Ethias S.A.

Full Rating Report

Ratings

Ethias S.A.

Insurer Financial Strength Rating	BBB+
Long-Term Foreign-Currency IDR	BBB
Dated subordinated debt	BB+

Ethias Droit Commun AAM

Insurer Financial Strength Rating	BBB+

Sovereign Risk

Long-Term Foreign-Currency IDR	AA
Long-Term Local-Currency IDR	AA

Outlooks

Insurer Financial Strength Ratings	Stable
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Local-Currency IDR	Negative

Financial Data

Ethias S.A

(EURm)	2014	2013
Total adjusted equity	1,163	1,295
Total assets	19,771	20,533
Net income	-135	110
Gross written premiums	2,401	2,716

Source: Ethias

Related Research

AG Insurance (July 2015)

KBC Insurance (September 2014)

SNS Reaal – Insurance Activities (VIVAT; June 2014)

Analysts

Federico Faccio
+44 20 3530 1394
federico.faccio@fitchratings.com

Amelie Hibos
+33 144 299 178
amelie.hibos@fitchratings.com

Key Rating Drivers

Adequate Capital Position: Fitch Ratings considers Ethias's group capitalisation as adequate. Ethias's group regulatory solvency fell significantly to 146% at end-2014 from 185% at end-2013. It however recovered to 186% at end-1H15 due to earnings generated during the period.

Ethias's capital score in Fitch's Prism Factor-Based Model (Prism FBM) was 'Somewhat Weak', based on 2014 financials. However, the reduction of the 'First A' reserves is likely to be beneficial for the Prism FBM score and Fitch expects that a score of 'Adequate' will be achieved in 2015.

Exposure to Interest-Rate Risk: Ethias is exposed to interest-rate risk as life technical liabilities are subject to high minimum guaranteed returns and there is a significant duration gap between life assets and liabilities (8.7 years at end-2014; 6.1 years at end-June 2015). Ethias is acting to mitigate this risk by, for example, lengthening asset duration and buying out policyholders.

Moderate Financial Leverage: Ethias's financial leverage ratio (FLR) was 25% at end-June 2015 (2014: 23%), a level commensurate with the ratings. The company issued EUR232m dated subordinated bonds in 1H15 as part of an exchange offer, refinancing outstanding perpetual subordinated debt of EUR250m. As the new issue refinanced debt of nearly the same amount, the leverage ratio was unaffected.

Robust Underlying Profitability: Ethias's net income is derived mainly from non-life business. In 2014, non-life profitability remained robust, with a reported combined ratio of 89.2% (2013: 91%) and a strong technical result of EUR263m. Fitch expects Ethias to maintain strong non-life underwriting profitability through its business plan for 2015-2019. Profitability of the life business was satisfactory in 2014 with technical income of EUR130m before 'reserve clignotante' (2013: EUR28m).

High Investment Risk: At end-2014, the ratio of risky assets to equity was 143%, much reduced from 312% at end-2009 but still high for the rating category and compared with peers. Fitch expects the improving trend to continue as the company de-risks its balance sheet. The ratio was 134% at 1H15.

Litigation Risk Materialised: In 2014, Ethias booked a loss of EUR377m – the full disputed amount – following a negative ruling in its litigation with the Belgian tax authority. This resulted in an overall reported net loss of EUR135m for the year. Fitch expects Ethias to record a marginal profit in 2015, with robust underlying underwriting performance offsetting the cost of buying out policyholders.

Rating Sensitivities

Failure to Improve Prism Score: Failure to improve the Prism FBM Score to 'Adequate' could trigger a downgrade of Ethias's ratings.

Higher Financial Leverage: Ethias's ratings could be downgraded if the FLR increases from the current level of 25% (based on 1H15 financials).

Failure to Maintain Profitability: Failure to maintain a strong level of technical profitability, reflected in a combined ratio above 100% (2014: 89.2%) could also result in a downgrade.

Reduction in Risky Assets: A reduction in the ratio of risky assets to equity to below 90% (2014: 143%), with non-life combined ratio maintained below 95% and capital at a strong level, could lead to an upgrade.

Market Position and Size/Scale

Strong Position in Domestic Market

- Solid business position concentrated on Belgian market
- EC's commitments fulfilled, restructuring near completion
- Efficient distribution channel

Solid Business Position Concentrated on Belgian Market

Ethias has a solid business in the Belgian insurance market. It was the fourth-largest insurer in 2014 by gross written premiums (GWP), with a market share of 11.3% in non-life insurance and 8.6% in life insurance. Ethias has strong historical links with Belgian local public organisations, with a market share of more than 80% in this sector.

Ethias's product range is aimed at retail clients and public authorities, such as regions, communities, provinces, the federal state of Belgium, more than 580 towns and communes, schools and hospitals but also private companies. In June 2014, the European Commission (EC) allowed Ethias to offer certain life insurance products (including unit-linked products) to individuals. Non-life insurance, such as motor, household and health insurance, is also offered to individuals.

In 2014, Ethias's GWP fell by 12 percent to EUR2.4bn. The fall is a consequence of the high amount of group life single premiums written in 2013. Most of Ethias's life premiums are savings-type products. In 2014, 95% of life premiums related to group life business and the remainder comprised the run-off book of individual life and a small amount of life reinsurance and unit-linked business. The non-life business is well diversified. In 2014 motor business was Ethias largest line (35% of premiums), followed by accident and health (34%), fire and other property (14%), third-party liability (9%) and other (8%).

EC's Commitments Fulfilled, Restructuring Nears Completion

On 12 June 2014, the EC acknowledged the completion of a number of items in the initial restructuring plan and made changes to the outstanding ones. The restructuring plan was initially implemented in May 2010, when the EC required Ethias, in return for support received from the Belgian authorities, to dispose of some of its activities and to significantly improve its underwriting performance.

Ethias had fulfilled all requirements imposed by the EC, with the exception of the disposal of its retail life insurance activity and payment of dividends to its public shareholders. However, the EC recognised that this had not been possible because of market conditions and the need to strengthen Ethias's capital base in the light of uncertainty of capital requirements under Solvency 2.

The revised commitments recognised that the run-off of the retail life business will take longer than originally expected and no specific targets have been set. However, the EC still requires Ethias to maintain technical profitability and risk management practices in line with market best practice. The EC has also permitted Ethias to sell unit-linked and life protection policies.

Efficient Distribution Channel

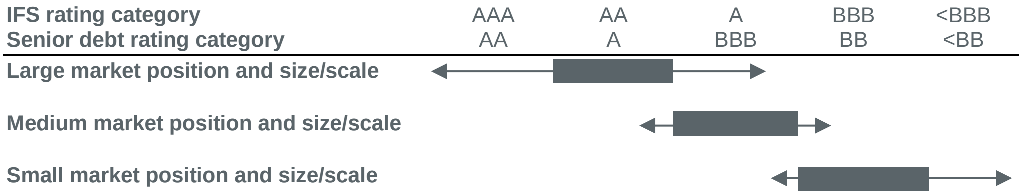
Ethias distributes almost all of its business through salaried sales staff who deal with individual clients, and insurance inspectors who deal with public corporate clients, mostly local governments and state-related organisations. All products offered by Ethias to individual clients are marketed directly through offices or via the internet and call centres.

Related Criteria

Insurance Rating Methodology (September 2015)

Figure 1

Ratings Range Based on Market Position and Size/Scale



Source: Fitch

Ownership is Neutral to Rating

Ethias was formed in 1919 as Société Mutuelle des Administrations Publiques (Insurance Mutual for Local Public Authorities; SMAP). One of its objectives was to offer its members – local government organisations – lower tariffs than those generally available from traditional insurers. In 2003, SMAP was renamed Ethias, which originally comprised four mutual insurance companies and their subsidiaries.

The group suffered from severe difficulties in the wake of the global financial crisis, and at end-2008 its legal structure had to be changed to allow the Belgian public authorities to recapitalise it. Operational activities were placed in a limited-liability company (Ethias), owned by the holding company Vitrufin, of which the Belgian public authorities own 75% and Ethias Droit Commun AAM, one of the group's historical component companies, holds 25%.

Ethias Droit Commun (the only mutual insurance company left in the group) includes a portion of workers' compensation business, which accounts for less than 6% of the group's premiums. The company has a 95% quota share reinsurance treaty with Ethias.

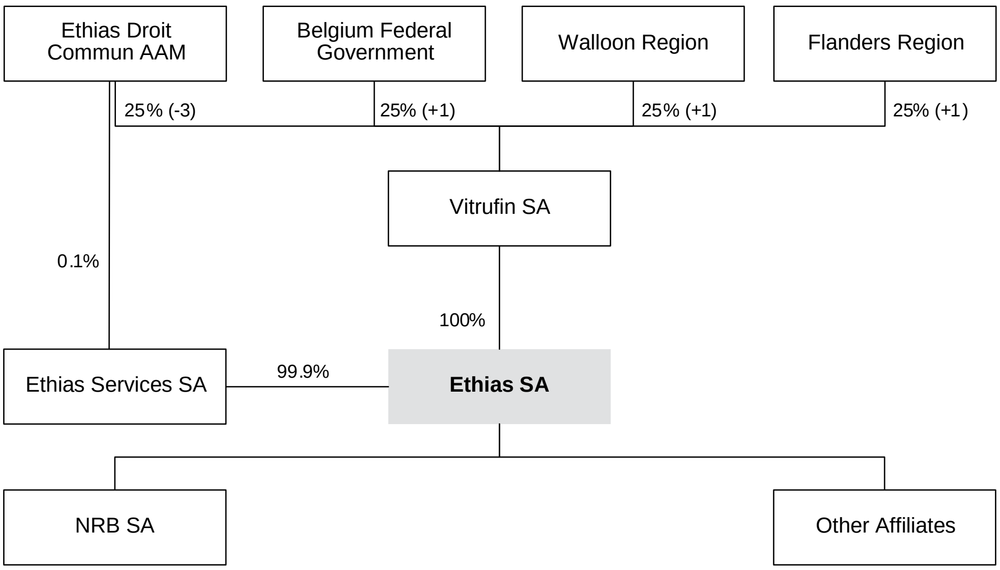
Fitch believes that the Belgian authorities would provide additional support to the group should the need arise. However, the rating is based on the company's stand-alone profile and does not factor in any potential state support.

Corporate Governance and Management

Corporate governance and management are effective and neutral to the ratings. In 2009, Ethias reorganised its management structure to clearly assign tasks and management responsibilities. It entirely redesigned its internal reporting system, allowing for regular and frequent management reporting on key activities: business operations, investment and risk management.

Figure 2

Structure Diagram



Source: Ethias

Industry Profile and Operating Environment

Sovereign and Country- Related Constraints

Fitch rates the sovereign obligations of Belgium at ‘AA’ with a Negative Outlook. The Country Ceiling is ‘AAA’. The Country Ceiling expresses the maximum limit for foreign-currency ratings of most, but not all, issuers in a given country. Given these high levels, the ratings of Belgian insurance organisations and other corporate issuers are not likely to be constrained by sovereign or macroeconomic risks, and in the case of Ethias, no constraints are biting.

Mature Market Under Pressure

Belgium is a mature insurance market, with total premiums of EUR33bn (end-2014), of which more than 50% relates to life insurance, mostly savings. The non-life market is dominated by motor and household insurance.

Growth in 2014 was mainly driven by savings products with guaranteed interest rates but also unit-linked savings products. However, demand for such products can be volatile, reflecting financial markets. Non-life premiums only increased slightly.

Belgian insurers’ profitability is under pressure due to low interest rates and stiff competition. Non-life profitability can be affected by natural catastrophes (e.g. a hailstorm in Brussels in 1H14).

Fitch expects profitability to remain volatile, sustained by fierce competition and movements in the financial markets.

Special Reserve Mandatory

Following a continual decline in returns on government bonds, the Belgian regulator introduced a mandatory special reserve in 1992, the reserve clignotante, requiring companies to put aside a special reserve for all contracts that have guaranteed interest rates 10bp higher than a defined fixed rate, the taux clignotant. Companies that were able to demonstrate that they operated a prudent asset-liability management policy were freed from this requirement.

However, in light of persisting low interest rates, the regulator has removed the special dispensation clause and has ordered all companies to set aside the special reserve relative to the taux clignotant. This is regardless of their previous asset/liability management and reserving positions. Under Belgian GAAP, the special reserve is shown as a reserve, whereas under IFRS accounting it is part of the company’s shareholders’ funds.

Peer Analysis

Strong Underwriting Result, Weaker Net Profitability and Capital

Ethias's peers are the mid-to-large Benelux composite insurers. Ethias is smaller than peers in the sample (see Figure 3). All of the insurers in this peer group have limited exposure to non-domestic markets (except AG Insurance through Ageas).

Ethias's underlying profitability, as measured by the combined ratio, was the strongest in 2014 within this group, although its net result was negative. The net loss is largely explained by the tax provision Ethias booked following the adverse ruling on its tax dispute with the Belgian tax authority. In 2014, Achmea's and VIVAT's (formerly REAAL) net income were also affected by non-recurring items.

Ethias's peers are more strongly capitalised, with the exception of VIVAT that is expecting to receive a capital contribution from its new parent company, Anbang.

Figure 3

Peer Comparison – 2014

Company	IFS rating of primary operating entities	Assets (EURm)	Shareholders' equity (EURm)	IFRS profit (EURm)	Return on assets[a] (%)	Combined ratio (%)	Return on equity[b] (%)	EU Solvency I ratio (%)	Financial leverage ratio (%)
Achmea	NR	93,205	9,818	16	0.1	102.5	0.2	215	21
AG Insurance	A+/Stable	74,260	6,488	530	0.9	101.2	9.2	210	32
VIVAT	BBB/RWE	60,525	2,015	-605	-1.4	110.9	-26.3	136	44
KBC Insurance	A−/Stable	37,921	3,296	391	1.5	94.3	11.9	323	0
Ethias[c]	**BBB+/Stable**	**19,771**	**1,130**	**-135**	**-0.7**	**89.2**	**-11.0**	**179**	**23**

[a] Group pre-tax income/2013-2014 average total assets
[b] Group net income/2013-2014 average group shareholders' equity
[c] Unconsolidated accounts, Belgian GAAP
Source: Companies, Fitch

Figure 4
Capitalisation and Leverage

(EURm)	2010	2011	2012	2013	2014	Fitch's expectation
Total adjusted equity	1,151	1,063	1,207	1,295	1,163	Fitch expects Ethias's group regulatory capital to be more than 150% at end-2015, and that a Prism FBM Score of 'Adequate' will be achieved.
Group regulatory solvency ratio (%)	n.a.	n.a.	185	185	146	
Regulatory solvency ratio (%)	162	158	184	190	179	
Financial leverage ratio (%)	25	26	23	21	23	
Net written premiums to equity (non-life) (x)	1.0	1.1	1.0	0.9	1.1	
Net leverage (non-life) (x)	3.8	4.2	3.7	3.5	4.0	
Operating leverage (life) (x)	13.3	14.1	11.0	10.8	11.8	

Source: Ethias annual reports, Fitch

Adequate Regulatory Capital, Weak Prism Score

- Adequate regulatory capital
- Weak Prism score, expected to improve
- Moderate financial leverage
- Significant unrealised gains

Adequate Regulatory Capital

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 the fall in interest rates that increases the value of the liabilities and the loss of the tax dispute. The ratio however recovered to 186% in 1H15 due to the earnings generated in the semester.

Ethias SA's solo regulatory ratio – not fully taking into account the adverse impact of lower interest rates – was a strong 183% at end-June 2015.

High guarantees on certain life portfolios penalise Ethias's capital in a risk-based framework. Ethias is targeting a Solvency 2 ratio of 150%, excluding transitional measures on technical liabilities.

Weak Prism Score, Expected to Improve

Ethias's score based on year-end 2014 results in Prism FBM is 'Somewhat Weak'.

The reduction of the First A reserves and the associated likely improvement in Value-In-Force (VIF) are likely to be beneficial to the Prism FBM score. Fitch expects that a score of 'Adequate' will be achieved in 2015, although the cost of the First A transaction will hurt earnings and ultimately group equity.

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

Moderate Financial Leverage

Ethias's debt leverage was 23% at end-2014, a level commensurate with the ratings. The company issued EUR232m dated subordinated bonds in 1H15 as part of an exchange offer, refinancing outstanding perpetual subordinated debt of EUR250m. As the debt issuance refinanced debt of nearly the same amount, Ethias's financial leverage ratio was unaffected by the issuance.

Significant Unrealised Gains

Unrealised gains on Ethias's bond portfolio are significant (end-1H15: EUR1.3bn), reflecting the reduced yields on Belgian government bonds. Unrealised gains are not included in shareholders' equity under Belgium GAAP and are only partially included in the Prism FBM TAC.

Figure 5

Debt Service Capabilities and Financial Flexibility

(x)	2010	2011	2012	2013	2014	Fitch's expectation
Fixed charge coverage ratio (incl. realised and unrealised gains) [a]	-10.6	-3.1	10.1	5.6	13.5	Fitch expects a run rate for fixed-charge coverage of more than 7x, excluding payments to Vitrufin.
Fixed charge coverage ratio (excl. realised and unrealised gains) [b]	13.1	16.2	17.1	3.9	8.0	

[a] Including interest charge related to Vitrufin SA subordinated debt: 2010: -10.6; 2011: -3.1; 2012: 3.2; 2013: 2.3; 2014: 13.5
[b] Including interest charge related to Vitrufin SA subordinated debt: 2010: 13.1; 2011: 16.2; 2012: 5.4; 2013: 1.6; 2014: 8.0
Source: Ethias annual reports, Fitch

Financial Flexibility Relies on Belgian Public Authorities

- Indirect debt burden from holding company
- Fixed-charge coverage commensurate with ratings
- Likely external Support

Indirect Debt Burden From Holding Company

In 2012, Vitrufin issued debt to buy the Dexia shares from Ethias. However, Vitrufin relies on Ethias for dividends to pay the interest and principal on its EUR278m debt. In 2014, Ethias did not pay dividends (2013: EUR25m) as a way of bolstering its capital position ahead of the implementation of the Solvency 2 regime.

Dividend payments are conditional on the regulatory solvency ratio being at least 150%, which limits the financial drag from the holding company.

Fixed Charge Coverage Commensurate With Ratings

Ethias's fixed-charge coverage is commensurate with the ratings. Despite the loss in 2014, the fixed-charge coverage ratio was 8.0x excluding realised and unrealised gains and 13.5x including realised and unrealised gains (2013: 3.9x and 5.6x). Those levels exclude the indirect debt burden from Vitrufin.

The bonds issued by Vitrufin will mature in 2019.

Likely External Support

Fitch believes that the Belgian authorities would provide additional support should the need arise. This view reflects the authorities' majority ownership of the company and Ethias's provision of insurance to Belgian public organisations and their employees.

Figure 6

Financial Performance and Earnings

(EURm)	2010	2011	2012	2013	2014	Fitch's expectation
Net income	-199	-25	180	110	-135	Fitch expects earnings to only break even in 2015 as a result of the payout to First A customers. However, profitability should increase and normalise from 2016 as the company implements cost-reducing measures.
Pre-tax income before reserve clignotante	n.a.	n.a.	222	212	35	
Net combined ratio (%)	101.5	78.6	92.0	91.0	89.2	
Net income return on equity (%)	-16.9	-2.3	16.0	8.8	-10.8	
Pre-tax operating return on assets (excl unrealised gains) (%)	1.1	1.4	1.5	0.3	0.7	
Pre-tax operating return on assets (incl unrealised gains) (%)	-0.9	-0.3	0.9	0.5	1.2	

Source: Ethias annual reports, Fitch

Satisfactory Profitability

- Litigation risk materialised
- Profitability tempered by special reserve
- Strong non-life performance
- Depressed life profitability

Litigation Risk Materialised

The dispute between Ethias and the Belgian tax authority ended in Ethias losing the case on 28 November 2014. The company booked a loss of EUR377m – the full disputed amount – in 2014 as a result of the negative outcome, despite the possibility of making appeals on points of law.

Profitability Tempered by Special Reserve

In 2014, profitability suffered from the unfavourable tax ruling as well as the effect of the special reserve (reserve clignotante). Ethias booked a loss of EUR135m (2013: profit of EUR110m).

Despite the cost of the Switch IV operation (reduction of 'First A' reserves), Fitch expects Ethias to record a marginal profit in 2015, given its robust underlying underwriting performance.

Fitch's analysis of volumes growth suggests that Ethias has on average expanded its life and non-life businesses in line with the market in Belgium over 2014-2010, although individual years have been more volatile given the run-off of the retail life business imposed by the EC.

Fitch views cautiously growth at rates greater than the market or peers, especially during periods of competitive pricing pressure.

Strong Non-Life Performance

Ethias's net result is derived mainly from non-life business. The technical non-life result for Ethias was a strong EUR263m in 2014 (2013: EUR202m), after 'reserve clignotante', predominantly due to low claims severity in 2014. The net combined ratio for the group was 89.2% in 2014 (2013: 91.0%). Tight control of operating costs is key to the group's strategy, which is reflected in the combined ratio.

Fitch expects Ethias to maintain strong non-life underwriting profitability throughout the business plan period of 2015-2019.

Depressed Life Profitability

The life result before provisions for reserve clignotante was EUR130m in 2014, a result stronger than 2013 but boosted by non-recurring items and higher realised gains. Fitch anticipates a negative life result in 2015 because of the loss associated with the Switch IV operation and lower interest rates. From 2016, the life business may contribute to profitability, but only to a limited extent as interest rates are low and the retail life business is running off.

Figure 7

Investment and Asset Risk

(%)	2010	2011	2012	2013	2014	Fitch's expectation
Risky assets to equity[a]	297	182	144	144	143	Fitch expects the group's investment policy to remain unchanged. However, the agency expects the risky assets to equity ratio to fall over time as Ethias de-risks its balance sheet.
Unaffiliated shares to equity	67	65	37	36	33	
Non-investment grade bonds to equity	87	67	61	61	61	
Investments in affiliates to equity	143	50	46	47	49	

[a] This ratio is a combination of unaffiliated common stock, investments in affiliates and non-investment grade bonds. All investments at book value
Source: Ethias annual reports, Fitch

High Proportion of Risky Investments

- High risky assets ratio, expected to fall
- Adequate quality of assets portfolio

High Risky Assets Ratio, Expected to Fall

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

At end-2014, the investment breakdown at book value was: 76% bonds, 5% equities (including affiliates), 6% loans and mortgages, 6% deposits with cedents, 6% cash and cash equivalents and 1% real estate. The proportion of equities, at 5% of invested assets, is in line with Belgian peers.

Adequate Quality of Assets Portfolio

The credit quality of the life and non-life bond portfolios is adequate, with an average rating of 'A-'. This measure is a risk-weighted average taking into account the second-best rating available on each instrument. 95% of the bond portfolio is rated 'BBB' or higher.

Figure 8

Asset/Liability and Liquidity Management

(%)	2010	2011	2012	2013	2014	Fitch's expectation
Liquid assets/net technical reserves - excluding unit linked	91	90	92	84	86	Fitch expects management action to reduce Ethias' exposure to interest-rate risk. Fitch does not expect material changes in liquidity management.
Liquid assets/policyholder liabilities	88	88	89	82	84	

Liquid assets: Unaffiliated equities, cash and cash equivalents and investment-grade bonds
Source: Ethias annual reports, Fitch

Exposure to Interest Rate Risk, but Reducing

- Significant mismatch between assets and liabilities
- Interest-rate risk reduced further to the Switch IV operation
- Surrenders in retail life managed

Significant Mismatch Between Assets and Liabilities

Ethias is exposed to interest-rate risk as life technical liabilities are subject to high minimum guaranteed returns, and there was duration gap of 8.7 years between assets and liabilities in the life accounts at end-2014. The gap shrank to 6.1 years by end-1H15 following the Switch IV operation in 1Q15 (see below).

The guarantee profile for the life insurance book has improved in recent years, as Ethias reduced its exposure to higher-rate guarantees. However, it remains exposed to interest-rate risk: the average guaranteed rate in the individual life portfolio was 3.09% at 31 March 2015 (but on a smaller amount of life reserves as the book is running off) while the average guarantee in the group life business was 2.69%, falling from 3.09% in 2013 and 2.95% in 2014.

Interest-Rate Risk Reduced Further to the Switch IV Operation

In 1Q15, Ethias launched a commercial initiative, operation Switch IV, to incentivise customers to redeem the capital intensive First A products, under which the (high) guarantees are paid until the policyholder reaches the age of 99. Customers were given four years of interest in case of full redemptions, or partial redemptions of a minimum of EUR100,000.

As a result of this operation, EUR1.9bn of reserves related to First A products were redeemed, leaving EUR1.4bn outstanding at the end of June 2015. The average guarantee has remained unchanged at 3.44%.

Fitch views positively the Switch IV operation as it will improve Ethias' risk-based capital position in the long run, although the associated cost will hurt earnings and group equity in 2015.

Surrenders in Retail Life Managed

During the financial crisis, and especially at end-2008, Ethias suffered a liquidity crisis due to withdrawals by clients of their investments in its main individual life products, as there was no penalty on policyholder surrender.

The company is now managing the levels of surrenders, as the Switch IV operation testifies.

Individual life mathematical reserves are falling and were EUR3,083m at end-1H15 (end-2014: EUR5,274m).

Figure 9

Reserve Adequacy

(%)	2010	2011	2012	2013	2014	Fitch's expectation
Loss reserves/CY incurred losses	3.3	4.4	3.7	3.7	3.9	Fitch expects Ethias's non-life reserves to continue to develop favourably.
Loss reserves/equity	2.8	3.0	2.7	2.6	2.9	
CY paid losses/incurred losses	0.9	1.2	1.0	0.9	0.9	
Change in ratio of loss reserves/earned premiums	0	0	2.0	0.2	-0.3	
Reserve development/prior year equity (Group, IFRS)	n.a.	-16.7	-6.7	-4.5	-19.7	
Reserve development/PY loss reserves (Group, IFRS)	n.a.	-9.0	-3.4	-2.6	-12.1	
Reserve development/net earned premium (Group, IFRS)	n.a.	-16.1	-6.0	-4.5	-20.6	

Note: Negative numbers denote positive reserve developments. CY: current year. PHS: policyholders' surplus. PY: prior years
Source: Fitch

Adequate Reserves

- Reserving profile of moderate importance, adequate reserve growth
- Adequate non-life reserving

Reserving Profile of Moderate Importance, Adequate Reserve Growth

Reserve leverage relative to capital and to incurred losses is of a 'moderate' importance for Ethias (as defined in Fitch's criteria), partly due to its exposure to long-tail lines, partly due to its relatively small capital base.

Fitch believes Ethias's loss reserves grew at a rate commensurate with growth in underwriting exposures over the past five years.

Adequate Non-Life Reserving

Fitch believes that Ethias's level of technical provisions is prudent, in light of regulatory requirements and practices in Belgium.

Fitch regards the overall reserving as adequate. Analysis of the group's claims development triangles (based on IFRS accounts) indicates favourable development in recent years.

Figure 10

Reinsurance, Risk Management and Catastrophe Risk

(%)	2010	2011	2012	2013	2014	Fitch's expectation
Reinsurance recoverables to equity	3.3	6.7	3.3	5.0	5.7	Fitch does not expect any material change to Ethias's reinsurance programme.
Net written premiums to gross written premiums	94.2	95.4	96.1	96.4	97.1	

Source: Ethias annual reports, Fitch

Reinsurance and Risk Mitigation Appropriate

- Reinsurance of limited importance
- Good-quality reinsurers

Reinsurance of Limited Importance

The group is not a big purchaser of reinsurance, as shown by its high retention rates, averaging 99.7% in life insurance and 97% in non-life insurance in 2014. This corresponds to the group's moderate risk profile, resulting mainly from the low insurance risk related to its individual non-life and savings-type life businesses. Fitch considers the level of reinsurance protection to be appropriate, in light of the low-risk characteristics of business underwritten.

Good-Quality Reinsurers

Most of the protection purchased is in the form of non-proportional treaties, supplemented by facultative covers. The quality of Ethias's external reinsurance providers is robust. The main carriers are SCOR S.E. (IFS Rating: AA-/Stable) and Hannover Re SE (IFS Rating: AA-/Stable).

Figure 11

Ethias Droit Commun AAM

(EUR000)	2010	2011	2012	2013	2014	Fitch's expectation
Gross premiums	145,912	144,416	153,562	158,560	156,317	Fitch expects Ethias Droit Commun to continue its moderate growth pace and maintain robust profitability.
Net premiums	7,373	7,113	10,427	10,807	9,017	
Net income	1,416	1,404	3,053	2,406	2,413	
Net premiums to equity (x)	0.01	0.01	0.02	0.02	0.02	
Shareholders' funds	514,333	515,737	518,790	521,196	523,609	
Technical provisions	967,456	942,025	995,637	1,024,946	1,054,536	

Source: Fitch

Mutual Company With Strong Capital

- Strong capitalisation
- Niche player
- Holding company's shareholder

Strong Capitalisation

Capitalisation is strong at the group's mutual company Ethias Droit Commun, with the regulatory solvency ratio at 3,045% at end-2014 (2013: 3,376%). The high level of solvency coverage is due to a combination of the low amount of premiums retained in the group due to the 95% quota share agreement with Ethias S.A. and the high absolute amount of own funds. Ethias Droit Commun is the only mutual insurance company left in the group.

Niche Player

Ethias started to sell public agents' workers' compensation insurance products in Belgium in 1924. Due to its long experience and historical links it is now the leader in this market, with EUR156m of gross premiums underwritten in 2014 (2013: EUR159m).

Holding Company's Shareholder

Ethias Droit Commun held 25% of the group's holding company, Vitrufin, at end-2014. This participation represents almost one-third of its total invested assets. Fitch does not expect significant changes in the company's activity, structure or management in the coming years.

Appendix: Other Ratings Considerations

Below is a summary of additional ratings considerations of a 'technical' nature that are part of Fitch's ratings criteria.

Group IFS Rating Approach

Ethias S.A is the group's main operating entity. Fitch also regards Ethias Droit Commun as a 'Core' entity under the agency's insurance group rating methodology because it is 95% reinsured by Ethias S.A and has a 25% share in Ethias's holding company, Vitrufin. Ethias S.A and Ethias Droit Commun share the same IFS rating based on Fitch's evaluation of the group as a whole.

Notching

For notching purposes, the regulatory environment of Belgium is assessed by Fitch as being 'Effective', and classified as following a Group Solvency approach.

Notching Summary

Holding Company

Not applicable.

IFS Ratings

For Ethias S.A., a baseline recovery assumption of 'Good' applies to the IFS rating, and standard notching was used from the IFS anchor rating to the implied operating company IDR.

Debt

Not applicable (no rated debt issues).

Hybrids

For the two issues rated by Fitch (EUR250m dated debt and EUR250m perpetual debt), a baseline recovery assumption of 'Below Average' and a non-performance risk assessment of 'Moderate' were used. The ratings are two notches below the IDR, which is based on one notch for recovery and one notch for non-performance risk.

Hybrids – Equity/Debt Treatment

Figure 12

Hybrids Treatment

Issuer – Ethias SA	Amount	CAR Fitch (%)	CAR reg. override (%)	FLR debt (%)
Dated subordinated debt	250	0	100	100
Perpetual subordinated debt	250[a]	0	100	100
Dated subordinated debt	75	0	100	100

CAR – Capitalisation ratio: FLR – Financial leverage ratio
For CAR, % tells portion of hybrid value included as available capital, both before (Fitch %) and after the regulatory override
For FLR, % tells portion of hybrid value included as debt in numerator of leverage ratio
[a] Original amount. Only EUR14m remains outstanding following the exchange offer in July 2015
Source: Fitch

Exceptions to Criteria/Ratings Limitations

None.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.