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Research Update:

French Protection Institution AG2R Prevoyance Downgraded To 'BBB+' On Weaker Underwriting Performance; Outlook Stable

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Overview

- Increasing claims and higher costs related to France's reform of the legal retirement age are dampening AG2R Prevoyance's efforts to improve its underwriting performance.
- Furthermore, increasing credit risk in AG2R's investment portfolio is weighing on its financial profile.
- We are consequently lowering our ratings on AG2R and its subsidiary PRIMA to 'BBB+' from 'A-'.
- The stable outlook reflects our anticipation that AG2R's strong competitive position should help gradually improve its underwriting performance and that good capital adequacy will likely support AG2R's overall credit profile over the next one to two years.

Rating Action

On Dec. 4, 2012, Standard & Poor's Ratings Services lowered its long-term counterparty credit and insurer financial strength ratings on French protection institution AG2R Prevoyance and its subsidiary PRIMA to 'BBB+' from 'A-'. The outlook is stable.

Rationale

The downgrade reflects our opinion 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.

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 group in France. 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. 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 to be 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 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.

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.

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.

Related Criteria And Research

- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Interactive Ratings Methodology, April 22, 2009

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
AG2R Prevoyance		
PRIMA		
Counterparty Credit Rating	BBB+/Stable/--	A-/Negative/--
Financial Strength Rating	BBB+/Stable/--	A-/Negative/--

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