FitchRatings

RATING ACTION COMMENTARY

Fitch Maintains Coface on Rating Watch Negative

Thu 14 May, 2020 - 11:52 ET

Fitch Ratings - Paris - 14 May 2020: Fitch Ratings has maintained all ratings of Coface SA and its operating subsidiaries (together referred as Coface) on Rating Watch Negative (RWN), with the exception of the Short-Term Ratings of Coface SA. The latter have been taken off RWN and affirmed at 'F1'. A full list of rating actions is detailed below.

KEY RATING DRIVERS

The rating actions are based on Fitch's current assessment of the impact of the coronavirus pandemic, including its economic impact, under a set of rating-case assumptions described below. These assumptions were used by Fitch to develop pro-forma financial metrics for Coface that are compared with both rating guidelines defined in its criteria, and relative to previously established rating sensitivities for Coface.

Coface's ratings were placed on RWN on 31 March 2020 to reflect the adverse impact of the coronavirus outbreak on the global trade credit insurance industry and the resulting expected sharp deterioration in Coface's technical results due to the severity of the economic recession. The RWN also reflects Fitch's view that Coface's overall post-recovery financial profile could be weaker than before and no longer be in line with its 'AA-' Insurer Financial Strength Ratings.

Our pro-forma analysis shows that our COVID-19 assumptions have a material impact on Coface's profitability. We expect the Fitch-calculated combined ratio (net of reinsurance) to increase significantly above 100% in 2020 (reported combined ratio at end-2019: 77.7%) and net income return on equity (ROE) in 2020 to fall materially outside our rating sensitivity.

Under our pro-forma analysis, we continue to view Coface as strongly capitalised. Our analysis indicates that assumed market-value losses on its insurance and factoring assets as well as its insured credit portfolio will put pressure on capitalisation metrics but not cause significant capital depletion. We expect Coface's Solvency II ratio to remain within the company's target of 155%-175% (190% at end-2019). The pro-forma Fitch-calculated financial leverage ratio (FLR) remains below our 25% rating sensitivity under Fitch's rating-case assumptions.

In our view, Coface has strong liquidity, with cash representing 21% of its investment portfolio at end-March 2020, and no major near-term debt maturities.

The affirmation of the Short-Term Ratings of Coface SA reflects a low likelihood of downgrade of more than one notch of Coface SA's Long-Term Ratings on our rating-case assumptions. Under our criteria, Short-Term Ratings are directly linked to Long-Term Ratings.

KEY ASSUMPTIONS

Assumptions for Coronavirus Impact (Rating Case):

Fitch used the following key assumptions, which are designed to identify areas of vulnerability, in support of the pro-forma ratings analysis discussed above:

--Decline in key stock market indices by 35% relative to 1 January 2020.

--Increase in two-year cumulative high-yield bond default rate to 13%, applied to current non-investment grade assets, as well as 12% of 'BBB' assets.

--A coronavirus infection rate of 5% and a mortality rate (as a percent of infected) of 1%.

--A slightly declining investment margin reflecting both upward and downward pressure on interest rates, with widening spreads and notable declines in government rates.

RATING SENSITIVITIES

The ratings remain sensitive to a material change in Fitch's rating-case assumptions with respect to the coronavirus pandemic. Periodic updates to our assumptions are possible given the rapid pace of changes in government actions in response to the pandemic, and the pace with which new information is made available on the medical aspects of the outbreak. A discussion of how ratings would be expected to be impacted under a set of stress-case assumptions is included at the end of this section to help frame sensitivities to a severe downside scenario.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-- A material adverse change in Fitch's rating assumptions with respect to the coronavirus impact.

-- Expectation that the combined ratio will be above 100% in 2021 (2019: 77.7%)

-- Expectation that the Fitch-calculated ROE will be below 5% in 2021 (2019: 8%).

-- Solvency II ratio falling below 160%.

-- Fitch-calculated FLR rising above 25% (2019: 19%) on a sustained basis.

-- An adverse change in Fitch's view of the business risk profiles of the global trade credit insurance industry in general and Coface, in particular.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-- A material positive change in Fitch's rating assumptions with respect to the coronavirus impact.

-- A positive rating action is prefaced by Fitch's ability to reliably forecast the impact of the coronavirus pandemic on the financial profile of Coface.

-- The ratings could be removed from Rating Watch and affirmed if, based on emerging results and developments, Fitch gains confidence that the combined ratio will be below 100% in 2021, and assuming that our assessment of Coface's capitalisation and business profile remains unchanged.

-- An upgrade is unlikely in the medium term, given Coface's smaller size and lower product diversification than higher-rated insurers.

Stress Case Sensitivity Analysis

-- Fitch's stress case assumes a 60% stock market decline, two-year cumulative high-yield bond default rate of 22%, high-yield bond spreads widening by 600bp, more prolonged declines in government rates, heightened pressure on capital-market access, a coronavirus infection rate of 15% and mortality rate of 0.75%.

-- The implied-rating impact under the stress case would be a downgrade of up to two notches.

BEST/WORST CASE RATING SCENARIO

International scale credit 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, visit 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.

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 entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Coface Re SA	Ins Fin Str	AA-	Rating Watch Maintained
Coface Finanz GmbH	LT IDR	A+	Rating Watch Maintained
COFACE SA	LT IDR	A+	Rating Watch Maintained
	ST IDR	F1	Affirmed
• subordinated	LT	A-	Rating Watch Maintained
• senior unsecured	ST	F1	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Insurance Rating Criteria (pub. 02 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Prism Factor-Based Capital Model, v1.7.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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

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