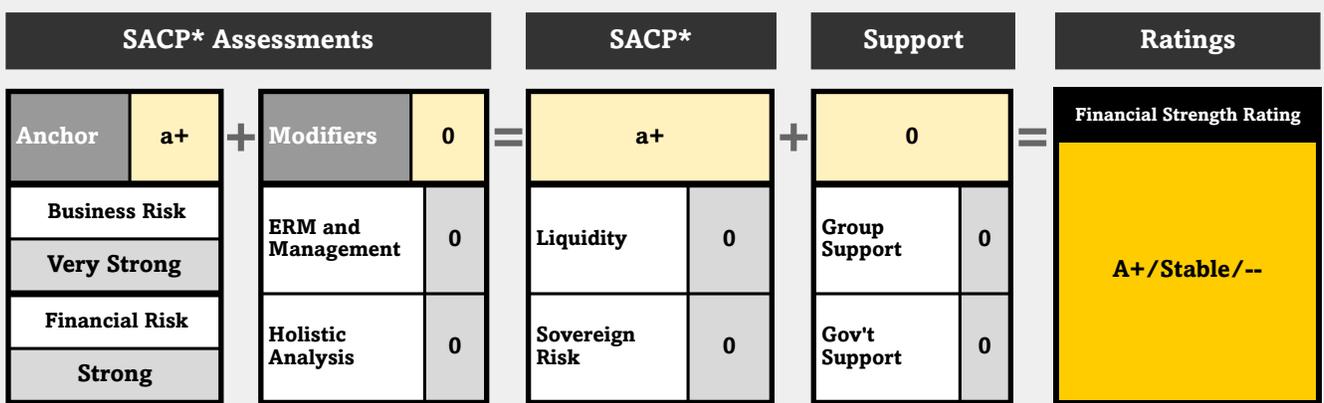
Financial Risk Profile

Other Assessments

Other Considerations

Related Criteria

# BMO Reinsurance Ltd.



\*Stand-alone credit profile.  
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

## Major Rating Factors

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>Very strong competitive position in creditor life reinsurance business with direct distribution from parent Bank of Montreal</li> <li>Positive operating performance based on above-average returns relative to peers</li> <li>Strong capital and earnings assessment supported by parent</li> </ul>	<ul style="list-style-type: none"> <li>Earnings volatility in property catastrophe business</li> <li>Small total adjusted capital (TAC) base below \$1 billion</li> <li>Lack of access to capital markets apart from the wider group</li> </ul>

## Rationale

S&P Global Ratings' ratings on BMO Reinsurance Ltd. reflect the group's very strong business risk profile (BRP) and strong financial risk profile, leading us to an anchor of 'aa-/a+'. We select the lower of the anchors to reflect BMO Re's franchise position and return metrics vis-à-vis peers'. We base our ratings on BMO Re's very strong competitive position in the creditor life insurance business and consistently strong operating performance compared with peers. We also base our ratings on capital adequacy that is redundant at the 'AAA' level per our risk-based capital (RBC) model offset by a smaller capital base of less than \$1 billion and exposure to property catastrophe--which we view as a low-frequency, but high-severity, business.

## Outlook: Stable

The stable outlook reflects our expectation that BMO Re will maintain its very strong competitive position over the next 18-24 months supported by its profitable, well-established creditor life reinsurance business while maintaining capital adequacy at the 'AAA' level per our RBC model.

### Downside scenario

We may lower our ratings in the next 18-24 months if BMO Re's competitive position weakens--for example, if the parent no longer supports the creditor life reinsurance business or if its operating results deteriorate, particularly due to higher-than-expected losses in its property catastrophe line. We could also lower the ratings if capital adequacy declines below the 'AAA' level or we lower our group credit profile on the parent.

### Upside scenario

We are unlikely to raise the ratings on BMO Re in the next 18 to 24 months.

## Macroeconomic Assumptions

- U.S. real GDP growth of 3.0% in 2018, 2.5% in 2019, and 1.8% in 2020
- Eurozone real GDP growth of 2.1% in 2018, 1.7% in 2019, and 1.5% in 2020
- Canadian real GDP growth rate of about 2.0% in 2018 and 2019
- U.S. core Consumer Price Index (CPI) at 2.5% in 2018 and 1.9% in 2019
- Canadian CPI of about 2% in 2018 and 2019

### Key Metrics

(Mil. C\$)	--Year ended Dec. 31--				
	2019*	2018*	2017	2016	2015
Total revenue	>700	>700	559.0	577.0	1,051.0
EBIT	>200	>200	140.0	221.0	214.0
Return on equity (%)	>50.0	>50.0	41.8	61.1	58.8
Return on revenue (%)	>30.0	>30.0	25.1	38.3	20.4

\*Forecast data reflect S&P Global Ratings base-case assumptions.

## Business Risk Profile: Very Strong

BMO Re is a Barbados-domiciled reinsurer and wholly owned subsidiary of BMO Investments Ltd., a company

incorporated in Bermuda. Its ultimate parent is Bank of Montreal, one of the big five Canadian banks. The company's core program is creditor reinsurance. This program reinsures Canadian life, health, and disability insurance risks that originate from Bank of Montreal bank branches for third-party direct insurers in Canada. BMO Re also covers property catastrophe risks and specialty property and casualty (P/C) risks globally and participates in a small number of life retrocession pools and life catastrophe treaties.

BMO Re's BRP is characterized by its very strong competitive position in creditor reinsurance and very favorable operating performance. It also reflects our low risk industry and country risk assessment score for the global life reinsurance sector.

We view BMO Re's competitive position as very strong, based on its well-established position in the creditor life reinsurance market. It posts very strong earnings compared with peers and is diversified by product and geography. In 2017, BMO Re posted a return on revenue of 25% versus 38% in 2016. While the creditor life insurance segment continued to be a stable and favorable contributor in 2017, earnings were dampened by BMO Re's property catastrophe operations which posted losses stemming from hurricanes and earthquakes. The company took rate actions in 2018, and we will monitor its progress in managing this risk. If losses related to the property catastrophe business become and remain outsized, we could regard this as a credit negative. The company's insurance risk exposures are also well-diversified throughout the Canadian and international markets. In our view, this provides BMO Re with relative stability compared with primary insurers that are more exposed to county-specific risks.

## **Financial Risk Profile: Strong**

We consider BMO Re's capital and earnings to be strong. For year-end 2017, its capital adequacy was redundant at the 'AAA' level per our RBC model. BMO's very strong earnings capacity allows for regular dividends to its parent and supports its capital strength. But if we believe capital adequacy will dip below the 'AAA' per our RBC model and stay there, we would consider this a credit negative. Our view of capitalization is partially offset by BMO's small capital base of less than \$1 billion since its stand-alone capitalization is more exposed to single-event risk.

In our view, BMO Re has a moderate risk position due to the inherent volatility of property catastrophe business. This exposure has grown over the past few years, and we believe this raises the volatility profile because the business' nature is primarily low frequency/high severity. This is offset by the company's high-quality and well-diversified investment portfolio. BMO Re manages its credit risk prudently with all assets held within appropriate limits as prescribed by the group's approved investment policy guidelines.

We consider BMO Re's financial flexibility as adequate. We view the intercompany preferred shares as capital. These preferred shares were put in place to help optimize the group's Basel capital position. Its preferred and common dividend obligation to its parent are set by its board of directors and could be suspended or deferred in times of extreme financial stress given the multiple income streams available to the parent.

## Other Assessments

We consider BMO Re's management and governance to be satisfactory. The senior management team resides in Barbados and participates in several committees and working groups with the group's senior management personnel to ensure due diligence and maximize strategic development and business expansion.

We consider BMO Re's enterprise risk management (ERM) to be adequate. BMO Re ensures that each operating group acts within its delegates risk-taking authority. Its ERM group and corporate support areas provide oversight and perform individual assessments of risk. The corporate audit division assesses the effectiveness of the company's internal control.

We consider BMO Re strategically important to the wider group. Although the reinsurance business brings a source of dividends and diversification, we believe it to be less integral to the parent's overall strategy than its core banking operations. The strategically important status reflects our expectation that the parent would provide extraordinary support to BMO Re under certain circumstances.

Although BMO is domiciled in Barbados, its investments are generally denominated in U.S. or Canadian dollars; it does not have material asset or liability risks from the Barbados market. As such, we do not cap or directly link our rating on BMO Re to that of the Barbados sovereign (SD/SD as of June 2018). In our view, the selective default of the Barbados sovereign does not impair BMO's financial strength.

### Other Considerations

#### Accounting considerations

BMO Re reports its financial results on International Financial Reporting Standards basis (fiscal year-end, Oct. 30, 2017). Its financial statements are audited by KPMG, which noted no material exceptions in the most recent report.

## Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - Life: Liquidity Model For U.S. And Canadian Life Insurers, April 22, 2004

### Ratings Detail (As Of October 10, 2018)

#### Operating Company Covered By This Report

##### **BMO Reinsurance Limited**

Financial Strength Rating

*Local Currency* A+/Stable/--

Issuer Credit Rating

*Local Currency* A+/Stable/--

#### Related Entities

##### **Bank of Montreal**

Issuer Credit Rating

A+/Stable/A-1

Commercial Paper

*Foreign Currency* A-1

Preferred Stock

*Canada National Scale Preferred Share* P-2

*Canada National Scale Preferred Share* P-2(Low)

Preferred Stock

BBB

Preferred Stock

BBB-

Senior Subordinated

A-

Senior Unsecured

A+

Short-Term Debt

A-1

Subordinated

A-

Subordinated

BBB+

##### **Bank of Montreal Chicago Branch**

Issuer Credit Rating

*Local Currency* --/--/A-1

Commercial Paper

*Local Currency* A-1

Senior Unsecured

A+

##### **BMO Capital Markets Corp**

Issuer Credit Rating

--/--/A-1

##### **BMO Capital Trust II**

Preferred Stock

BBB

##### **BMO Financial Corp**

Issuer Credit Rating

A+/Stable/A-1

##### **BMO Harris Bank National Assn.**

Issuer Credit Rating

A+/Stable/A-1

#### Domicile

Barbados

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