# COFACE SA

## And Core Subsidiaries

**Full Rating Report**

### Ratings

**COFACE SA**

| | |
|---|---|
| Long-Term IDR | A+ |
| Short-Term IDR | F1 |

**Compagnie française d'assurance pour le commerce extérieur**

| | |
|---|---|
| Insurer Financial Strength | AA− |
| Long-Term IDR | A+ |
| Short-Term Insurer Financial Strength | F1+ |

See Appendix for other subsidiaries' ratings

**Sovereign Risk**

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

### Outlooks

| | |
|---|---|
| Insurer Financial Strength | Stable |
| Long-Term IDRs | Stable |
| Sovereign Long-Term IDRs | Stable |

### Financial Data

**COFACE SA**

| (EURm) | 2016 | 9M17 |
|---|---|---|
| Total assets | 7,061 | 7,255 |
| Total equity | 1,755 | 1,784 |
| Gross written premiums | 1,202 | 925 |
| Net combined ratio (%) | 97.4 | 89.8 |
| Net profit | 41.5 | 55.0 |
| Solvency II cover (x) | 1.50 | 1.48[a] |

[a] 1H17. Source: Coface accounts

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## Key Rating Drivers

**Very Strong Business Profile:** The Coface group (Coface) is the world's third-largest credit insurer. Its main operating entity is Compagnie française d'assurance pour le commerce extérieur. Coface has an estimated 16% market share in the credit insurance industry, and operates in 67 countries and in multiple economic sectors (for example, natural resources and construction). Coface's product range is not diverse as it is a specialist insurer, but it has a strong franchise in credit insurance with a high level of geographical diversification.

**Solid Capitalisation:** Fitch Ratings believes Coface's capitalisation is solid and the insurer's risk-management framework is robust. This view is based on Coface's moderate multiple of nominal net credit exposure to equity and appropriate reserving. At end-June 2017, Coface's Solvency II ratio was 148% (end-2016: 150%), within the company's target range of 140%-160%. Operating leverage (net premiums written to equity) was also strong at 0.5x in 2016.

**Low Financial Leverage, High TFC:** The Fitch-calculated financial leverage ratio (FLR), which excludes factoring assets, was 18% at end-2016, unchanged from end-2015 and in line with the 'AA' IFS criteria median guidelines. Fitch does not expect Coface to raise additional financial debt over the medium term. However, Coface's total financing and commitments (TFC) ratio – a measure of debt and debt-like obligations – was high at 1.6x (end-2015: 1.6x). The level of the TFC ratio reflects the funding of the factoring business.

**Strong Profitability:** Earnings in 2016 were hit by adverse claims experience caused by the economic downturn in certain regions, particularly South America and Asia, where Coface is a market leader. Weaker client activity and soft pricing conditions in mature markets also weighed on 2016 profits, with the net combined ratio deteriorating to 97.4% (2015: 83.1%) and Fitch-calculated return on equity (ROE) falling to 2.4% from 7.3%.

However, the net combined ratio improved to 89.8% in 9M17; Fitch expects Coface's management actions to have a positive impact on profitability in 2017.

**Strategic Plan Under Way:** In 2016, Coface launched a new three-year strategic plan, which aims to enhance its financial performance through three initiatives: stronger risk management, greater operational efficiency and the prioritisation of value over growth. Fitch views this plan positively and believes Coface is on track to achieve its 2019 targets.

**Adequate Financial Flexibility:** Fitch considers that Coface has adequate access to external funding, in the form of operating debt, commitments received from banks and the contingent equity line that Coface put in place in February 2016 to protect its solvency capital.

## Rating Sensitivities

**Lower Capital, Higher Leverage:** The ratings could be downgraded if Coface's net premiums written-to-equity ratio increases to 1.1x (2016: 0.5x) or its financial leverage rises to 25%.

**Deterioration of Profitability:** The ratings could also be downgraded if the combined ratio increases to above 100% or the Fitch-calculated ROE remains below 5% over a sustained period.

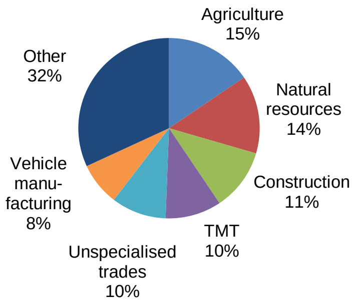
**Upgrade Unlikely:** A rating upgrade is unlikely in the medium term, given Coface's limited size and level of product diversification compared to larger, higher-rated insurers.

### Risk Exposure by Country

| Country | (%) | Rating |
|---|---|---|
| Germany | 15.1 | AAA |
| France | 10.4 | AA |
| United States | 8.9 | AAA |
| Italy | 8.3 | BBB |
| UK | 5.8 | AA |
| Spain | 5.6 | BBB+ |
| Netherlands | 3.3 | AAA |
| Poland | 2.5 | A− |
| Japan | 2.4 | A |
| China | 2.2 | A+ |
| Others | 35.5 | n.a. |
| **Total** | **100** | **n.a.** |

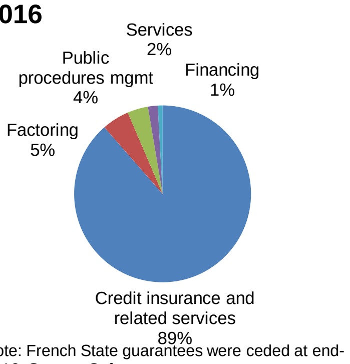
Source: Coface, Fitch

### Group's Debtor Outstandings by Trade Sector




Source: Coface

### Revenue by Business Line 2016




Note: French State guarantees were ceded at end-2016. Source: Coface

## Business Profile

### Very Strong Business Profile

- Strong presence worldwide
- Focus on credit insurance
- Specialist yet diversified player
- Short-tail business, responsive approach

### Strong Presence Worldwide

Coface is the world's third-largest credit insurer after Euler Hermes and Atradius with an estimated market share of 16% within this business line. In 2016, it had more than EUR1.2 billion of gross written premiums. It has a presence in 67 countries and employs over 4,000 staff. Coface operates predominantly in France, Germany, Italy, Austria, the United Kingdom, Spain and North America.

### Focus on Credit Insurance

Coface's strategy has focused since 2012 on its core credit insurance activities, which account for nearly 89% of total revenues. The group has retained other activities, including credit information, debt collection and factoring (notably in Germany and Poland), but only those that add value to its core trade credit insurance business.

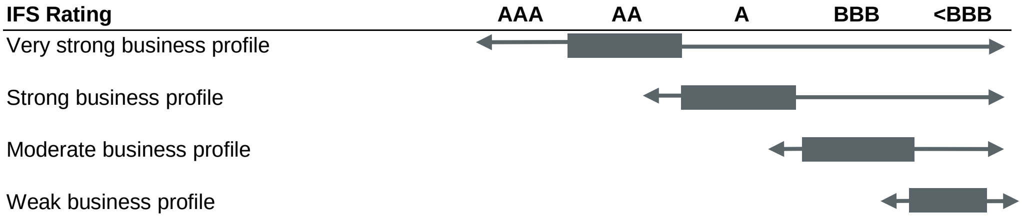
### Specialist Yet Diversified Player

Coface, despite being a specialist player, is well diversified by sector and region. The company operates through a direct sales network in 67 countries; including partnerships, it is present in 100 markets, with 64% of its revenues coming from the 10 biggest of these. Product-distribution channels vary according to the country of operation. In 2016, direct-sales networks and tied agents represented 33% of Coface's total sales force, but more than half of its business is introduced by brokers.

### Short-Tail Business, Responsive Approach

Coface's underwriting portfolio consists mainly of short-tail business where the risk is borne by the insurer for up to 180 days and claims are generally reported prompted. Coface is able to respond promptly, when necessary, to adjust the terms and conditions of its policies and to impose stricter underwriting conditions. This enabled the group to recover quickly following the financial crisis in 2008-2009.

### Ratings Range Based on Business Profile




Source: Fitch

### Related Criteria

Insurance Rating Methodology (April 2017)

### Corporate Governance and Management

Fitch considers corporate governance and management adequate and neutral to the rating.

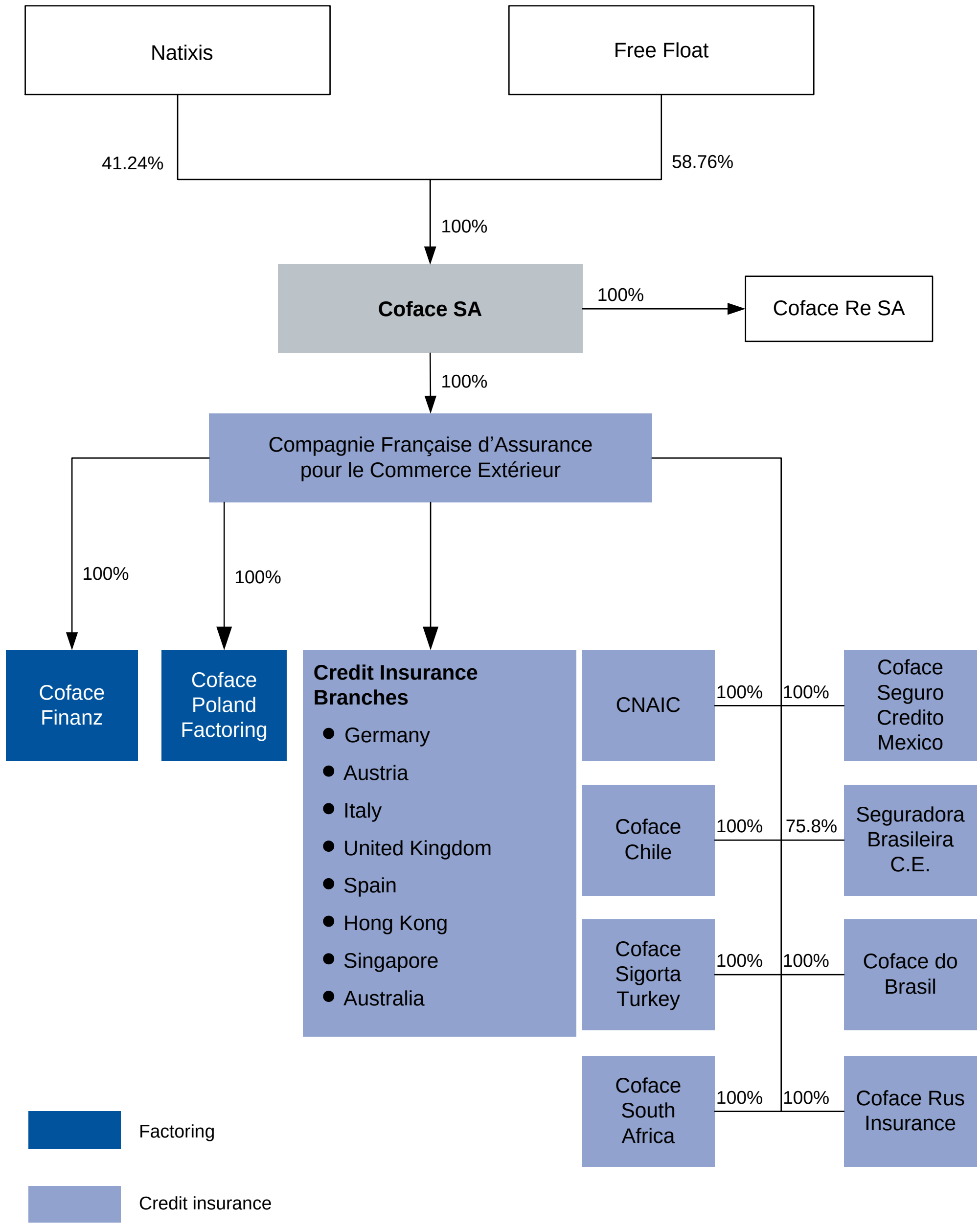
Coface's board of directors has 11 members and the managing board has eight members. (The executive committee, which includes regions' CEOs in addition to the management board, has 15 members.) The company is governed by the French insurance code. The Autorité de Contrôle Prudentiel et de Résolution (ACPR) is its main regulator as the company is headquartered in France.

## Ownership Is Neutral to Rating

Coface has been listed on the French regulated market, Euronext Paris, since June 2014. As at 30 June 2017, public shareholders owned 58.52% of the company, with Natixis holding 41.24% and Coface employees 0.24%. We expect Natixis to reduce its stake over time. The Coface ratings reflect the group's own stand-alone credit profile, as we do not view the Natixis shareholding as having any ratings implications (positive or negative) for Coface.

The Coface group legal structure (see diagram below) shows the group's key operating subsidiaries (excluding sub-holdings).

### Simplified Group Structure Diagram




Source: Coface

**Sovereign and Country-Related Constraints**

Fitch rates France ‘AA’ with a Stable Outlook, and 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 French insurance organisations and other corporate issuers are not likely to be constrained by sovereign or macroeconomic risks, and in the specific case of Coface, no constraints are biting.

## Industry Profile and Operating Environment

### Operating Environment Remains Challenging

The operating environment remains challenging in the credit insurance industry. High levels of available capacity, a benign claims environment and fierce competition, especially in more mature markets, have driven down prices.

The International Credit Insurance and Surety Association (ICISA) has yet to publish 2016 figures, however, Fitch expects total insured exposure covered by trade credit insurance to have continued growing in 2016 versus 2015.

The demand for trade credit insurance is linked with global trade trends, as well as political risks. In 2016, Fitch expects demand to have increased, especially in Asia, the Middle East and North Africa and to a lesser extent in sub-Saharan Africa.

The high level of competition in the credit insurance market – particularly from government export credit agencies and new capacity in the London and Chinese markets – has kept prices low. In 2016, Fitch estimates that claims paid for the credit insurance sector rose after ending a three-year downward trend in 2015.

In 2017, the agency believes that premiums and insured exposure will continue growing albeit to a lower pace, and the cost of claims will fall as insurers adapt their policies to the increased claims frequency recorded in 2016. Nonetheless, in the credit insurance business, profitability is likely to remain subdued in the short term.

**Ratings Range Based on Industry Profile/Operating Environment**

| **IFS Rating** | **AAA** | **AA** | **A** | **BBB** | **<BBB** |
|---|---|---|---|---|---|
| **Debt** | **AA** | **A** | **BBB** | **BB** | **<BB** |
| Non-life insurance | | | | | |

Source: Fitch

## Peer Analysis

### A Major Player in the Global Credit Insurance Market

Three major European groups – Euler Hermes, Atradius and Coface – dominate the global credit insurance market, with an estimated combined market share of around 60% in 2016. The rest of the market comprises smaller companies, which have a strong regional influence (such as China Export & Credit Insurance Corporation, which has a strong presence in the east Asian market and 16% market share worldwide).

Credit insurers face challenging market conditions and fierce competition, and their underwriting performance can be volatile. Even so, Fitch considers that earnings remain solid for the leading credit insurers.

Coface's financial performance in 2016 was in line with peers', as shown in the table below. Coface is adequately capitalised and posted a regulatory ratio that was broadly in line with peers. However, Coface is less exposed to debtors relative to its total capital than its peers, meaning that it tends to be less exposed to systemic risks or default risk affecting debtors.

In terms of financial performance, Coface lags behind peers by the absolute amounts of net profit and revenues, reflecting its relative size. Coface's combined ratio was higher than its peers in 2016 due to a heavier loss ratio.

### World's Largest Credit Insurers

| | Euler Hermes (NR) | | | Atradius (NR) | | | Coface (IFS: AA−) | | |
|---|---|---|---|---|---|---|---|---|---|
| **(EURm)** | **2014** | **2015** | **2016** | **2014** | **2015** | **2016** | **2014** | **2015** | **2016** |
| Total turnover | 2,527 | 2,638 | 2,570 | 1,627 | 1,718 | 1,761 | 1,441 | 1,490 | 1,411 |
| Gross earned premiums | 2,126 | 2,205 | 2,170 | 1,458 | 1,537 | 1,558 | 1,133 | 1,186 | 1,115 |
| - % of turnover | 84 | 84 | 84 | 90 | 89 | 88 | 79 | 80 | 79 |
| Other revenues (services income) | 401 | 433 | 400 | 169 | 181 | 203 | 308 | 304 | 296 |
| - % of turnover | 16 | 16 | 16 | 10 | 11 | 12 | 21 | 20 | 21 |
| Retention rate (%) | 70 | 70 | 71 | 55 | 56 | 57 | 76 | 78 | 77 |
| Net earned premiums | 1,482 | 1,549 | 1,531 | 815 | 862 | 894 | 866 | 920 | 858 |
| Net loss ratio (%) [a] | 62 | 53 | 52 | 41 | 43 | 42 | 51 | 53 | 65 |
| Net expense ratio (%) [a] | 27 | 27 | 28 | 37 | 37 | 36 | 29 | 30 | 32 |
| Combined ratio (%) [a] | 75 | 81 | 80 | 78 | 80 | 78 | 80 | 83 | 97 |
| - Average last 3 years (2014-2016; %) | | | 79 | | | 79 | | | 87 |
| Consolidated net income | 314 | 304 | 288 | 135 | 178 | 212 | 125 | 126 | 42 |
| Total capital[b] | 4,259 | 4,551 | 4,411 | 2,174 | 2,408 | 2,421 | 2,816 | 2,889 | 3,036 |
| Solvency II regulatory ratio (%) | n.a. | 162 | 166 | n.a. | n.a. | n.a. | n.a. | 147 | 150 |
| Total exposure to debtors | 860,000 | 890,000 | 883,000 | 515,114 | 562,644 | 587,104 | 508,037 | 475,419 | 492,657 |
| Total exposure/total capital (x) | 202 | 196 | 200 | 237 | 234 | 243 | 180 | 165 | 162 |

[a] Reported ratios
[b] Equity + claims reserve
Source: Fitch and annual reports Euler Hermes, Atradius and Coface

## Capitalisation and Leverage

| (x) | 2012 | 2013 | 2014 | 2015 | 2016 | Fitch's expectation |
|---|---|---|---|---|---|---|
| Regulatory capital ratio[a] | 6.8 | 8.3 | 7.1 | 1.5 | 1.5 | Fitch expects Coface to remain strongly capitalised. Financial leverage and TFC are expected to remain at or close to their current levels. |
| Net premium written/equity | 0.5 | 0.5 | 0.6 | 0.6 | 0.5 | |
| Net leverage[b] | 1.2 | 1.1 | 1.2 | 1.2 | 1.3 | |
| Gross leverage[c] | 1.5 | 1.5 | 1.6 | 1.6 | 1.6 | |
| Financial leverage (%) | 1 | 1 | 18 | 18 | 18 | |
| Total financing & commitments ratio | 1.2 | 1.2 | 1.5 | 1.6 | 1.6 | |
| Net credit exposure to equity (x) | 40 | 41 | 47 | 43 | 39 | |

[a] Solvency I until 2014, Solvency II from 2015
[b] The ratio is calculated by dividing the sum of net premiums written and insurance liabilities, less any ceded reserves, by equity
[c] The ratio is calculated by dividing the sum of direct and assumed premiums written and total gross liabilities by equity
Source: Fitch, Coface

### Capitalisation Supportive of Ratings, Low Leverage

- Solvency margin strong but sensitive to underwriting risk
- Limited utilisation ratios protect capital
- Low and stable financial leverage
- TFC ratio remains relatively high

### Solvency Margin Strong but Sensitive to Underwriting Risk

Fitch considers Coface's capitalisation to be strong and supportive of its ratings. This view is based on Coface's moderate multiple of nominal net credit exposure to equity and appropriate reserving. Fitch also views Coface's risk-management framework as robust.

At end-June 2017, Coface's Solvency II ratio was 148% (end-2016: 150%), within the company's target of 140%-160%. Operating leverage (net premium written to equity) was also strong in 2016. Factoring activities, which comprise 5% of revenues, represent 15% of the solvency margin requirement.

According to Coface's estimates, a 1:20 stress event (loss ratio of 95%) would reduce the Solvency II coverage to 127%. A loss ratio equivalent to the level during the 2008/2009 economic downturn would reduce the coverage to 111%. At that point, though, the contingent equity line would be triggered, adding three percentage points to the solvency coverage ratio (114%). Fitch takes a positive view of the protection offered by the contingent equity line in the event of extreme adverse events.

While Coface's solvency ratio is sensitive to underwriting stresses, its sensitivity to market shocks is limited.

### Limited Utilisation Factors Protect Capital

Limits granted by Coface are not fully used by its clients; there is an average utilisation ratio of no more than 30%, which contributes to capital protection. Indemnification is usually capped at 85%-90% of the loss, and each policy has a maximum limit of liability.

### Low and Stable Financial Leverage

The FLR was 18% at end-2016. The FLR has been stable since subordinated notes were issued in March 2014. The FLR is in line with Fitch's 'AA' IFS criteria median guidelines. Fitch does not expect the FLR to rise substantially because we do not see Coface raising additional financial debt in the near future.

### TFC Ratio Remains Relatively High

The total financing and commitments (TFC) ratio is a measure of debt and debt-like obligations. Coface's TFC ratio was relatively high at end-2016, and above the peer average, at 1.6x. The level of the TFC ratio reflects the funding of the factoring business.

## Debt-Service Capabilities and Financial Flexibility

| (x) | 2012 | 2013 | 2014 | 2015 | 2016 | Fitch's expectation |
|---|---|---|---|---|---|---|
| Fixed-charge coverage ratio (excluding realised and unrealised capital gains) | 68 | 53 | 13 | 10 | 6 | Fitch expects Coface's fixed-charge coverage ratio to improve in line with profitability to above 7x in 2017. |

Source: Fitch, Coface

**Holding Company Liquidity/Bank Facilities**

In July 2017, Coface signed a new syndicated back-up facility for EUR700 million to back up the commercial paper programme. This line replaces EUR600 million bilateral lines.

These back-up credit lines were provided by high-credit-quality banks including: Société Générale (A/Stable), Crédit Agricole (A+/Stable), Natixis (A/Stable), HSBC (AA−/Stable), BNP Paribas (A+/Stable) and BRED Banque Populaire (A/Stable).

Coface also had EUR1bn commitments given to Coface Finanz (German factoring) and Coface Factoring Poland (mainly surety bonds).

## Strong Fixed-Charge Coverage, Adequate Financial Flexibility

- Fixed-charge coverage ratio expected to improve
- Adequate financial flexibility

### Fixed-Charge Coverage Ratio Expected to Improve

Coface's fixed-charge coverage ratio, as calculated by Fitch, was 6x at end-2016 (2015: 10x). Interest payments (EUR18 million, stable compared with 2015) relate mainly to the EUR380 million in subordinated notes issued in March 2014. Despite the volatility of Coface's earnings, Fitch expects its coverage ratio to remain commensurate with the ratings.

The total amount of interest expenses should be stable as Coface does not plan to increase financing debt. Fitch expects the coverage ratio to increase above 7x in 2017.

### Adequate Financial Flexibility

Fitch believes Coface to have sufficient access to external funding in the form of operating debt, commitments received by banks, or the EUR100 million contingent equity line.

The funding of the factoring business is well diversified by source (securitisation 44%, commercial paper 26%, bilateral credit lines 22% and local credit lines 8%, by financial institution (eight banks rated within the 'A' or 'AA' categories), by term (60% short term, 40% medium term), and by concentration (maximum 20%, financed by a single bank).

Coface issued EUR380 million of subordinated notes in March 2014 before its IPO in June 2014.

## Financial Performance and Earnings

| (%) | 2012 | 2013 | 2014 | 2015 | 2016 | Fitch's expectation |
|---|---|---|---|---|---|---|
| Net income (EURm) | 124.1 | 127.4 | 125.0 | 126.2 | 41.5 | Fitch expects Coface's financial performance to improve in 2017 following the execution of its strategic plan. |
| Net income return on equity[a] | 7.3 | 7.2 | 7.1 | 7.3 | 2.4 | |
| Pre-tax operating profit return on equity [a] | 11.9 | 9.1 | 11.1 | 10.9 | 5.8 | |
| Net combined ratio[b] | 79.7 | 82.5 | 79.7 | 83.1 | 97.4 | |
| Net loss ratio[b] | 53.3 | 53.8 | 50.4 | 52.5 | 65.5 | |

[a] Fitch calculated
[b] Reported
Source: Fitch

## Strong Earnings Profile, Strategic Plan Under Way

- Strong profitability,  but earnings hit in 2016
- Strategic plan under way
- Selective risk acceptance

### Strong Profitability, but Earnings Hit in 2016

In 2016, Coface reported lower net income of EUR42 million (2015: EUR126 million) and its Fitch-calculated ROE was a low 2.4% (2015: 7.3%). In 9M17, net income was EUR55 million (9M16: EUR1.2 million on a like-for-like basis).

A certain level of volatility is inherent in credit insurers' business. Coface's profit was hit by higher claims in regions such as South America and Asia, where it has a leading position as a trade-credit insurer. Weaker client activity and soft pricing conditions in mature markets also weighed on earnings. As a result, Coface's underwriting performance deteriorated significantly in 2016, with the net combined ratio at 97.4% (2015: 83.1%). Its financial results were also pressured by low interest rates.

However, Fitch expects Coface's profitability (both underwriting and net income) to recover in 2017, as the company executes its strategic plan, reprices business and enhances risk selection. Furthermore, Coface is targeting EUR30 million of cost savings through the plan period. Coface also relies on external reinsurance to absorb some loss ratio volatility.

The reported combined ratio improved significantly in 9M17 to 89.8% (9M16: 99.8%, excluding State Export Guarantees Management); at end-Sep 2017, Coface improved its full-year guidance on the loss ratio by 4pp to below 54% (9M17: 49.5%). Coface expects to achieve a combined ratio of around 83% across the cycle, which Fitch considers is achievable.

The factoring business is expected to continue to contribute favourably to Coface's performance.

### Strategic Plan Under Way

Coface launched a strategic plan in 2016, 'Fit to Win', which aims to enhance its financial performance over three years through the implementation of three transformation initiatives: reinforcement of risk management, improvement of operational efficiency, and prioritisation of value over growth.

The underwriting policy is being reorganised as part of the plan by regrouping commercial and risk underwriting to better connect drivers of sales and profitability.

Fitch views this plan as positive for Coface's credit profile and believes that successful implementation will strengthen Coface's franchise and decrease its risk profile. However, soft pricing conditions are likely to continue to exert pressure on Coface's results in the short term.

### Selective Risk Acceptance

Fitch considers Coface's exposure to risk to be adequate, with 81% focused on highly rated risks, as measured by Coface's internal risk-assessment system. The risk-acceptance rate was an average 15% for the non-investment-grade category over the past 18 months to end-June 2017.

## Investment, Asset Risk and Liquidity Management

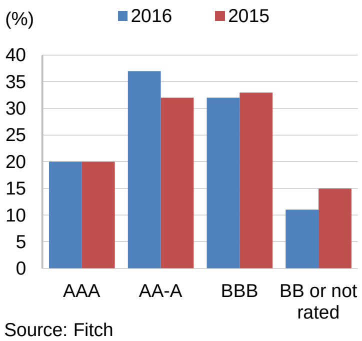
| (%) | 2012 | 2013 | 2014 | 2015 | 2016 | Fitch's expectation |
|---|---|---|---|---|---|---|
| Risky assets[a]/equity | 9.4 | 24.6 | 41.0 | 38.0 | 28.6 | Fitch does not expect any material change in Coface's investment strategy, which remains focused on fixed-income assets, with strict rules and diversification guiding the risk portfolio. |
| Unaffiliated common stocks/equity | 7.7 | 11.3 | 18.0 | 19.3 | 14.1 | |
| Non-investment grade bonds/equity | 0.8 | 12.3 | 21.9 | 17.5 | 13.8 | |
| Investments in affiliates/equity | 0.9 | 1.0 | 1.1 | 1.1 | 0.8 | |
| Liquid assets/technical reserves | 162 | 182 | 195 | 215 | 196 | |

[a] Risky assets include sub-investment-grade bonds, equities and affiliates (excluding factoring receivables)
Source: Coface, Fitch

## Diversified Investment Strategy, Exposure to Factoring Receivables

- Diversified investment portfolio
- FX risk covered by asset-liability matching
- Manageable exposure to factoring receivables
- Strong liquidity

### Coface Bonds' Portfolio Ratings 2016




Source: Fitch

### Diversified Investment Portfolio

Coface has a diversified investment strategy and is predominantly invested in fixed-income instruments (69% of total invested assets at end-June 2017) with an average rating of 'A−', and loans (17%) of similar credit quality. The bond portfolio is well diversified by geography, with eurozone and North America accounting for the largest exposure, as a result of Coface's business mix, and split equally between sovereign and non-sovereign. However, 11% of the bond portfolio was invested in below-investment-grade bonds at end-2016 (15% in 2015).

Equities represented 7% of investments, 50% of which is hedged, and real estate 7%. The risky assets-to-equity ratio, as calculated by Fitch, remains low.

Coface has reorganised and centralised its investment policy since 2013. The company outsources administrative services such as middle- and back-office management reporting to Amundi, a leading European asset manager. Coface remains in charge of its overall asset allocation.

### FX Risk Covered by Asset-Liability Matching

A large part of Coface's revenue is earned outside the eurozone, and is therefore exposed to FX risk. However, there is a good currency match between assets and liabilities. The company's strategic asset allocation requires a systematic hedging for euro entities, and asset-liability matching for other entities in case of currency risk.

### Manageable Exposure to Factoring Receivables

In 2016, Coface's factoring receivables accounted for 35% of total assets (in line with the three-year average). Fitch considers these receivables, mainly arising from corporates, as being of moderate quality. Coface has developed an internal scoring system to assess debtor and ceding risks.

The proportion of receivables due and not yet recovered was 22% of total receivables (2015: 24%), with no non-performing receivables (receivables over 90 days past due) compared with 12% in 2015. Fitch considers Coface's exposure to factoring receivables as manageable and that factoring receivables are well diversified across sectors and geographies.

### Strong Liquidity

Coface's high liquidity ratio, which is stable at around 200%, suggests liquidity is strong, supported by the quality and short duration (around three years on average, maximum four) of its investment portfolio.

## Reserve Adequacy

| (%) | 2012 | 2013 | 2014 | 2015 | 2016 | Fitch's expectation |
|---|---|---|---|---|---|---|
| Loss reserves/current-year incurred losses (x) | 2.0 | 1.9 | 1.9 | 1.8 | 1.7 | Fitch expects Coface to continue to maintain adequate reserve levels. Prior-year reserves should continue to contribute greatly to results. |
| Loss reserves/equity (x) | 0.5 | 0.5 | 0.5 | 0.5 | 0.6 | |
| Current-year paid losses/incurred losses (x) | 1.1 | 1.0 | 1.0 | 0.9 | 0.8 | |
| Change in loss reserves/earned premium | -10.1 | 0.5 | -6.6 | 0.0 | 21.4 | |
| One-year reserve development/prior-year equity | -11.9 | -9.0 | -11.8 | -11.4 | -5.7 | |
| One-year reserve development/prior-year loss reserves | -21.5 | -18.5 | -25.4 | -23.4 | -11.4 | |

Source: Fitch

### Strong Reserving Practices

- Consistently favourable claims development

### Consistently Favourable Claims Development

Coface's reserving practices have been favourable since 2003 (excluding the underwriting year 2008). The prior years' reserve release impact on the loss ratio was 20% on average over 2012-2016.

Fitch does not expect material changes to reserving practices in the next years, and we believe that the group's conservative reserve levels will support profitability through reserve releases in the coming years.

## Reinsurance, Risk Management and Catastrophe Risk

| (%) | 2012 | 2013 | 2014 | 2015 | 2016 | Fitch's expectation |
|---|---|---|---|---|---|---|
| Net premiums written/gross premiums written | 74.3 | 73.9 | 79.1 | 78.9 | 79.2 | Fitch expects Coface to maintain a ceding ratio at current levels and to continue to purchase prudent reinsurance protection. |
| Reinsurance recoverables/equity | 21.6 | 19.3 | 18.9 | 21.7 | 22.8 | |

Source: Fitch

### Conservative Reinsurance Programme

- High reinsurance utilisation smoothing profitability through the cycle
- Reinsurance centralised at group level via Coface Re
- Conservative level of reinsurance programmes
- Reinsurance providers carefully selected

### High Reinsurance Utilisation Smoothing Profitability Through the Cycle

Coface is actively using reinsurance, which Fitch views positively, with 21% of gross written premiums ceded to reinsurers in 2016 (stable compared with 2015), as it serves to smooth profitability in times of financial disturbance. As part of its 'Fit to Win' plan, Coface will rely more on external reinsurance to absorb some loss-ratio volatility, although this could have a detrimental impact on profitability.

### Reinsurance Centralised at Group Level via Coface Re

Since January 2015, Coface Re - the captive reinsurance company of Coface group – has provided internal reinsurance to Coface (including its subsidiaries and branches). The company provides its reinsurance services on a global basis and manages the group's external reinsurance arrangements.

Coface has had a reinsurance policy centralised at group level since 2003, the main objectives of which are to mitigate aggregated losses through a quota-share treaty and excess-of-loss cover, and to protect individual subsidiaries through internal stop-loss programmes. This programme provides the company with a view of the entire group, enabling it to take appropriate actions quickly, which Fitch views positively.

### Conservative Level of Reinsurance Programmes

In 2017, Coface increased the limits of its two external excess-of-loss treaties, one per risk and another per country for single risk. Coface also raised its quota-share treaty to 26% from 20% to cover attrition claims. Coface had already added a stop-loss treaty to its reinsurance programme to cover the retention. Deductibles are adjusted annually in relation to the group's net assets and the net annual probable maximum loss (at a 99% confidence level), taking into account internal sharing mechanisms.

Reinsurance programmes are structured so that no more than 3% of the group's total adjusted equity is at risk (net of taxes) from an individual claim, which Fitch views as conservative.

### Reinsurance Providers Carefully Selected

The quality of the reinsurance panel is satisfactory: core providers are rated within the 'AA' and 'A' categories. The group's main reinsurance providers are: Hannover Rueck SE (IFS Rating: AA−/Stable); SCOR S.E. (IFS Rating: AA−/Stable); Partner Reinsurance Company Ltd (IFS Rating: A+/Stable); and Munich Re (IFS Rating: AA/Stable).

## Key Non-Insurance Operations/Exposure

| (%) | 2012 | 2013 | 2014 | 2015 | 2016 | Fitch's expectation |
|---|---|---|---|---|---|---|
| Factoring business/total revenues | 5 | 5 | 5 | 5 | 5 | Fitch expects other activities to remain at current levels, consistent with Coface's intention to focus on its credit insurance activity. |
| Debt collection and services/total revenues | 7 | 7 | 7 | 7 | 6 | |

Source: Fitch

## Ancillary Non-Insurance Activities Neutral to Ratings

- Stable factoring
- Debt collection and information services

### Stable Factoring

In 2016, factoring activities comprised 5% of total revenues, in line with previous years, and Fitch expects this segment's contribution to remain constant, in line with Coface's strategy to focus on its credit insurance business.

### Debt Collection and Information Services

Coface is active in the complementary businesses of financial information and the recovery of trade receivables to leverage the group's expertise on recoveries related to its own credit insurance business. Revenues from the group's services activity were stable at 6.4% of total revenues in 2016. Central Europe accounts for most of the debt collection and information services.

Fitch views the non-insurance operations as neutral to Coface's ratings, as they remain small compared to the core trade credit insurance services. Revenues generated by the factoring business and ancillary services contribute to earnings diversification but they are operationally different in terms of risk management, accounting and solvency-reporting standards, and this can absorb resources from the core activities.

**Complete Ratings List**
**Compagnie française d'assurance pour le commerce extérieur**
Long-Term IDR 'A+'/Stable
IFS Rating 'AA−'/Stable
Short-Term IFS Rating 'F1+'
**COFACE SA (holding co)**
Long-Term IDR 'A+'/Stable
Short-Term IDR 'F1'
Commercial paper 'F1'
Subordinated debt 'A−'
**Coface North America Insurance Company (CNAIC)**
IFS Rating 'AA−'/Stable
**Coface Finanz GmbH**
Long-Term IDR 'A+'/Stable
**Coface Re SA**
IFS Rating 'AA−'/Stable

## Appendix: Other Ratings Considerations

Below is a summary of additional ratings considerations of a "technical" nature that are part of Fitch's ratings criteria.

### Group IFS Rating Approach

Coface is rated on a group approach, with its main subsidiaries being considered 'Core'. The ratings of the core entities are therefore based on our evaluation of the strength of the group as a whole.

### Notching

For notching purposes, the regulatory environment of France is assessed by Fitch as being Effective, and classified as following a Group Solvency approach.

#### Notching Summary

**IFS Ratings**
A baseline recovery assumption of 'Good' applies to the IFS rating, and standard notching was used from the IFS "anchor" rating to the operating company IDRs.

**Operating company debt**
Not applicable.

**Holding company IDR**
Standard notching was applied between the insurance operating company and holding company IDRs for a group solvency regulatory environment.

**Holding company debt**
Not applicable.

**Hybrids**
For the EUR380 million subordinated debt issued by Coface SA, and taking into account the irrevocable and unconditional subordinated guarantee of Compagnie française d'assurance pour le commerce extérieur, a baseline recovery assumption of 'Below Average' and a non-performance risk assessment of 'Moderate' were used. Notching of minus 2 was applied relative to the Compagnie française d'assurance pour le commerce extérieur IDR, which was based on minus 1 for recovery and minus 1 for non-performance risk.

Source: Fitch

### Short-Term Ratings

Coface's Short-Term IFS Rating is 'F1+', which is standard when the Long-Term IFS rating is 'AA−'.

The short-term debt rating of the EUR600 million commercial paper issued by COFACE SA is 'F1', which is standard when the Long-Term IDR is 'A+'. The issue is entirely backed by five credit lines.

### Hybrids – Equity/Debt Treatment

#### Hybrids Treatment

| Hybrid | Initial amount | FBM[a] Fitch (%) | FBM[a] reg. override (%) | FLR[b] debt (%) |
|---|---|---|---|---|
| COFACE SA Subordinated debt | EUR380m | 0 | 100 | 100 |

[a] FBM: Prism factor-based capital model
[b] FLR: Financial leverage ratio. For FLR, % tells portion of hybrid value included as debt in numerator of leverage ratio
Source: Fitch

### Criteria Variations

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.