

RATING ACTION COMMENTARY

Fitch Places Coface on Rating Watch Negative

Tue 31 Mar, 2020 - 11:43 ET

Fitch Ratings - Paris - 31 Mar 2020: Fitch Ratings has placed Compagnie francaise d'assurance pour le commerce exterieur's (Coface France), Coface North America Insurance Company's and Coface Re SA's Insurer Financial Strength (IFS) Ratings on Rating Watch Negative (RWN). The issuers are major insurance operating entities in the Coface group (Coface).

Fitch has also placed Coface SA's Long-Term Issuer Default Ratings (IDR) and short-term ratings on RWN. Coface SA is the group's top holding company.

A full list of rating actions is detailed below.

RATING ACTIONS

ENTITY/DEBT	RATING
Coface Re SA	AA-

ENTITY/DEBT	RATING		
	Ins		Rating
	Fin		Watch On
	Str		
Coface Finanz GmbH	LT	A+	Rating
	IDR		Watch On
COFACE SA	LT	A+	Rating
	IDR		Watch On
	ST	F1	Rating
	IDR		Watch On
● subordinated	LT	A-	Rating

[VIEW ADDITIONAL RATING DETAILS](#)

KEY RATING DRIVERS

The rating actions reflect the adverse effects of the COVID-19 pandemic on the global trade credit insurance industry and the resulting increased probability that Coface would breach Fitch's downgrade sensitivities. In our view, the risks related to potentially much weaker claims experience are somewhat offset by Coface's strong pricing and risk-management capabilities, as well as by the group's robust capitalisation.

Fitch expects deterioration in Coface's technical result for 2020 due to higher claim rates from rising corporate insolvencies amid a global economic recession and supply chain disruption. We also expect Coface's gross premiums to fall in 2020, and possibly also in 2021, as a result of slowing volumes of activity, active risk selection and lower client retention rates, which are partly offset by price increases.

Fitch views the global trade credit industry as one of the insurance sub-sectors most affected by the decline in economic activity triggered by the pandemic, due to its sensitivity to corporate defaults. However, as observed in past crises, the trade credit industry is resilient, and profitability tends to bounce back rapidly.

We expect Coface's capitalisation to decrease marginally in 2020, but to remain strong. This view is based on the group's very strong Solvency II (S2) ratio of 190% at end-2019. According to Coface, a 1-in-50 crisis scenario (i.e. based on the level of loss ratio corresponding to the 98th percentile) would lower the S2 ratio to 169%. Coface's conservative insurance asset allocation (risky assets-to-equity ratio, as calculated by Fitch, low and stable at around 26% at end-2019) is also expected to mitigate the negative impact on capital of market value declines.

We take a favourable view of Coface's ability to respond promptly to the current crisis. As a credit insurer, Coface has the ability to swiftly reprice or scale down risk exposure. The group has been reducing the most sensitive exposures in the hardest-hit sectors and countries through limit reductions or, in extreme cases, policy cancellations. Coface had already been reducing risk exposure in 2H19 in anticipation of a global economic slowdown.

Coface has recently cut back on the risk of its investment portfolio, reducing allocations to equity and high-yield credits. After dividend payment, Coface expects cash to represent around 22% of its investment portfolio. We believe the actions taken by Coface will help mitigate the effect of a sharply deteriorating economy on its financial results. In addition, in some markets, such as France and Germany that represent respectively 11.3% and 13.6% of Coface's exposure, governments have put in place measures to support businesses' ability to pay their clients, thereby reducing the risk to credit insurers.

RATING SENSITIVITIES

Fitch is developing updated assumptions to support a review of the insurance companies it rates, focused on the significant uncertainties created by the onset of the pandemic. Assumptions will be put in place for interest rates; declines in the market values of stocks, bonds, derivatives and other capital market instruments typically owned/traded by insurance companies; market liquidity; COVID-19 infection and mortality rates; and the magnitude of COVID-19-related

claim/benefit exposures. Fitch plans to conduct pro-forma analysis for individual companies to reflect these assumptions, and compare the pro-forma results to current rating sensitivities. Fitch expects to downgrade ratings if sensitivities are notably breached. Coface will be part of this review.

Coface's ratings will be downgraded if the application of Fitch's rating-case assumptions would indicate a pro-forma financial profile that falls outside one or more of the following sensitivities, with limited prospects for a rapid recovery:

- Combined ratio rising above 100% (2019: 77.7%)
- Fitch-calculated return on equity (ROE) falling below 5% (2019: 8%)
- S2 ratio falling below 160% (2019: 190%)
- Fitch-calculated financial leverage ratio (FLR) rising above 25% (2019: 19%)

If the pro-forma analysis suggests an affirmation or a potential downgrade of the IDRs of no more than one notch, the short-term ratings of Coface SA will be affirmed at 'F1'.

A fast resolution of the coronavirus crisis, with minimal impact on Coface's financial performance and earnings, would result in an affirmation of Coface's ratings. We currently view this scenario as highly unlikely.

We view an upgrade as unlikely in the medium term, given Coface's smaller size and lower product diversification than higher-rated insurers'.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entities, either due to their nature or to the way in which

they are being managed by the entities. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

BEST/WORST CASE RATING SCENARIO

Ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings <https://www.fitchratings.com/site/re/10111579>.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[Insurance Rating Criteria \(pub. 02 Mar 2020\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

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ENDORSEMENT STATUS

Coface Finanz GmbH	EU Issu
Coface North America Insurance Company (CNAIC)	EU Issu
Coface Re SA	EU Issu
COFACE SA	EU Issu
Compagnie Francaise d'Assurance pour le Commerce Exterieur SA	EU Issu



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<https://www.fitchratings.com/site/dam/jcr:6b03c4cd-611d-47ec-b8f1-183c01b51b08/Rating%20Definitions%20-%203%20May%202019%20v3%206-11-19.pdf>

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