

FITCH AFFIRMS ETHIAS S.A. AT IFS 'BBB'; OFF RWP; OUTLOOK POSITIVE

Fitch Ratings-London-10 January 2017: Fitch Ratings has affirmed Ethias S.A.'s Insurer Financial Strength (IFS) Rating at 'BBB' and Long-Term Issuer Default Rating (IDR) at 'BBB-' and removed them from Rating Watch Positive (RWP). The Outlooks are Positive. A full list of rating actions is at the end of this commentary.

The rating actions follow an announcement by Ethias that it completed on 23 December 2016 an offer (Switch VI) to certain policyholders of 'First A' products aimed at strengthening its Solvency II position and reducing the sensitivity of its Solvency II coverage ratio to changes in interest rates.

KEY RATING DRIVERS

The Positive Outlook reflects Fitch's expectation that the Switch VI operation will make both Ethias' Solvency II margin and Fitch's Prism Factor Based Model (FBM) score less sensitive to interest rate changes. Fitch therefore expects Ethias' capital and earnings profile to improve in 2017. Fitch will assess Ethias' Prism FBM score when 2016 financials become available.

Despite the cost, estimated by the company at EUR191m, associated with the Switch VI operation, Fitch views this initiative positively as it has improved Ethias' capital position and is likely to have reduced the group's sensitivity to interest rate changes.

Ethias is exposed to interest-rate risk as life technical liabilities are subject to high minimum guaranteed returns and also because of a duration gap between assets and liabilities in life accounts. However, the gap shrank significantly to 2.2 years as of end-September-June 2016 from 3.2 years in 2015, following reinvestments in long-term Belgian treasury notes and the purchase of hedging derivatives.

In November 2016, Ethias launched a commercial initiative, Switch VI, to incentivise customers to redeem capital-intensive "First A" products. Customers were given a 25% premium on the surrender value in redemptions. The offer aimed at reducing Ethias' exposure to interest rate risk associated with the First A products, under which guarantees are paid until the policyholder reaches the age of 99.

Upon the closing of the offer on 23 December 2016, out of EUR1.4bn outstanding reserves (BGAAP), EUR762m were redeemed and a further EUR20m are pending. As a result, the amount of reserves associated with First A products was reduced by around 55%; the average guarantee has remained unchanged at 3.44%.

The Switch VI marks another step in Ethias' efforts to reduce the amount of contracts related to "First A" products. Since 2014, around 80% of reserves related to these products have been redeemed by policyholders.

The group's regulatory Solvency II ratio fell to 116% in 9M16 (excluding transitional measures), driven by lower interest rates, but should improve by 22% since the closing of Switch VI, according to Ethias' estimates.

RATING SENSITIVITIES

The ratings could be upgraded if Ethias' duration gap between assets and liabilities within its life accounts improves from 2.2 years at end-September 2016, provided the Prism FBM score remains at "Strong" or better based on 2016 financials.

The Outlook is likely to be revised to Stable if Ethias' score in Prism FBM weakens to "Adequate" based on 2016 financials or the duration gap fails to improve.

FULL LIST OF RATING ACTIONS

Ethias S.A.:

IFS Rating affirmed at 'BBB'; Off RWP; Outlook Positive

Long-Term IDR affirmed at 'BBB-'; Off RWP; Outlook Positive

Undated subordinated debt affirmed at 'BB'; Off RWP

Dated subordinated debt affirmed at 'BB'; Off RWP

Ethias Droit Commun AAM:

IFS Rating affirmed at 'BBB'; Off RWP; Outlook Positive

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Applicable Criteria

Insurance Rating Methodology (pub. 15 Sep 2016)

<https://www.fitchratings.com/site/re/887191>

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