FITCH UPGRADES ETHIAS S.A.'S IFS TO 'BBB+'; OUTLOOK STABLE

Fitch Ratings-London-27 June 2017: Fitch Ratings has upgraded Ethias S.A.'s Insurer Financial Strength (IFS) Rating to 'BBB+' from 'BBB' and Long-Term Issuer Default Rating (IDR) to 'BBB' from 'BBB-'. The Outlooks are Stable. A full list of rating actions is at the end of this commentary.

The upgrades reflect the completion of Ethias's recovery plan in May 2017 and resulting strengthening of capital profile and reduced exposure to interest rate risk. Ethias is planning further actions aimed at strengthening its capital position, although these may negatively impact profitability in 2017.

KEY RATING DRIVERS
The ratings reflect Ethias's strong capital position, as indicated by Fitch's Prism FBM, good profitability, albeit potentially volatile, and strong franchise in Belgium. Offsetting these factors are Ethias's moderate exposure to interest rate risk, and the reliance of its parent company, Vitrufin, on Ethias for funding the payment of interest and principal on its EUR278 million debt. This is likely to exert pressure on Ethias's capital and cash flow over the next two years.

On 12 May 2017 Ethias announced the completion of the recovery plan that it initiated in October 2016, following a request by the National Bank of Belgium (NBB). The plan comprised strengthening its capital position and reducing the sensitivity of its Solvency II coverage ratio to low interest rates. We expect one further measure outlined by the NBB, financial reinsurance on credit spreads of corporate bonds, to be carried out in 2017. Ethias also integrated Whestia, a small insurance subsidiary, at end-June 2017, marginally benefiting Ethias's solvency position.

The recovery plan included measures to reduce Ethias's exposure to interest-rate risk associated with the capital-intensive 'First A' products, under which guarantees are paid until the policyholder reaches the age of 99. The main measure, a 'Switch VI' offer, where customers were offered a 25% premium on contract value in case of surrenders marked another step in Ethias's efforts to reduce the amount of contracts related to First A products. Since 2014, around 80% of reserves related to these products have been redeemed by policyholders.

Ethias launched a new 'Switch VII' offer on 29 May 2017, offering policyholders of First A products a financial incentive to redeem their contracts. If the offer is successful, Ethias's capital profile is likely to further improve in 2017. The offer closes on 7 July 2017. In addition, Ethias is in discussion with potential buyers for the remaining part of the First A portfolio. The disposal may come at a cost, but it would contribute to significantly reducing Ethias's exposure to interest rate risk.

Ethias has a strong but still volatile capital position, reflecting its exposure to interest-rate risk. At end-2016, Ethias's group regulatory Solvency II ratio was 146%, excluding transitional arrangements. It improved to 157% in 1Q17 following data enhancements. Ethias targets a Solvency II ratio of 150%. Fitch's Prism FBM score for Ethias was 'Strong' based on end-2016 data, after deduction of the Vitrufin debt (2015: 'Strong'). Ethias's financial leverage (FLR) ratio, including Vitrufin's debt, was 28% at end-2016 (2015: 33%).

Vitrufin relies on Ethias for dividends to pay the interest and principal on its EUR278 million debt, which matures in January 2019. Ethias has historically pre-funded all interest expenses related to the Vitrufin debt via dividend payments that are deducted from Ethias's solvency capital. In 2018, Ethias plans to pay further dividends of EUR278 million (EUR45 million ordinary dividend on 2017 result and EUR233 million as a dividend in account on 2018 result) to Vitrufin.

Ethias's IFRS net income was EUR424 million in 2016, after a profit of EUR638 million in 2015 and a significant loss in 2014 of EUR598 million. Despite the profit in 2016, Ethias's financial performance is sensitive to interest-rate changes and can be volatile.

Fitch estimates that the Switch VII offer could cost Ethias up to EUR150 million, depending on the acceptance rate. Further, the announced intention to dispose the remaining First A reserves could result in a one-off loss for Ethias. This would negatively impact profitability in 2017, despite being positive for Ethias's capital profile.

Ethias is exposed to interest-rate risk as life technical liabilities are subject to relatively high minimum guaranteed returns. However, Fitch views this risk to be reducing as liabilities reduce. Therefore, the agency places limited reliance on the duration gap between assets and liabilities, despite the potential for it to increase with changes in business mix.

RATING SENSITIVITIES
The ratings could be upgraded on redemption of Vitrufin's debt and if Ethias's Prism score remains at least "Strong", the Solvency II ratio above 150% and FLR below 25%.

The ratings are likely to be downgraded if Ethias's Prism FBM falls to "Adequate" or FLR increases to above 35%.

FULL LIST OF RATING ACTIONS

Ethias S.A.:
IFS Rating upgraded to 'BBB+' from 'BBB'; Outlook Stable
Long-Term IDR upgraded to 'BBB' from 'BBB-'; Outlook Stable
Undated subordinated debt upgraded to 'BB+' from 'BB'
Dated subordinated debt upgraded to 'BB+' from 'BB'

Ethias Droit Commun AAM:
IFS Rating upgraded to 'BBB+' from 'BBB'; Outlook Stable

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Additional information is available on www.fitchratings.com

Applicable Criteria
Insurance Rating Methodology (pub. 26 Apr 2017)
https://www.fitchratings.com/site/re/897260