MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Covea Cooperations' Aa3 insurance financial strength rating with a stable outlook

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ParisMarch 4, 2020 - Moody's Investors Service ("Moody's") has today affirmed the Aa3 insurance financial strength rating of Covea Cooperations (Covea). The outlook is stable.

The rating action follows Covea's announcement that it reached an agreement with EXOR N.V. (EXOR) to acquire PartnerRe Ltd. (PartnerRe), a global reinsurer, for a cash consideration of $9.0 billion (€8.2 billion).

Covea is the leading French property and casualty (P&C) insurance group and ranks number four in the overall French insurance market. It reported gross earned premiums of €16.9 billion in 2018 and shareholders' equity of €15.2 billion as at year-end 2018.

PartnerRe Ltd., based in Bermuda, is the 12th largest global reinsurer. It reported gross earned premiums of $6.0 billion (€5.5 billion) in 2018 and shareholders' equity of $6.5 billion (€5.9 billion) as at year-end 2018.

RATINGS RATIONALE

While the acquisition of PartnerRe expands Covea's product and geographic reach as well as add earnings diversification, Moody's views the transaction negatively on the group's financial profile because it lowers capitalization significantly, increases goodwill and increases earnings volatility. Despite these negatives, Covea will maintain a conservative balance sheet following the transaction. In particular, the affirmation of Covea's rating reflects Moody's view that, despite the transaction being paid entirely in cash, the group will maintain a very strong capitalisation and very good financial flexibility following the acquisition.

The acquisition will significantly reduce Covea's Solvency II ratio, from above 400% at year-end 2019 to around 240% on a pro forma basis. Nonetheless, this ratio will remain above that of many Aa3 rated peers. The sensitivity of the group's Solvency II ratio to a decrease in equity markets and to a decrease in interest rates will also remain limited. In addition, because Covea is a mutualist group, all future earnings will be retained and will strengthen the group's solvency ratio. Moody's expects the group to generate profits representing more than 10 percentage points of Solvency II ratio every year on a normalized basis, based on yearly net income averaging €0.9 billion in the last five years for Covea and an additional average net income of €0.3 billion for PartnerRe in the same period, although PartnerRe's net income has been significantly more volatile, particularly in heavy catastrophe years.

The group's adjusted financial leverage will also deteriorate on a pro forma basis given PartnerRe's outstanding debt (€2.4 billion as at year-end 2018) will be added to Covea's debt (€0.6 billion as at year-end 2018) on a consolidated basis. Nonetheless, Covea will maintain conservative financial leverage metrics, below many other highly rated insurers, keeping some capacity to issue subordinated debt and strengthen its solvency.

Moody's adds that the acquisition of PartnerRe will give rise to significant goodwill on Covea's balance sheet. Nonetheless, the ratio of goodwill and intangibles assets over shareholders' equity will remain consistent with Moody’s expectations for Aa-rated insurers. Reserving risk will also increase given the long tail nature of PartnerRe's casualty reserves, although reserves have consistently developed favorably across the majority of its lines of business. The significant excess in Covea’s retail business reserves will also ensure a very strong level of reserve adequacy overall.

Commenting on the impact of the acquisition on Covea’s business profile, Moody’s says that the group’s geographic and business diversification will be significantly enhanced. The weight of French business will reduce to 66% from 88% before the acquisition. The group will also gain exposure to life and P&C reinsurance businesses (25% of premiums on a consolidated basis post acquisition). At the same time, the group’s risk profile will increase and profits’ volatility will rise, as PartnerRe is significantly exposed to natural catastrophes and man-made risks and covers US liability and casualty risks which are increasingly subject to social inflation.

Moody’s expects that Covea will largely rely on PartnerRe’s expertise to manage these risks. Therefore, Moody’s will closely monitor the ability of Covea to retain key personnel. More positively, the limited overlap between existing Covea and PartnerRe's businesses will limit integration risks. In addition, Moody’s understands that it is Covea’s intention to let PartnerRe continue to develop its current strategy, which should limit disruption risk at PartnerRe level.

WHAT COULD CHANGE THE RATING

Moody’s says that an upgrade of Covea’s rating is unlikely at this stage. Nonetheless, positive pressure could be exerted in case of continued profitable diversification of the business outside of France and in life reinsurance, while strengthening capital levels (with a Solvency II ratio above 350%) and maintaining very low financial leverage.

Conversely, negative pressure on the rating could arise in case of (1) a material reduction in the group’s capital, as evidenced by a Solvency II ratio sustainably below 250%, (2) an increase in financial leverage above 30% and a decrease in earnings coverage below 7x, (3) a reduction in profitability, as evidenced for example by a combined ratio sustainably above 100%, combined with a sustained increase in the volatility, (4) a significant deterioration in its asset quality, or (5) failure to develop PartnerRe's business, for example in case of inability to retain key personnel.

The methodologies used in this rating were Life Insurers Methodology published in November 2019, and Property and Casualty Insurers Methodology published in November 2019. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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