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AG2R Prevoyance

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AG2R Prevoyance

Major Rating Factors

Operating Company Covered By This Report
Financial Strength Rating
Local Currency
BBB+/Stable/--

Strengths:

- Strong competitive position.
- Good capital adequacy.

Weaknesses:

- Subdued, albeit still good, operating performance prospects.
- Constrained, albeit still good, financial flexibility.

Rationale

The ratings on French protection institution AG2R Prévoyance (AG2RP), the main entity of the AG2R group (AG2R), reflect Standard & Poor's Ratings Services' view of its strong competitive position and good capitalization. Partly offsetting these factors are subdued, albeit good, operating performance prospects. Lower earnings will also dampen financial flexibility, which we view as good, however. The ratings on subsidiary PRIMA reflect its core status within AG2R.

We view AG2R's competitive position as strong. AG2R has sound positioning nationwide and in various economic sectors as a leading group protection and health insurer. Together, AG2R and La Mondiale form one of the leading life, accident, and health insurance groups in France.

In addition, AG2R's successful integration of other protection institutions has helped it increase sector and geographic spread. This long-standing presence in the French group-protection business has bolstered AG2R's expertise in its chosen market, in our view, and helped it reach the No. 2 position in France. However, we believe that AG2R's concentration in France and a high level of reinsurance partly offset its strong competitive position. We forecast AG2Rs gross premium written (GPW) to increase in 2012 and 2013 by a mid-single digit, mainly owing to growth in health business.

We view risk-adjusted capital adequacy as good. Despite a significant proportion of soft forms of capital, like the present value of future profits, we consider that AG2R's level of capital compares well with that of peers in the French market. A conservative quota-share reinsurance program relieves AG2R from a substantial portion of its capital requirements. We also view reserving as prudent.

We consider that increased claims on health and disability business and high costs related to the change in legal retirement age in France are hampering AG2R's efforts to improve its underwriting performance. Higher claims have prevented AG2R from meeting its underwriting earnings targets and will likely remain constraints on operating performance over the next two years. However, we expect AG2R to benefit from what we view as a strong and well-entrenched competitive position in its niches, allowing it to gradually improve its operating performance over the next two years. Consequently, our base-case scenario factors in our forecast that AG2R will post a non-life combined (loss and expense) ratio in the 112%-115% range in 2012, improving to less than 112% in 2013. AG2R's non-life business comprises health, accident, accidental death, disability, and worker's compensation insurance. We also expect the group's term-life business to boast a combined ratio of less than 70% over the same period. The expense ratio should continue to average 20%. These figures should translate into operating earnings of €25 million to €40 million yearly, all other factors remaining equal.

Increasing risks related to the investment portfolio are also weighing on AG2R's financial profile. We still consider the average credit quality of AG2R's investment portfolio strong, but at the lower end of the range according to our criteria. Credit risk increased during 2011 and 2012, dampening the quality of AG2R's investments. The proportion of equities in the portfolio remains below the French market average, but still adds to earnings volatility.

A more subdued earnings outlook also constrains the company's financial flexibility, which in our view is the main cause of AG2R's funding future needs.

Outlook

The stable outlook reflects our anticipation that AG2R's strong competitive position should help gradually improve its underwriting performance. It also factors in our belief that good capital adequacy will likely support the group's overall credit profile over the next one to two years.

We could lower the ratings if, over that period, AG2R's operating performance did not meet our underlying base-case assumptions. We could also lower the rating if capital adequacy weakened as a result of deteriorating investments, exceptional losses, or unfunded growth, or if AG2R's business profile were to weaken.

We could raise the ratings if the group's operating performance materially and sustainably exceeded our base-case forecasts, with equally prudent reserving, and if capital adequacy improved to levels more supportive of the ratings.

Corporate Profile: A Leading Protection Group In France

Since its creation in 1951, AG2R has managed compulsory pensions for French private-sector employees through the ARRCO and AGIRC pension schemes. It has also developed insurance activities--group and individual term life, group accident and health, individual health, and long-term care (LTC)--over the years. Compulsory pension contributions reached €7.8 billion in 2011, for which AG2R assumes no risk and acts as a fund manager and administrator, while insurance activities, for which AG2R carries the risk, accounted for €2.5 billion. Although they share workforce and administration means, the company's insurance and compulsory pension businesses are kept separate from a financial standpoint. In this analysis, we only focus on AG2R's insurance activities.

AG2R is part of the AG2R La Mondiale group. In January 2008, La Mondiale (BBB+/Negative/--) and AG2R created a "Société de Groupe d'Assurance Mutuelle" (SGAM), a French legal framework that allows mutual companies to create operational links and financial solidarity and act as groups.

With GPW of €1.4 billion in 2011, AG2RP (the rated entity) is a leading protection institution in France. It is the largest entity in the AG2R group and provides group term life and accident and health insurance to French private-sector enterprises. The subsidiary PRIMA provides individual insurance and is known mostly for its LTC products.

In addition to AG2RP and PRIMA, the group acts through numerous entities, mainly mutual companies specializing in individual health insurance.

AG2R's sales force includes 500 commercial employees. The group also distributes through brokers, but mainly through Arial, the joint venture with La Mondiale.

Competitive Position: Strong Expertise And The Leader In Group Protection Business

Table 1

AG2R Group Business Statistics					
	--Year ended Dec. 31--				
(Mil. €)	**2011**	**2010**	**2009**	**2008**	**2007**
Non-life: Gross premiums written	1,886	1,952	1,806	1,770	1,659
Annual change (%)	(3.4)	8.1	2.1	6.7	20.7
Life: Gross premiums written	593	748	874	730	777
Annual change (%)	(20.7)	(14.5)	19.8	(6.5)	9.5
Total gross premiums written	2,479	2,699	2,681	2,500	2,436
Annual change (%)	(8.2)	0.7	7.2	2.6	16.9
Non-life: Net premiums written	1,266	1,372	1,255	1,282	1,195
Annual change (%)	(7.7)	9.3	(2.1)	7.3	19.6
Life: Net premiums written	210	164	291	249	320
Annual change (%)	20.2	(43.6)	16.8	(22.2)	22.6
Total net premiums written	1,476	1,536	1,546	1,531	1,515
Annual change (%)	(3.9)	(0.7)	1.0	1.0	20.2

We view AG2R's competitive position as strong. We base our opinion on the company's acknowledged expertise and strong franchise in group protection business, and large local geographic and sector coverage. Concentration in France somewhat weakens the company's competitive position, as does reliance on reinsurance.

AG2R writes group-term and workers' compensation disability (WCD) insurance for 59 professional sectors and has access to a population of 6.5 million. It is the second largest protection group in France. In this business—which is generated through sectorwide agreements that set common protection coverage for all the employees in a sector--AG2R has substantial advantages over traditional insurers. These include its historical nonprofit orientation and its governance, based on "paritarisme". The company's strong expertise, developed through sectorwide agreements, also allows it to develop a comprehensive offer to large companies and small and midsize enterprises, which account for a sizable 60% of its premiums.

In addition, AG2R holds the No. 2 position and a 15% market share in group health insurance in France. AG2R's strong position in group WCD is a real advantage, since it enables the group to equip its clients with health coverage as well. AG2R also boasts a leading position in LTC, thanks to more than 20 years of experience in that segment through its subsidiary PRIMA.

At year-end 2011, overall GPW decreased by 6%, owing to decreasing premiums at Arial, a 50%-50% joint venture with La Mondiale specialized in group pensions and protection for large companies. Excluding Arial's GPW, subject to volatility, we expect AG2R's GPW to increase in 2012 by a mid-single digit, mainly through growth in health business.

AG2R's concentration in France exposes its business to changing regulation, such as increased tax on health and life business, and the change in retirement age in 2010. AG2R makes significant use of reinsurance, in our view, ceding approximately 33% of premiums. Its business position is therefore subject to the maintenance of good reinsurance conditions.

Management And Corporate Strategy: Focus On Organic Growth And Cost Control

We view AG2R La Mondiale's strategy as focused because it builds on the two groups' complementary expertise. AG2R's strategy is to maintain its position in the mature group protection market, while expanding in accident and health among other clients. This strategy is closely linked with that of La Mondiale, which aims to expand in its historical niches: pensions and savings. We view operational links between AG2R and La Mondiale as increasingly strong and likely to produce further synergies over time.

Strategy

AG2R's growth strategy mainly relies on organic growth and low-capital-intensive partnerships. The group may consider consolidating small protection institutions if the opportunity arises, particularly if it doesn't have high funding needs. AG2R and La Mondiale have had a joint strategic plan since 2009 and a common umbrella brand "AG2R La Mondiale." The current, three-year 2012-2014 plan focuses on client relationships and profitable growth. Nevertheless, we expect strategy to be less driven by growth targets than by capital and cost management.

Operational management

The AG2R-La Mondiale SGAM has one CEO and five deputy CEOs. The deputy CEOs are responsible for different business segments and support functions but they all cover both AG2R and La Mondiale. The SGAM has one executive committee and one board of directors. This recognizes the integration between the two groups' governance histories, while aiming at smoothly embedding the partnership in both cultures. The operational workforces operate by line of business (protection, savings, and pensions) at the SGAM level and share back office departments. In addition, distribution channels now operate under joint networks, for example, savings, convenience ("Réseau de Proximité"), and enterprises.

Financial management

We consider AG2R's financial management framework to be simple but prudent. The group manages its solvency with reference to the statutory Solvency I ratio, which it aims to maintain at more than 140%. More recently, the group has built internal tools based on Solvency II metrics to allow an assessment of its risk-adjusted capital adequacy, which we view as likely to facilitate its setting up of a risk-adjusted tolerance framework. The group uses embedded-value figures internally, as a comparative measure, but not for monitoring.

Enterprise Risk Management: Adequate

AG2R's enterprise risk management (ERM) is adequate, in our opinion, with an adequate risk management culture and adequate controls for the most significant risks. ERM is of moderate importance to the ratings, owing to AG2R's focus on group protection and health in one market, France. The ERM culture is adequate, in our view.

Jointly operated with La Mondiale, AG2R's risk management department produces risk reporting, supervises the effectiveness of risk controls, and coordinates risk-adjusted projects such as Solvency II. The department set up a risk committee in 2009, built a separate group risk management from the financial department in 2011, and is increasingly deploying efforts to spread the risk culture across the group. A recent risk-mapping exercise also illustrates the group's adequate risk culture. In our view, one of the main weaknesses of the department's ERM is the lack of an explicit risk tolerance framework.

Underwriting risk management is adequate, in our opinion, because AG2R sets explicit underwriting rules. The management of reserving risk is adequate, although it basically relies on standard methodologies, using industry morbidity and mortality tables. Reserving adequacy and methodologies are checked internally by the risk management department.

Market risk management is also adequate. AG2R has set up explicit limits on overall exposure to equities, property, and to individual issuers.

The lack of a consolidated modeling platform and an explicit tolerance framework, in our view, continue to prevent AG2R from performing strategic risk management.

Accounting: AG2R Reports Under IFRS Since 2009

AG2R reported under International Financial Reporting Standards (IFRS) for the first time in 2009 due to its partnership with La Mondiale, which has reported under IFRS since 2007. AG2R reported pro forma IFRS figures for the year ending 2008.

We base our views on the combined accounts of AG2R group, which comprises 18 legal entities, among them AG2RP, PRIMA, ISICA Prévoyance, INPCA, Primamut, and Prémalliance.

In our analysis of AG2R's operating performance, we consider, among other ratios, the non-life combined ratio, which relates to all the activities classified as non-life by the French insurance regulation (WCD, accidental death, health, and LTC). In most cases, WCD and group term life are sold under a group protection package, although group term is classified as life insurance under French regulation. There are cross subsidies between the two sections' underwriting earnings, and profit sharing with policyholders is determined on the basis of the aggregate underwriting earnings. The premium split between WCD and group term life generally does not reflect risk-based allocation. Consequently, we consider the performance of the group's protection segments as a whole and mostly use the accident and health combined ratio as an indicator of claims improvement or deterioration.

Operating Performance: Pension Reform And Increased Health Claims Will Likely Subdue Future Operating Performance

Table 2

AG2R Group Operating Statistics					
	--Year ended Dec. 31--				
(Mil. €)	**2011**	**2010**	**2009**	**2008**	**2007**
Non-life gross premiums written	1,886	1,952	1,806	1,770	1,659
Life gross premiums written	593	748	874	730	777
Retained earnings	6	(19)	40	4	63
Return on reported equity (%)	1.0	(2.9)	6.1	0.6	9.7
Non-life: Net loss ratio (%)	93.8	92.9	83.5	82.2	89.9
Non-life: Total net expense ratio (%)	17.5	22.0	23.4	18.3	15.3
Non-life: Net combined ratio (%)	111.2	114.9	106.9	100.5	105.1
Non-life: Gross combined ratio (%)	109	112.7	103.5	97.5	102.3
Life: Net acquisition expense ratio (%)	13.6	21.2	6.8	6.7	4.6

Although underlying earnings fundamentals remain good, we consider that AG2R's underwriting performance is still hampered by the effects of France's pension reform, which led to additional costs in 2011 and 2012. Our concerns are mitigated by management's actions to closely monitor expenses and increased profitability in other lines of business.

Overall, we view the accident and health segment's average combined ratio of 108% over the past five years as adequate owing to the long-term nature of underlying risks. Group term life and LTC provide good diversification and benefits from a strong loss ratio of respectively 50.2% and 55.2%.

The profitability of the group protection business is also generally limited by granular profit-sharing policies that restrict cross subsidies to the aggregate group level, thereby reducing this segment's access to surpluses. In addition, changes in legislation in health business and higher-than-expected claims have also hampered the loss ratio, which increased to 83.6% in 2011 from 76.6% in 2010. We expect both effects to continue to weigh on AG2R's combined ratio, although decreasingly, over the two coming years. Consequently, for our base-case scenario we factor in our forecast that AG2R will post a non-life combined ratio in the 112%-115% range in 2012, improving to less than 112% in 2013. We also expect the group's term-life business to boast a combined ratio of less than 70% over the same period. The expense ratio should continue to average 20%.

This should translate into operating earnings of €25 million to €40 million yearly, all other factors remaining equal.

Investments: Comparatively Limited Market Risk, But High Exposure To Credit Risk

Table 3

AG2R Group Investment Statistics					
	--Year ended Dec. 31--				
(Mil. €)	**2011**	**2010**	**2009**	**2008**	**2007**
Portfolio performance					
General account invested assets	3,568	3,505	3,802	3,489	3,243
Separate accounts/unit linked assets	866	881	842	797	948
High risk assets / Total invested assets (%)	13.1	15.1	9.2	10.7	11.6
Portfolio composition (book value)					
Investment in affiliates (%)	0	0	0	0.8	0.9
Bonds and other fixed-interest securities (%)	79.8	78.7	86	84.9	85.4
Equities and other variable-interest securities (%)	6.6	7.4	6.1	7.8	7.8
Property (%)	6.5	7.7	3.1	2.1	2.2
Cash and bank deposits (%)	2.3	2.2	2.0	4.3	2.9
Other investments (%)	4.8	4.0	2.9	0.1	0.8

We view AG2R's investment profile as good, thanks to manageable credit risk and comparatively limited market risks compared with other French insurers'. However, we consider that a legacy of high exposure to hybrid and senior debt hampers the quality of the company's investments.

Credit risk

The average rating of the bond portfolio is 'A-', slightly down from a year ago with 83% of the bonds rated 'A-' or higher and 30% rated 'AAA' as of year-end 2011. The strong credit quality of the bond portfolio is somewhat mitigated by a significant proportion of fixed-income instruments (17%) invested in financial institutions' subordinated debt securities, 63% of which are rated 'BBB' or higher and issued by multiple banks.

Market risk

We consider market risk to be manageable, with the share of equities lower than market average at 7.6% of investments at year-end 2011. The equity holdings are well diversified by sector and geography. Real estate allocation reflects the market average at about 6% of investments.

Interest rate risk

AG2R's interest rate risk arises mainly from the long-tail LTC business and is managed through the substantial investment in fixed-income bonds.

Liquidity: Strong Balance Sheet Liquidity

AG2R's liquidity is strong, in our opinion, with aggregate outgoings largely covered by premium income both before and after accounting for reinsurance transfers. Should any cash needs arise, AG2R's investment assets are highly marketable and could provide additional liquidity.

Capitalization: Good And Resilient Despite Higher Credit Risk And Lower Interest Rates

We consider capitalization to be good, with good risk-based capital adequacy and good quality of capital.

Capital adequacy

According to our risk-based capital model, capital adequacy is good and shows good resilience despite lower interest rates, dampening the impact of the loss reserve discount, lower average credit ratings on investments, and increasing credit risk charges. The quality of capital is also good, with 47% of the total adjusted capital (TAC) made up of core surpluses. As part of the TAC, we include the present value of future profits, after a downward adjustment of 30%.

Reserving

We view AG2R's reserves as adequate. AG2R uses conservative assumptions in setting case and incurred but not reported reserves, as shown by the consistently favorable reserve development in the WCD segment. AG2R increased its reserves in 2010 following the change of the legal retirement age to 62 from 60 years. Possible reserve reinforcements related to such change might still occur, but we view their likely impact on the rating as manageable.

Reinsurance

We believe AG2R's external reinsurance program is conservative, owing to the mix of per-risk and per-event excess-of-loss coverage for WCD, death, and catastrophe risk. Reinsurer counterparty risk is mitigated by a policy of limiting cessions by reinsurer and by the reinsurers' strong credit quality. Most of the meaningful reinsurers are rated higher than 'A+'.

Financial Flexibility: Adequate Relative To Needs, But Weakened By A Limited Number Of Capital Sources

Table 4

AG2R Group Financial Statistics					
	--Year ended Dec. 31--				
(Mil. €)	**2011**	**2010**	**2009**	**2008**	**2007**
Total assets	5,793	5,689	5,828	5,476	5,386
Reinsurance utilization ratio (%)	40.5	43.1	42.3	38.8	38.0

AG2R's capital needs stem principally from organic growth, which we expect the group will monitor relative to its funding abilities.

Financial flexibility is underpinned by relatively low subordinated debt on the balance sheet, with total debt to TAC limited to 4%. Also, we view AG2R's ability to increase premiums if needed as a positive element to financial flexibility.

The current financial-solidarity terms with La Mondiale limit potential capital relief through fund transfers, debt, and reinsurance to 10% of the lending group's net assets. Our opinion is that these terms, in their current format, are unlikely to significantly enhance AG2R's financial flexibility.

Finally, despite a debt-free balance sheet, we believe AG2R's ability to issue subordinated debt is still limited. AG2R's key source of financial flexibility remains, in our opinion, its earnings retention abilities.

Related Criteria And Research

- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Interactive Ratings Methodology, April 22, 2009
- Group Methodology, April 22, 2009

Ratings Detail (As Of December 27, 2012)	
Operating Company Covered By This Report	
AG2R Prevoyance	
Financial Strength Rating	
Local Currency	BBB+/Stable/--
Counterparty Credit Rating	
Local Currency	BBB+/Stable/--
Domicile	France

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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