FitchRatings

FITCH AFFIRMS ETHIAS S.A.'S IFS AT 'BBB+'; OUTLOOK STABLE

Fitch Ratings-London-25 September 2015: Fitch Ratings has affirmed Ethias S.A.'s (Ethias) Insurer Financial Strength (IFS) rating at 'BBB+' and Long-term Issuer Default Rating (IDR) at 'BBB'. The Outlooks are Stable. Concurrently, Fitch has also affirmed Ethias's subordinated debt at 'BB+'. A full list of rating actions is available at the end of this commentary.

KEY RATING DRIVERS

Ethias's IFS rating reflects the company's adequate regulatory capital position, moderate financial leverage and robust non-life underlying profitability. However, Ethias is exposed to interest rate risk given the significant duration gap between assets and liabilities, is weakly capitalised as measured by Fitch's Prism factor-based capital model (Prism FBM) and has a high ratio of high-risk assets-to- equity.

Fitch considers Ethias's group regulatory capitalisation as adequate. In 2014, Ethias's group regulatory solvency was 146%, significantly lower than 185% in 2013. The sharp decline followed Ethias's setback in a tax dispute and a higher value of the liabilities as a result of lower interest rates. The group regulatory solvency ratio, however, recovered to 186% in 1H15 due to earnings generated during the period. Ethias's solo regulatory ratio - not fully taking into account the adverse impact of lower interest rates - was 183% at end-June 2015.

High guarantees on certain life portfolios penalise Ethias's capital in a risk-based framework. Ethias targets a Solvency 2 ratio of 150%, excluding transitional measures on technical liabilities. Ethias's score based on year-end 2014 results in the Prism FBM is 'Somewhat Weak'. However, a reduction of the reserves "First A" and the associated likely improvement in value-in-force (VIF) are likely to be beneficial to the score. Fitch expects Ethias to achieve a score of "Adequate" in 2015, although the cost of the "First A" transaction would negatively impact earnings and ultimately equity.

Ethias is reducing its equity exposure, and this should be beneficial to both its Solvency 2 margin and Prism FBM score. Ethias has also been discussing with the Belgian regulator on further capital management actions.

Ethias's financial leverage ratio (FLR) was 23% at end-2014, a level commensurate with the ratings. The company issued EUR250m dated subordinated bonds in 1H15 as part of an exchange offer, refinancing outstanding perpetual subordinated debt of the same amount. Leverage was consequently unaffected.

Ethias's net result is derived mainly from non-life activity. Ethias reported a strong technical non-life result of EUR263m in 2014 (2013: EUR202m), after 'reserve clignotante', predominantly due to low claims severity through the year. The net combined ratio was 89.2% in 2014 (2013: 91%). Tight control of operating costs is key to the Ethias's strategy. Fitch expects Ethias to maintain strong non-life underwriting profitability throughout its business plan for 2015-2019.

At end-2014, the ratio of high risk assets to equity was 143%, in line with 2013. Although the ratio is much reduced from 312% at 2009, it remains outside the median for the 'BBB' rating category. Fitch, however, expects the ratio to fall throughout the business plan 2015-2019 as Ethias de-risks its balance sheet. The ratio was 134% in 1H15.

Ethias is exposed to interest rate risk as life technical liabilities are subject to fairly high minimum guaranteed returns. The duration gap between assets and liabilities in the life accounts was 8.71 years at end-2014. The gap shrank to 6.14 years as of 30 June 2015 following the "Switch IV" operation in 1Q15.

Ethias is the group's main operating entity. Ethias Droit Commun AAM is considered a 'Core' entity according to Fitch's group rating methodology. The company is 95% reinsured through a quota-share agreement by Ethias and it has a 25% share in Ethias's holding company, Vitrufin. It has the same IFS rating, based on Fitch's evaluation of the strength of the group as a whole.

RATING SENSITIVITIES

Factors that could trigger a downgrade of Ethias's ratings include:
-Failure to improve Prism FBM Score to "Adequate" in 2015.
-Financial Leverage Ratio (FLR) increasing from the current level of 25% (based on 1H15 financials).
-Failure to maintain a strong level of technical profitability, as reflected in a combined ratio above 100% (2014: 89.2%)

Conversely, a reduction in the ratio of high risk assets to equity to below 90% (2014: 143%), coupled with non-life's combined ratio below 95% and strong capitalisation, could lead to an upgrade.

FULL LIST OF RATING ACTIONS

Ethias S.A.:
IFS rating: affirmed at 'BBB+'; Outlook Stable
Long-term IDR: affirmed at 'BBB'; Outlook Stable
Undated subordinated debt: affirmed at 'BB+'
Dated subordinated debt: affirmed at 'BB+'

Ethias Droit Commun AAM:
IFS rating: affirmed at 'BBB+'; Outlook Stable

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Applicable Criteria
Insurance Rating Methodology (pub. 16 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=871172