

Ethias SA

Full Rating Report

Ratings

Ethias SA

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

Sovereign Risk

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

Outlooks

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

Financial Data

Ethias SA (Consolidated IFRS)

(EURm)	2017	2016
Total equity	2,521	2,305
Total assets	18,755	19,499
Net income	161	424
Gross written premiums	2,440	2,406
Solvency II ratio (%) ^a	205	146

^a 183% taking into account a dividend payment of EUR268 million to repay Vitrufin's senior loan in January 2019

Source: Ethias, annual report 2017

Key Rating Drivers

Outlook Positive: Ethias SA's Positive Outlook reflects Fitch Ratings' view that the likely full repayment of Vitrufin debt and the full disposal of the insurer's capital-intensive individual life portfolio will lead to a strengthening in Ethias's capitalisation, profitability and financial flexibility.

Improving Credit Profile: The ratings reflect Ethias's strong capital position, good profitability and sound business profile in Belgium. These strengths are counterbalanced by a moderate, albeit reducing, exposure to interest-rate risk, and the reliance that parent company Vitrufin places on Ethias for funding, through dividends, the payment of interest and principal on its EUR278 million debt maturing in January 2019.

Parent Loan Repayment Likely: Ethias paid EUR150 million dividends to Vitrufin in May 2018 related to its 2017 net income and plans to pay another EUR118 million in 2H18 as an interim dividend on its 2Q18 (or 3Q18) earnings. Fitch understands that Vitrufin is bound by the terms of the loan agreement to allocate Ethias's dividends in priority to repay the loan.

'First A' Disposal Credit Positive: Ethias has been running down its capital-intensive First A retail life reserves since 2010. Ethias announced the sale of its remaining First A portfolio (EUR189 million) in April 2018. The sale which was accounted for in 2017 has a positive effect on Ethias's risk-adjusted capital profile and duration gap.

Strong Capitalisation: Fitch expects Ethias's capitalisation to benefit from the normalisation of its dividend policy due to earnings retention from 2019. The volatility of its capital position has diminished via a reduction in the company's interest-rate risk exposure. At end-2017, Ethias's Solvency II (S2) margin, which excludes transitional arrangements and dividends, improved to 205% from 146% at end-2016. It has a 'Very Strong' score under Fitch's Prism Factor-Based Capital Model (Prism FBM) at end-2017, after deduction of the EUR268 million dividends.

Moderate Leverage: Ethias's financial leverage ratio (FLR) was stable at 20% at end-2017. If the EUR268 million dividends are deducted from the company's end-2017 equity, the ratio would be 22%. Fitch expects the ratio to remain broadly stable at end-2018.

Good Profitability: Ethias's underwriting performance is driven by the non-life business, whose profitability remains strong as demonstrated by a reported net IFRS combined ratio of 87.7% at end-2017. Nevertheless, the cost of the 2017 "Switch" operations (EUR109 million) and the First A sale (EUR106 million) drove return on equity (ROE) down to 6.7% at end-2017 from 20.7% at end-2016. Fitch expects earnings in 2018 to be less affected by non-recurring items and be more reflective of consistent technical results.

Reduced Duration Gap: Ethias has significantly reduced its exposure to interest-rate risk, resulting from historically high minimum guaranteed returns on life technical liabilities. Fitch views Ethias's investment policy as prudent. The overall risk profile of the investment portfolio remains a rating strength.

Rating Sensitivities

Upgrade on Debt Repayment: The ratings could be upgraded on redemption of Vitrufin's debt, provided that Ethias's Prism FBM score is at least "Strong", its S2 ratio is above 150% and FLR is below 25%.

Downgrade Unlikely: A downgrade is unlikely in the near term, but could occur if Ethias's Prism FBM score falls to 'Adequate' and the FLR rises over 35%.

Related Research

Belgian Insurance Dashboard – FYE2017 (March 2018)

Analysts

Manuel Arrivé, CFA
+33 1 44 29 91 77
manuel.arrive@fitchratings.com

Stephane Vago
+44 20 3530 1336
stephane.vago@fitchratings.com

Business Profile

Strong Position in Domestic Market

- Strong business position, concentration in Belgium
- Commitments to authorities fulfilled
- Full divestiture of First A life insurance contracts completed
- Efficient direct sales distribution

Strong Business Position, Concentration in Belgium

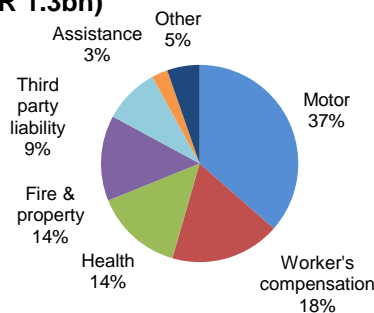
Ethias is active almost exclusively in the Belgian insurance market, where it has a strong position. It is the fourth-largest insurer in the country by gross written premiums (GWP) in 2016, with a 9% market share for all activities combined and 7.4% in life and 11.1% in non-life. Ethias is a direct insurer and the leading insurer in the public sector.

Ethias’s main clients are individuals and Belgian public authorities, such as regions, communities, provinces, the federal state of Belgium, cities and municipalities, schools and hospitals, but also private companies.

Life products comprise pension insurance and group insurance. Ethias is particularly active in the management of the first and second pillar pension schemes in the public sector. In 2017, Ethias launched a multi-employer pension fund to expand its pension offering. Non-life insurance services such as motor, household, workers’ compensation and health insurance are also offered to all client types.

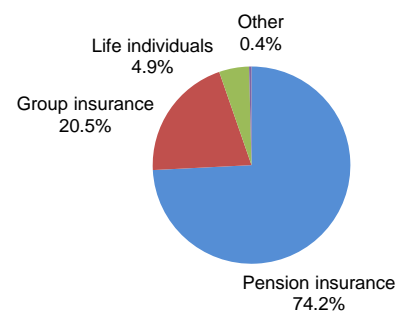
Ethias’ GWP increased by a modest 1.4% to EUR2.44 billion in 2017, driven by non-life. Life premium remained flat as the individual life portfolio is in run-off and low interest rates curtail growth of group-life portfolios. In non-life, new business in the private sector was the main driver of growth. Non-life business remains well diversified (see chart on the left).

2017 Non-Life Premium Mix: (EUR 1.3bn)



Source: Ethias, Fitch

2017 Life Premium Mix: (EUR 1.1bn)



Source: Ethias, Fitch

Commitments to Authorities Fulfilled

The European Commission confirmed in June 2017 that Ethias had fulfilled commitments imposed by the Commission, following the Belgian authorities’ EUR1.5 billion recapitalisation of the company via the investment vehicle, Vitrufin, in 2008. Ethias’s restructuring plan and associated commitments included the run-down of the retail life portfolio (so called “First A” products) and an improvement of underwriting performance.

Similarly, the National Bank of Belgium (NBB) considered in 2017 that the Ethias’s recovery program could be considered completed.

Related Criteria

Insurance Rating Criteria (November 2017)

Full Divestiture of ‘First A’ Life Insurance Contracts Almost Completed

Ethias has been running down its First A retail life reserves since 2010 to reduce its sensitivity to interest rates and improve its solvency margins. Ethias successfully conducted several “Switch” surrender offers between 2015 and 2017, whereby First A policyholders were given a financial incentive to redeem their contracts. The remaining First A portfolio (EUR189 million) was sold to Laguna Life, the Irish subsidiary of Monument Re Limited, in April 2018. The sale is subject to regulatory approval and is expected to close by year-end 2018.

Efficient Direct Sales Distribution

Ethias distributes almost all 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. Ethias has started a large-scale technological and organisational transformation to enhance the sales process and client experience.

Corporate Governance and Management

Corporate governance and management are effective and neutral to the ratings. Corporate governance was enhanced in 2017, with changes brought to the Board of Directors to be consistent with age limits, linguistic and gender parity objectives. The board consists of 16 members including 12 non-executive directors.

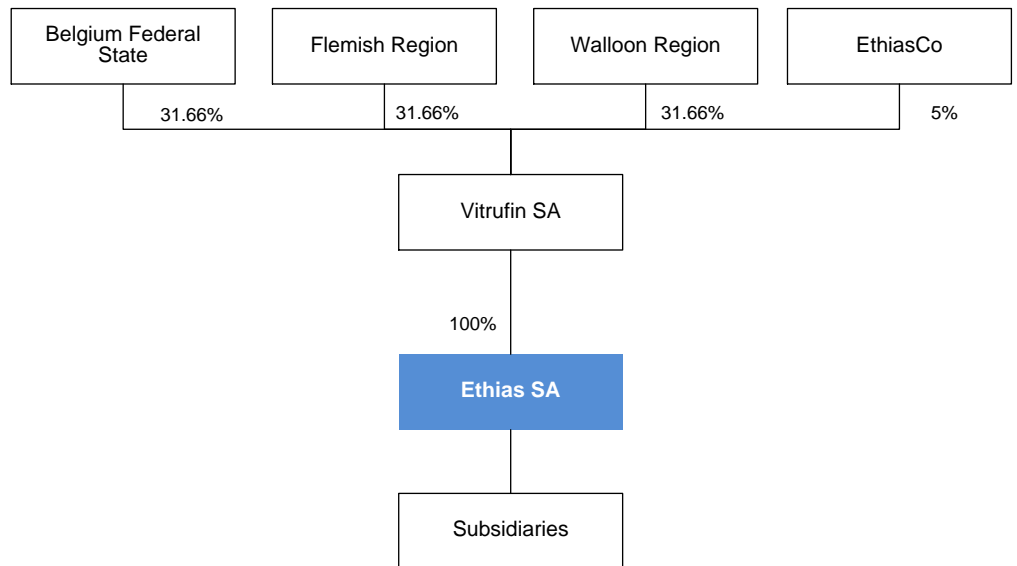
Ownership Is Neutral to Rating

Ethias 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 95%.

The capital structure of Vitrufin was simplified in 2017, leading to a decrease of EthiasCo1 (formerly Ethias Droit Commun) share from 25% to 5%. Ethias acquired the “Workers Compensation 1967” portfolio of Ethias Droit Commun for EUR1.5 million.

Fitch believes that the Belgian authorities would provide additional support to the group should the need arise. On 12 May 2017, Ethias’s shareholders agreed to maintain the current shareholding structure for another two years. However, the rating is based on the company’s standalone profile and does not factor in any potential state support.

Structure Diagram



Source: Ethias

¹ EthiasCo is a cooperative company, which manages investments in affiliates. It was formally Ethias Droit Commun AAM which changed its legal form in December 2017, following the transfer of its insurance business to Ethias SA.

Sovereign and Country-Related Constraints

Fitch rates the sovereign obligations of Belgium at 'AA-' with a Stable 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 insurance organisations and other corporate issuers in Belgium are not likely to be constrained by sovereign or macroeconomic risks.

Industry Profile and Operating Environment**Mature Market, Under Pressure**

Belgium is a mature insurance market but the life and non-life markets show different dynamics. Fitch estimates total premiums to have remained broadly stable at EUR27 billion at end-2017, of which around 55% relates to life insurance, mostly savings.

We expect the Belgian life and savings insurance market to have continued contracting in 2017. Lower sales in guaranteed products were only partially offset by higher unit-linked sales. By contrast, we expect the non-life market to have continued growing at a slow pace, in line with previous years and with Fitch's forecast for real GDP growth of 1.7% in 2017. An improved, albeit competitive, operating environment supported growth.

Life Earnings Constrained

The Belgian life market faces a difficult operating environment, as persistent low interest rates constrain profitability and product offerings. Life insurers responded by either limiting or stopping sales of traditional guaranteed products, while pushing sales of unit-linked contracts (estimated at 16% of total life insurance premium and 11% of assets in 2017). We believe that declining average guaranteed rates for new life insurance contracts will continue to damp demand for guaranteed products throughout 2018. The potential additional growth in unit-linked premiums will only partially offset the decline in guaranteed products' premiums.

Non-Life Market Resilient

The Belgian non-life market continues to grow at a slow pace. Benign claims experience in 2017 (in contrast with large losses in 2016 due to terrorist attacks and flooding), coupled with some tariff increases (despite competitive pressures), supported margins and improved combined ratios in 2017. Fitch expects non-life premiums to increase in line with GDP in 2018 and profitability to remain resilient with an aggregate combined ratio between 90% and 95%, assuming a normal level of weather-related claims and maintenance of pricing discipline.

Adequate Capitalisation

Belgian insurers remain adequately capitalised under S2, although their S2 ratios can be sensitive to changes in interest rates and coverage of solvency capital requirements (SCR) is below European peers (192% vs 239% as at end-September 2017). Insurers do take advantage of transitional measures to cover their SCR.

Peer Analysis

Strong Profitability and Underwriting Result, Moderate Capitalisation

Ethias's peers are the medium-to-large Benelux composite insurers (see peer table below). We also added Reale Mutua, a medium-size composite Italian insurer. Those insurers have limited exposure to non-domestic markets (except AG Insurance through Ageas).

Ethias's underlying profitability, as measured by combined ratio, was the strongest out of peers in 2017, as it was in the previous two years. Its profitability, as measured by return on equity, is in line with peers, despite one-off costs incurred in 2017.

Ethias's capitalisation has improved relative to peers over the past few years and its financial leverage ratio has remained comparable to those of other Benelux insurance companies.

Peer Comparison – 2017

Company	IFS Rating/Outlook	Total Assets (EURm)	Total equity (EURm)	IFRS profit (EURm)	Return on assets ^a (%)	Combined ratio (%)	Return on equity ^b (%)	Financial leverage ratio (%)	Solvency II ratio (%)
Ethias	BBB+/Positive	18,775	2,521	161	0.8	87.7	6.5	21	205
AG Insurance	A+/Stable	75,380	7,060	583	0.8	91	8.9	22 ^c	229
Reale Mutua	BBB+/Stable	20,013	2,579	148	1.1	98	6	0	202
VIVAT	BBB+/Evolving	56,566	3,547	-116	-0.2	99	-3.2	25	162

^a Group net income/2016-2017 average total assets

^b Group net income/2016-2017 average group shareholders' equity

^c 2016 leverage

Source: Companies, Fitch

Capitalisation and Leverage

(EURm)	2013	2014	2015	2016	2017	Fitch's expectation
Total equity	1,786	1,198	1,869	2,305	2,521	Fitch expects Ethias' capitalisation to stabilise because of a lower exposure to interest-rate risk and a more-stable dividend policy.
Group regulatory solvency I ratio (IFRS - %)	185	146	224	n.a.	n.a.	
Regulatory solvency I ratio (BGAAP - %)	190	179	179	n.a.	n.a.	
Group Solvency II	n.a.	n.a.	132 ^a	146 ^a	205 ^b	
Financial leverage ratio (%)	18	27	25	20	20	
Net written premiums to equity (non-life) (x)	0.7	1.0	0.7	0.6	0.5	
Operating leverage (life) (x)	7.9	12.8	6.7	4.8	3.9	

^a Excluding transitional arrangements
^b 183%, after all 2018 EUR268 million dividends
^c 22%, after all 2018 EUR268 million dividends
 Source: Ethias IFRS annual reports, Fitch

Strong but Volatile Capital Position

- Improving regulatory capital
- “Very Strong” Prism score
- Moderate financial leverage

Improving Regulatory Capital

Fitch considers Ethias group’s regulatory capitalisation to be strong. At end-2017, Ethias group S2 ratio was 205%, excluding transitional arrangements (146% at end-2016). The S2 ratio improved by 18pp following the surrender of EUR432 million First A contracts related to the “Switch VII” operation of May 2017. The company’s profitability and LACDT² contributed to the S2 margin by 22% and 16%, respectively.

If the payment of dividends to Vitrufin in 2018 (EUR268 million in total) are deducted, Solvency 2 margin is 183%. Ethias paid EUR150 million dividend to Vitrufin in May 2018 and plans to pay the balance as an interim dividend in 2H18.

“Very Strong” Prism Score

Ethias’ score based on year-end 2017 results in Prism FBM is “Very Strong”, after deduction of the dividends to be paid to Vitrufin in 2018 (EUR268 Million in total). The Prism score has improved since 2014, when it was “Somewhat Weak” because of the high guarantee on the retail life products that Ethias has been offloading since then. The further reduction of the amount of First A reserves in 2017 (following the Switch VII operations), was beneficial for the Prism FBM score.

Ethias capital profile at end-2018 should further benefit from the complete removal of First A reserve and reduced interest rates sensitivity. In addition, capitalisation will benefit from the normalisation of Ethias dividend policy (target 50% dividend pay-out ratio) from 2019 onwards, as the exceptional dividend payments of 2018 are unlikely to be repeated.

Moderate Financial Leverage

Ethias’ debt leverage was unchanged at 20% at end-2017. If EUR268 million dividends are deducted from the end-2017 equity, the ratio is 22%. Fitch expects the ratio to remain broadly stable at end-2018.

² National Bank of Belgium allows the SCR level to be reduced by deferred taxes (LACDT, or loss absorbing capacity of deferred taxes.), in accordance with Solvency II Regulation.

Debt-Service Capabilities and Financial Flexibility

(x)	2013	2014	2015	2016	2017	Fitch's expectation
Fixed-charge coverage ratio (incl. realised and unrealised gains)	21	-42	37	18	9	Fitch expects fixed-charge coverage to remain adequate but volatile in line with profitability. The company's financial flexibility largely relies on Belgian public authorities. Fitch expects Ethias's financial flexibility to improve, once it has paid the required dividends to redeem Vitrufin's senior debt, as planned.
Fixed-charge coverage ratio (excl. realised and unrealised gains)	16	-48	36	16	5	

Source: Ethias IFRS annual reports, Fitch

Adequate Financial Flexibility, Reliant on Belgian Public Authorities

- Holding company's debt repayment on track
- Volatile fixed-charge coverage
- External support likely if needed

Holding Company's Debt Repayment on Track

In 2012, Ethias' parent company Vitrufin issued debt to buy Dexia shares from Ethias. However, Vitrufin has been relying on Ethias for dividends to pay the interest and principal on its EUR278 million senior loan maturing in January 2019. Dividend payments are conditional on the regulatory S2 ratio being at least 100% to limit the financial drag from the holding company.

The table on the left shows how the Vitrufin loan will be repaid. In 2017, Ethias paid out EUR45 million dividends, related to its 2016 net result, to pay for the residual coupons on the Vitrufin loan.

Volatile Fixed-Charge Coverage

Ethias's fixed-charge coverage is adequate, but can fluctuate in line with financial performance. The fixed-charge coverage ratio has declined since 2015, in line with decreasing pre-tax operating earnings (including gains and losses) as calculated by Fitch.

External Support Likely if Needed

Fitch believes that the Belgian authorities would provide additional resources should the need arise. Our view reflects the authorities' majority ownership of the company until at least May 2019³, and Ethias's provision of insurance to Belgian public organisations and their employees.

Vitrufin's EUR278M Senior Loan Repayment in Jan 19

Sources	Amount (EURm)
Dividends (FY17 earnings) 2018	150 (paid in May 2018)
Dividends (FY18 earnings) 2H18	118 ^a (to be paid in 2H18)
Vitrufin assets	10

^a Advance on 2018 dividends, based on expected earnings as at 30 June 2018 (or 30 September 2018).

Sources: Ethias, Fitch

³ On 12 May 2017, Ethias's shareholders agreed to maintain the current shareholding structure for another two years.

Financial Performance and Earnings

(EURm)	2013	2014	2015	2016	2017	Fitch's expectation
Net income (after minorities)	325	-604	633	424	158	Fitch expects Ethias to maintain strong non-life underwriting results and continue improving its life operational results. Fitch also expects earnings to be less volatile than in the past as life results are becoming less sensitive to interest rates movements.
Net combined ratio (IFRS) (%)	90.8	89.2	86.1	89.4	87.7	
Net income return on equity (%)	21.1	-41.8	42.4	20.7	6.7	
Pre-tax operating return on assets (excl unrealised gains) (%)	1.3	-4.0	3.5	2.5	0.8	
Pre-tax operating return on assets (incl unrealised gains) (%)	1.8	-3.5	3.6	2.8	1.4	

Source: Ethias IFRS annual reports, Fitch

Good Profitability, Driven by Non-Life

- Diminishing historic volatility
- Strong non-life underwriting performance
- Low life profitability

Diminishing Historic Volatility

Ethias IFRS operational results increased to EUR332 million (from EUR257 million in 2016). However, Ethias' IFRS net income fell to EUR161 million in 2017 (from EUR424 million in 2016), mainly as a result of the costs associated with the Switch VII operation (EUR109 million) and the sale of First A reserves (EUR106 million), expected to close in 2S18. The negative effect on net income was partially offset by the reversal of life insurance provisions following the reduced projected horizon of First A from 30 years to six months (EUR97 million).

Fitch expects Ethias's financial performance in 2018 to be less affected by non-recurring items and be reflective of technical results, which are structurally driven by non-life business.

Strong Non-Life Underwriting Performance

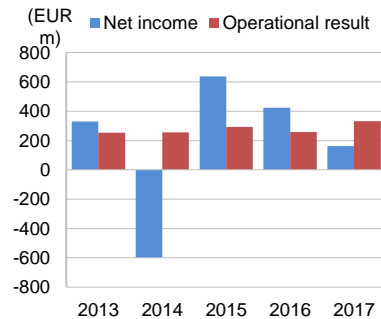
Fitch considers Ethias's non-life financial performance to be strong and consistent over time. The operational non-life IFRS result for Ethias increased slightly to EUR264 million (2016: EUR235 million). The net combined ratio (calculated in accordance with IFRS) improved to 87.7% at end-2017 from 89.4% at end-2016 and remains strong compared with peers. Direct distribution model, pricing optimisation and cost control contribute to Ethias non-life operational efficiency.

Low Life Profitability

Ethias' life profitability has been under pressure due to the prolonged period of low interest rates. The life operational result has been low since 2013, although it has improved from a loss in 2014.

Ethias Earnings

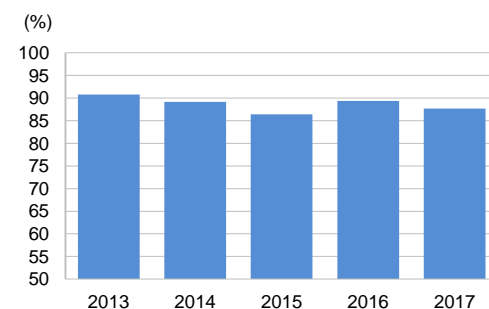
Under IFRS



Source: Ethias Fitch

Net Combined Ratio

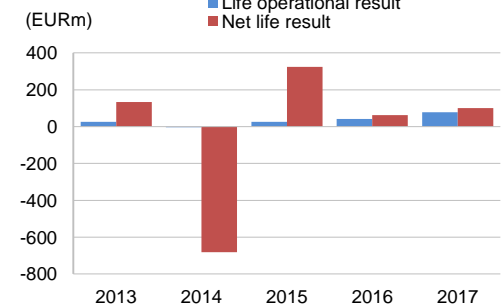
Under IFRS



Source: Ethias, Fitch

Life Business Earnings

Under IFRS



Source: Fitch, Ethias

Investment and Asset Risk

(%)	2013	2014	2015	2016	2017	Fitch's expectation
Risky assets to equity ^a	107	145	91	91 ^b	88 ^b	Fitch expects Ethias's investment policy and risky asset exposure to remain unchanged.
Unaffiliated shares to equity	59	79	40	27	28	
Non-investment grade bonds to equity	46	64	52	55	58	
Investments in affiliates to equity	1	2	0	6	4	

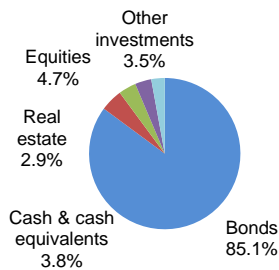
^a This ratio is a combination of unaffiliated common stock, investments in affiliates and non-investment-grade bonds. All investments at book value

^b In 2016 and 2017, non-rated and below investment-grade loans and deposits were added to risky assets exposure calculation. Previously, risky assets included non -rated and below investment-grade bonds, equities (including investments in affiliates)

Source: Ethias IFRS annual reports, Fitch

Investment Assets (Ex-Unit Linked)

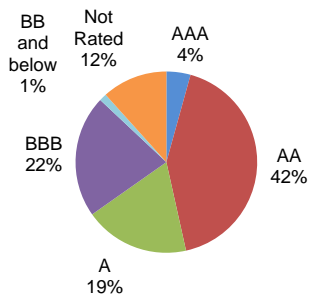
At end-2017



Source: Ethias, Fitch

Fixed-Income Portfolio

At-end 2017



Source: Ethias, Fitch

Limited Exposure to Risky Assets

- Prudent investment policy
- Good bond portfolio quality
- Low equity exposure

Prudent Investment Policy

Fitch views Ethias's investment policy, which was updated in 2017, as prudent. Ethias's risky assets-to-equity ratio remained stable at 88% at end-2017. The company has made sustained reductions in risky assets over time. The share of Unit-linked increased to 4.5% of investments (2016: 2.4%), as a result of transfers from traditional products. A breakdown of the investment portfolio (excluding unit-linked) is shown on the left.

Good Bond Portfolio Quality

Fitch regards the current credit quality of the life and non-life bond portfolios as good, with an average rating of 'A-'. This measure is a risk-weighted average taking into account the second-best rating available on each instrument. Ninety-three percent of the bond portfolio is rated 'BBB' or higher.

Sovereign bonds represent 62% of the total bond portfolio. Sovereign bond exposure is mostly oriented towards Belgium (56% of government portfolio), and France (15%). Exposure to Spain, Italy, Ireland, and Portugal, was EUR1.3 billion at end-2017, or 9% of the total bond portfolio. Ethias has reduced exposure to Belgium and France sovereign bonds spread-risk through derivatives in 2017.

Low Equity Exposure

The proportion of equity investments at end-2017 remained stable, just below 5% of the total investment portfolio.

Asset/Liability and Liquidity Management

(%)	2013	2014	2015	2016	2017	Fitch's expectation
Liquid assets/net technical reserves - excluding unit-linked	91	91	94	103	112	Fitch expects Ethias to continue to actively manage its exposure to interest-rate risk. The sale of the remaining First A portfolio will have a positive effect on duration gap in 2018. Fitch does not expect material changes in liquidity management.
Liquid assets/policyholder liabilities	89	89	92	100	105	

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

Further Reduction of Interest-Rate Risk

- Reduced duration gap
- Interest-rate risk reduced after redemption offers
- Strong liquidity profile

Reduced Duration Gap

Ethias's historically high exposure to interest-rate risk due to life technical liabilities subject to relatively high minimum guaranteed returns has fallen over the past five years. The duration gap shrank in 2017 to 0.9 years from to 2.8 years in 2016 and 3.2 years in 2015 following the Switch offers, reinvestments in long-dated bonds and the derivatives overlay programs. It was 8.7 years in 2014.

Life and non-life duration gaps are both around one year. Life asset duration and liability duration were 8 and 13 years, respectively, at end-2017. Overall, Fitch considers Ethias's management of its asset-liability duration mismatch to be adequate.

Interest-Rate Risk Reduced After Redemption Offers

The guarantee profile for the life insurance book has improved in recent years, as Ethias reduced its exposure to higher-rate guarantees and these guarantees are carried by a smaller amount of life reserves. The disposals came at a cost, but have significantly reduced Ethias' exposure to interest-rate risk.

Over the past five years, Ethias has successfully executed several redemption "Switch" offers on capital-intensive retail life insurance contracts, known as First A, under which high guarantees are paid until the policyholder reaches the age of 99. The last redemption offer in 2017, "Switch VII", by which policyholders were offered a 25% premium on contract value for redemptions, resulted in EUR432 million surrenders for a cost of EUR108 million.

As at end-2017, the average guaranteed rate was 2.8% in the individual life portfolio and 2.15% across the whole life portfolio. If approved by regulators, the sale of the remaining First A portfolio (3.46% guaranteed rate) will further reduce the overall average guaranteed rate and duration gap in 2018. Fitch considers Ethias's capacity to cover minimum guaranteed returns as adequate.

Strong Liquidity Profile

Ethias's liquidity profile is strong, with the ratio of liquid assets to net technical reserves at 112% at end-2017. Fitch considers that the group's liquidity management is cautious and, if needed, there is significant potential for raising liquidity from the group's good-quality fixed-income securities.

Reserve Adequacy

(%)	2013	2014	2015	2016	2017	Fitch's expectation
Loss reserves/CY incurred losses	2.4	2.5	2.5	2.4	2.5	Fitch expects Ethias's non-life reserves to continue to develop favourably. Life reserves are running down as Ethias moves away from interest rate-related products.
Loss reserves/equity	1.2	1.8	1.2	0.9	0.9	
Change in ratio of loss reserves/earned premiums	-0.5	-2.2	-2.5	-0.5	2.2	
Reserve development/prior-year equity	-7.3	-14.1	-32.2	-32.5	-22.8	
Reserve development/PY loss reserves	-4.7	-11.5	-17.6	-27.9	-24.9	
Reserve development/net earned premium	-8.4	-20.3	-30.7	-48.3	-40.3	

Note: Negative numbers denote positive reserve developments. CY: Current Year; PHS: PolicyHolders' Surplus; PY: Prior Years
Source: Fitch

Adequate Reserving Profile

- Moderate reserve leverage
- Adequate reserve growth
- Adequate non-life reserving practices

Moderate Reserve Leverage

Ethias has moderate and stable reserve leverage, as indicated by a ratio of reserves to both incurred losses and capital of 2.5x and 0.9x, respectively, at end-2017.

Adequate Reserve Growth

Fitch believes Ethias's loss reserves grew at a rate commensurate with growth in underwriting exposures over the past five years. Loss reserves compared to shareholders' equity are also quite stable over time, even taking into account the strong increase in Ethias's capital base since 2014.

Life individuals reserves (IFRS) continued to fall in 2017 (down by 75% since 2014) to EUR1.6 billion following the Switch operations.

Adequate Non-Life Reserving Practices

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

Analysis of the group's claims development triangles (based on IFRS accounts) indicates favourable reserve development in recent years. We expect Ethias's positive reserve releases to continue and reserving to remain adequate in 2018.

Reinsurance, Risk Management and Catastrophe Risk

(%)	2013	2014	2015	2016	2017	Fitch's expectation
Reinsurance recoverables to equity	12	15	10	8	9	Fitch does not expect any material change to Ethias's reinsurance strategy, which the agency considers appropriate.
Net written premiums to gross written premiums	96	97	97	97	98	

Source: Ethias IFRS annual reports, Fitch

Adequate Reinsurance and Risk Mitigation

- Appropriate reinsurance
- Good-quality reinsurers

Appropriate Reinsurance

The group is not a major purchaser of reinsurance, as shown by high retention rates averaging 99.8% in life insurance and 97.8% in non-life insurance in 2017. 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, with stability and low risks in Belgium, its main country of operations. Fitch continues to consider the level of reinsurance protection appropriate, in light of the low-risk characteristics of the 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 SE (IFS Rating: AA-/Stable) and Hannover Rueck SE (IFS Rating: AA-/Stable).

Ethias terminated reinsurance contracts in 2017 with Ethias Droit Commun, following the acquisition of the latter's "Workers Compensation Law 1967" portfolio. This resulted in a reduction of reinsurance counterparty risk exposure. There has not been any other material change to the reinsurance programs in 2017.

Appendix: Other Ratings Considerations

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

Notching

For notching purposes, Belgium’s regulatory environment is assessed by Fitch as ‘Effective’, and classified as following a Group Solvency approach.

Notching Summary

IFS Ratings

For Ethias SA, 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.

Operating company debt

Not applicable.

Holding company IDR

Not applicable.

Holding company debt

Not applicable.

Hybrids

For the two issues rated by Fitch (EUR402.7 million dated debt and EUR250 million 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.

Source: Fitch

Hybrids – Equity/Debt Treatment

Hybrids Treatment

Issuer – Ethias SA	Amount	CAR Fitch (%)	CAR reg. override (%)	FLR debt (%)
Dated subordinated debt	402.7 ^a	0	100	100
Perpetual subordinated debt	250 ^b	0	100	100
Dated subordinated debt	75	0	100	100

CAR – Capitalisation Ratio; FLR – Financial Leverage Ratio

For CAR, % indicates portion of hybrid value included as available capital, both before (Fitch %) and after the regulatory override

For FLR, % indicates portion of hybrid value included as debt in numerator of leverage ratio

^a Issued in two tranches, EUR231.9m in July 2015 and EUR170.8 million as tap issue in November 2015

^b Original amount. Only EUR14.3m remains outstanding following the exchange offer in July 2015

Source: Fitch

Exceptions to Criteria/Ratings Limitations

None.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.