# Fitch Ratings 2020 Outlook: French Insurance

## Capital under Pressure; Business Transformation Underway

### Life Sector Outlook: Revised to Negative

Fitch Ratings has revised its sector outlook on the French life insurance market to negative from stable. The outlook change reflects increasing pressure on the sustainability of the business model, and on capitalisation and earnings, due to prolonged low-to-negative interest rates.

We expect French insurers to take bolder action and adapt their business model to offset the strain on capital and earnings due to very low interest rates. However, the traditional risk aversion of French savers favouring products with guarantees coupled with a less favourable economic backdrop will make the on-going transition to a capital-light business model difficult to implement. This will exert pressure on the sector's underlying credit fundamentals in the short to medium term.

### Non-Life (*) Sector Outlook: Stable

The stable sector outlook reflects our view that non-life insurance companies' earnings profile is more resilient to low yields. We expect increased underwriting and expense discipline to improve technical profitability. This should contribute to offset the negative effect of higher reserves in long-tail lines and lower investment income due to falling yields.  We anticipate price increases to be modest and constrained by competition, particularly in retail, where bancassurers continue to gain market share to diversify away from their core, historic life business.

### Rating Outlook: Stable

The ratings outlook on French life insurance sector is stable, reflecting strong business profiles, capital positions and resilient profitability. These views are primarily reflective of the Stable Ratings Outlooks of the large French insurance companies that are either subsidiaries of global groups or major domestic players.

(*) Non-life consists of P&C, health and protection.

### What to Watch

- A life business mix shift from "Fonds Euros" to unit-linked and pension products amid a structural risk-aversion of French savers and competition away from asset management products
- The effects of management actions such as lower crediting rates, flow restrictions on general account, cost savings on life insurers' margins and capitalisation
- Potential regulatory changes addressing negative interest rate issues for insurers
- Improving non-life underwriting selectivity and pricing conditions amid higher competition from bancassurers

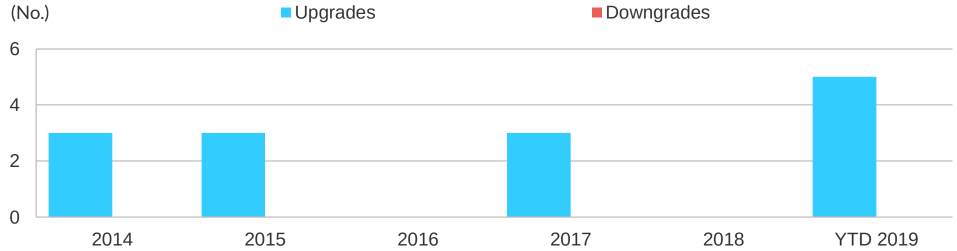
Manuel Arrivé, CFA, Director

"Prolonged low-to-negative interest rates put pressure on French insurer's underlying credit fundamentals.

In the life business, we expect insurers to further reduce the sensitivity of their capital and earnings to low interest rates, taking bolder management action to accelerate structural changes in the sector.

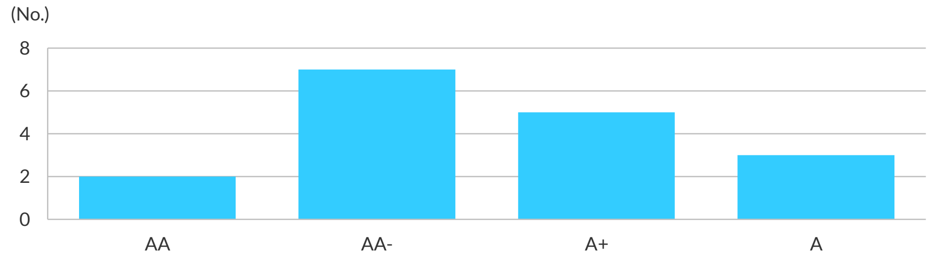
In non-life, a renewed focus on improving underwriting should help mitigate the negative effect of lower yields on investment income and reserves."

### French Insurance - Rating Changes




Note: This chart includes all France-based insurance entities, including rated French subsidiaries of international groups
Source: Fitch Ratings

### French Insurance - Rating Distribution




Note: This chart includes all France-based insurance entities, including rated French subsidiaries of international groups
Source: Fitch Ratings

## France / Life

### *Challenging Shift to Sustainable Business Mix*

Fitch expects French life insurers to accelerate the strategic re-orientation of their product mix towards hybrid unit-linked (UL) products, as a prolonged period of low interest rates threatens the long term sustainability of traditional business models. Key obstacles to the transformation are the traditional risk-aversion of French households and, to a lesser extent, the competition of non-insurance investment products. In addition, in our view, further changes to business mix favouring capital light products are more difficult to execute as macro-pressures and market volatility intensify.

### *Eroding but Strong Capitalisation*

Beyond the shift to capital-light products, Fitch expects French insurers to take financial measures to strengthen their capital positions (subordinated debt issuances, use of reinsurance) and reduce exposure to market risk (such as enhancing hedging programmes). Selected insurers may also consider placing life portfolio in run-off to eventually sell them. We estimate that Solvency 2 coverage ratios of French insurers will have eroded by around 15-25bps at year-end 2019 on average while remaining well within target range for most companies.

### *Proactive Interest Rate Risk Management*

Fitch expects French insurers to implement cash and derivatives-based strategies to reduce duration gap and hedge tail-risk. Our expectation is that crediting rates will be cut to below 1.5% on average, while loss-absorbing, deferred participating liabilities will continue to be strengthened. Guaranteed rates, currently at a modest 0.5% on average, will continue to decline as old business runs off.

### *Profitability under Pressure*

We believe that life insurers' profitability will remain constrained by the very low interest rates, and also sensitive to market drawdowns. We expect the margin by which average investment yields exceed crediting and guaranteed rates to erode over time but to remain positive. We expect UL management fees to remain stable in the short term and their share in life margins to increase.

### *Opportunities in New Pension and Savings Products*

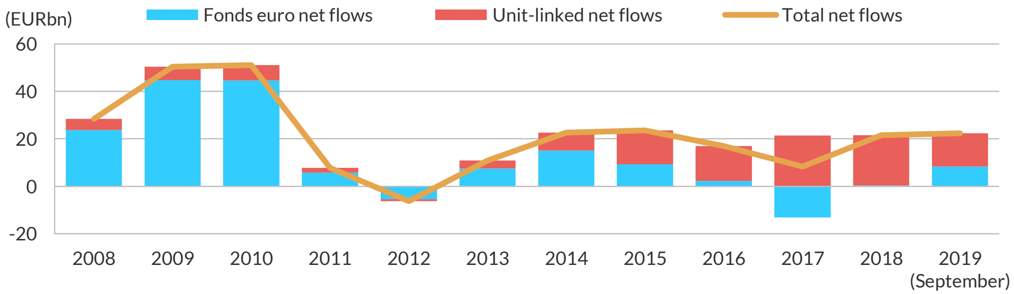
The launch of the new standardized pension product (the Plan Epargne Retraite – PER) in October 2019 represents a growth opportunity for insurers, particularly bancassurers, while allowing them to invest in risker, longer term assets, predominantly in unit-linked format. The reform will, however, intensify competition from asset managers. Insurers will also have to manage the risk of transfer of existing life insurance products to PER offered by competitors.

### *Potential for Supportive Regulatory Changes*

Discussions are in progress between policymakers and insurers on how to mitigate the effects of low interest rates on balance sheets while preserving customers' interest. The extent to which the review of Solvency 2 principles in 2020 reflects market conditions will also be an important of element of insurers' credit profiles.

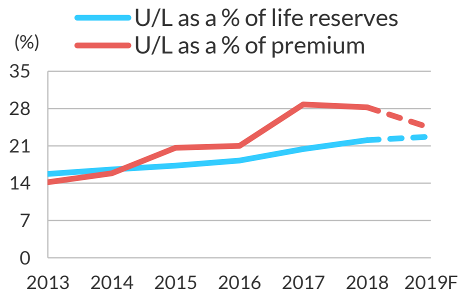
**Stronger Fonds Euro Net Flows in 2019**

Attractive for policyholders, unattractive for insurers



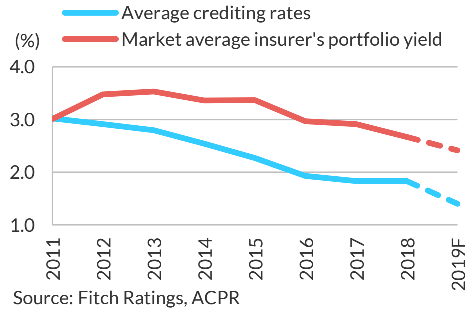

Source: Fitch Ratings, FFA

**Slowing Shift to Capital-Light Products**



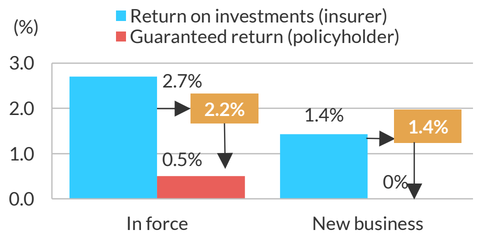

Source: Fitch Ratings, ACPR, FFA

**Lower Investment Yields to Drive Lower Crediting Rates**




Source: Fitch Ratings, ACPR

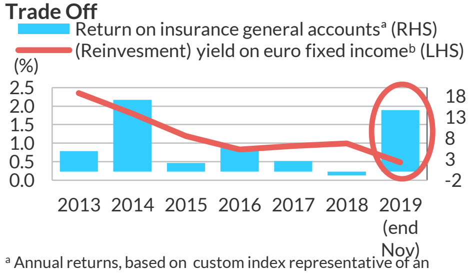
**Lower Yields a Drag on Earnings in 2019 and Beyond**




Estimates as at June 2019
Source: Fitch Ratings, Companies (French insurance companies or insurance company operating in France)

**Lower Reinvestment Yields vs. Higher Unrealised Gains**

**2018 and 2019: different illustration of the same Trade Off**




[a] Annual returns, based on custom index representative of an European Insurance Portfolio of direct bonds and equities holdings. Excludes funds, property, cash and alternative investments
[b] Average yield based on a custom index 60% 10y French Govt bond and 40% Euro IG Aggregate
Source: Fitch Ratings, Bloomberg, Lipper

## France / Non-Life

### *Diversification Strategies to Intensify*

Fitch believes that the prolonged period of low interest rates will increase French insurers' appetite for non-life insurance risks. This is positive for our assessment of French insurers' business risk and diversification. We expect bancassurers to continue their successful diversification into property and casualty (P&C) business; mutuals will attempt to defend market shares in health and improve profitability. Traditional insurers in France are usually composite players, well positioned to build on their already strong positions in most non-life lines.

### *Bancassurers' Growth to Outpace Market*

We expect bancassurers to continue diversifying into non-life business, away from their core traditional life insurance business, and growing faster than the market in 2020, mirroring the trends of the past 10 years. Their widespread banking networks, customer knowledge and track record for innovation will support profitable growth. We expect P&C to become core to bancassurers' business mix in the medium term, which will support the sustainability of the bancassurance business model.

### *Harder Pricing Expected in P&C*

Fitch expects P&C pricing to harden and outpace inflation in 2020, despite increased competition, primarily driven by higher cost of claims for material damages and medical expenses. However, we believe increases will be moderate in retail, because of lower claims frequency in motor and a benign 2019 cat year compared with 2018 and 2017. We expect higher price increases in commercial lines, where rates can be more flexible.

French insurers' increased focus on technical profitability could prove challenging, as inflexible costs, such as regulatory and innovation, are increasing. In addition, longer-tail non-life branches will be affected by low interest rates, pressuring profitability and ALM practices. Insurers can only respond by raising prices to a limited extent given competition.

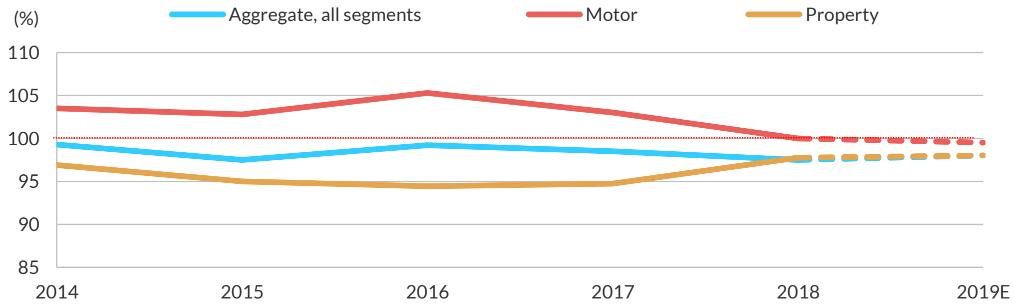
### *Competition to Increase for Mutuals*

Fitch expects French mutual insurers, traditionally market leaders in individual health, to continue to lose market share, due to the persistent competition from traditional insurers who have placed health and protection lines at the heart of their business strategy. Our belief is that mutuals will attempt to increase diversification into protection lines, which are less saturated than health and have better profitability prospects. Health mutuals will also continue consolidating to improve scale and efficiencies while non-mutuals will rely on organic growth, in our view.

### *Manageable Regulatory Changes in Health*

We expect the '100% Santé' reform to lead to moderate price increases in 2020, as the price impact of the reform will likely be carried over several years. A new law allowing policyholders to cancel health policies at any time should have a limited effect on the market. We expect group contracts, which typically are less profitable than individual products with combined ratios over 100%, to continue to drive growth but at a slower pace.

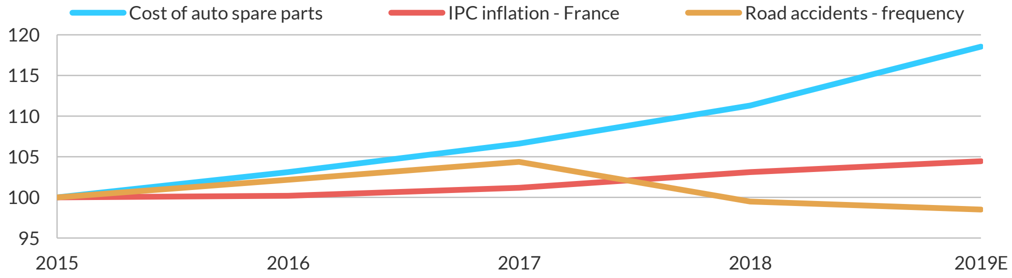
### Evolution of Net Combined Ratio




Source: Fitch Ratings, Fitch estimates, FFA

### Motor Claims : Diverging cost vs frequency trends

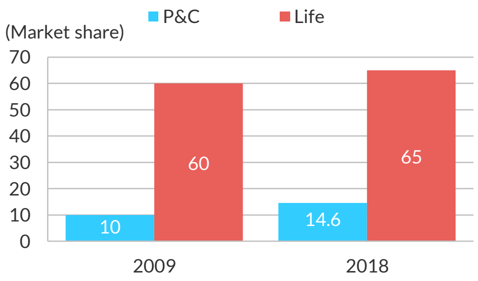
Rebased: 2015 = 100




Source: Fitch Ratings, INSEE, Ministere de l'Interieur, SRA

### French Bancassurers

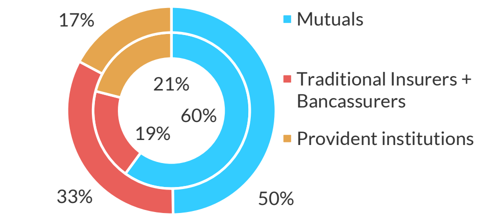
Market share increasing




Source: Fitch Ratings, FFA

### Health Market Share

Mutuals losing market share
Inner circle : 2006
Outer circle : 2018




Source: Fitch Ratings, CTIP, FFA, FNMF

## Appendix: Fitch-Rated French Insurance Companies

### Fitch-Rated French Insurance Companies

| **Allianz IARD S.A.** | **AA/Stable** |
|---|---|
| Allianz Vie | AA/Stable |
| Aviva Assurances | AA-/Stable |
| Aviva Vie | AA-/Stable |
| AXA France IARD | AA-/Stable |
| AXA France Vie | AA-/Stable |
| Coface Re SA | AA-/Stable |
| GAN Assurances | A/Positive |
| Generali IARD | A/Negative |
| Generali Vie | A/Negative |
| Groupama Assurances Mutuelles | A/Positive |
| Groupama GAN Vie | A/Positive |
| Harmonie Mutuelle | A+/Stable |
| MGEFI | A+/Stable |
| MGEN | A+/Stable |
| MUTEX | A+/Stable |
| Mutuelle Nationale Territoriale | A+/Stable |

Source: Fitch Ratings

## Outlooks and Related Research

2020 Outlooks

Global Economic Outlook (September 2019)

## Analysts

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