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Research Update:

French Insurers AG2R And La Mondiale Long-Term Ratings Raised To 'A-' On Stronger Integration; Outlook Stable

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Overview

- The fungibility of capital between French insurers AG2R Prévoyance and La Mondiale has improved, thanks to an increase in financial solidarity in 2015 and the high likelihood that the combined group, AG2R La Mondiale, will be regulated as a prudential group under the EU's Solvency II Directive.
- In addition, we expect that the group's more cautious risk management is helping to build buffers to mitigate the impact of low interest rates.
- We are therefore raising our long-term ratings on AG2R Prévoyance and La Mondiale to 'A-' from 'BBB+'.
- The stable outlook on both entities indicates that we expect the group to continue its integration efforts and to maintain consolidated capital adequacy at levels close to our 'A' benchmark.

Rating Action

On Oct. 19, 2015, Standard & Poor's Ratings Services raised its long-term counterparty credit and financial strength ratings on AG2R Prévoyance, La Mondiale, and Prima--core entities of French insurance group AG2R La Mondiale (AG2R LM)--to 'A-' from 'BBB+'. The outlooks are stable. At the same time, we also raised our long-term issue ratings on La Mondiale's subordinated debt to 'BBB' from 'BBB-'.

Rationale

The upgrade reflects our view that further integration between AG2R LM's subgroups, AG2R Prévoyance and La Mondiale, has increased the fungibility of their capital. We also consider that AG2R LM's merger with Protection Institution Réunica provided the group with further solvency buffers, and placed the group in a better position to weather the multiple changes in the French health and protection markets. In addition, we believe that a more cautious approach to risk management should help the group's resilience to the negative impact of low interest rates. These changes have led us to revise the group credit profile (GCP) upward to 'a-' from 'bbb+'.

The SGAM-AG2R LM general assembly voted in May 2015 to increase the automatic solidarity links between AG2R Prévoyance and La Mondiale to 30% of shareholders' equity from 10%. The Réunica group's integration with AG2R

Prévoyance has also increased equity by about €800 million, improving the AG2R subgroup's leeway to support La Mondiale in case of need. We also consider it highly likely that the French regulator will assess AG2R LM as a "prudentially regulated group", once AG2R LM finalizes the integration of the governance framework of all its affiliates. Notably, this would allow greater use of internal reinsurance to balance capital needs between the subgroups.

AG2R LM's risk management is taking steps to mitigate the negative impact of low interest rates. La Mondiale significantly strengthened policyholder profit-sharing reserves and lowered its appetite for volume growth, and is gradually its changing product mix toward one that is more unit-linked. In the first half of 2015, La Mondiale's premiums declined by 17.5% compared with 2014, but this included 11% growth in unit-linked contracts against a 26% fall in premium from traditional life insurance. We also observe that the investment in higher-risk assets (equities, real estate, speculative-grade bonds, and loans) has slightly declined relative to AG2R LM's consolidated capital base.

We also believe AG2R LM is better placed to manage the reshuffle in the health and protection sector from the Accord National Interprofessionnel (ANI). Although the liberalization of the insurer selection process for group term and disability coverage is virtually opening the doors to all insurers, the introduction with the ANI of mandatory group health coverage for small companies in 2016 creates compensating effects. In particular, we believe that AG2R Prévoyance's capacity to offer competitively priced packages that combine several types of coverages in a single relationship remains an attractive option for very small companies. In addition, we observe that AG2R has begun to reduce the high loss ratios in group protection through portfolio restructuring and price increases and expect AG2R to pursue this trend in the next three years.

We expect AG2R LM's capital and earnings to be in the moderately strong range in the next two years, with a risk-adjusted capital adequacy remaining below, but close to, the 'A' benchmark, according to our methodology. Our base-case assumptions include a very modest rise in long-term government bond yields by the end of 2016, and total internal capital generation of €0.7 billion-€0.9 billion over 2015-2017, in addition to the benefits of the integration of Réunica. We expect growth in risk-based capital requirements of about 4%-5% per year. We also anticipate La Mondiale will maintain significant policyholder bonus reserves after strengthening them in the first half of 2015.

We continue to consider that AG2R LM is more sensitive than its peers to changes in interest rates due to its higher share of guaranteed long-term pension liabilities, which represent about 25% of technical reserves (including policyholder participation reserves). We consider, however, that the limited portion of the pension liabilities that carry high guarantees and strategic risk management actions that AG2R LM is taking to limit the growth of guaranteed commitments partially mitigates the sensitivity to low interest rates.

Outlook

The stable outlook indicates that we expect AG2R LM will finalize the steps to become a prudentially regulated group and maintain consolidated capital adequacy close to the 'A' benchmark. We also expect that AG2R will continue to restore its technical profitability and that La Mondiale will continue to take action to reduce its sensitivity to low interest rates.

Downside scenario

We could lower the ratings over the next two years if:

- AG2R LM's capital adequacy unexpectedly deteriorated to levels materially below the 'A' benchmark for a sustained period, for example due to lower long-term bond yields than we currently assume in our base case, more aggressive volume growth than expected, or higher asset risk; or
- The profitability of the group's protection and health insurance markedly deteriorated as a result of stiffer competition or adverse developments in market dynamics, causing the group to miss its earnings targets.

Upside scenario

The upside potential to the ratings is remote in the next two-to-three years, in our view, as it would rely on the group materially strengthening capital adequacy or significantly modifying its product mix.

Ratings Score Snapshot

| | To | From |
|----------------------------|-------------------|-------------------|
| Financial Strength Rating | A-/Stable | BBB+/Positive |
| Group credit profile | a- | bbb+ |
| Anchor | a- | a- |
| Business Risk Profile | Strong | Strong |
| IICRA | Low Risk | Low Risk |
| Competitive Position | Strong | Strong |
| Financial Risk Profile | Upper Adequate | Upper Adequate |
| Capital and Earnings | Moderately Strong | Moderately Strong |
| Risk Position | Moderate Risk | Moderate Risk |
| Financial Flexibility | Adequate | Adequate |
| Modifiers | 0 | -1 |
| ERM and Management | 0 | 0 |
| Enterprise Risk Management | Adequate | Adequate |
| Management and Governance | Satisfactory | Satisfactory |
| Holistic Analysis | 0 | -1 |
| Liquidity | Exceptional | Exceptional |

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria And Research

Related Criteria

- Insurers: Rating Methodology, May 7, 2013
- Group Rating Methodology, November 19, 2013
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Related Research

- Outlooks On French Insurers AG2R And La Mondiale To Positive On Likely Stronger Integration Benefits; 'BBB+' Affirmed, Nov. 21, 2014

Ratings List

Upgraded; CreditWatch/Outlook Action

| | To | From |
|----------------------------|--------------|------------------|
| AG2R Prevoyance PRIMA | | |
| La Mondiale | | |
| Counterparty Credit Rating | A-/Stable/-- | BBB+/Positive/-- |
| Financial Strength Rating | A-/Stable/-- | BBB+/Positive/-- |
| La Mondiale | | |
| Junior Subordinated | BBB | BBB- |

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