Market Review
October 10, 2012

France's Non-Life Sector Resilient Despite Economic Difficulties

Solvency Margins Withstand Economic Strain.

The French insurance market has experienced significant volatility during the past few years, although the non-life sector continues to grow.

While the life market contracted in 2011, gross premium written (GPW) for non-life insurers continued to increase. The non-life sector benefited from a harder market, with rates for motor lines in particular lifted to improve profitability.

A benign year for natural catastrophes in 2011, compared with 2010, also supported the non-life market. The sector posted improved profitability levels in 2011 and is maintaining a solvency margin well above the regulatory required amount.

Despite rates being forecast to modestly increase, insurers could face strain on their overall profitability. Maintaining underwriting discipline is paramount, given the challenging macroeconomic environment that has resulted in continued low investment returns.

Market Overview

The economic slowdown in France has had a negative impact on the country's overall insurance market (including life insurance), with total GPW growing by a modest 3.4% in 2010 and falling 8% in 2011 (see **Exhibit 1**). France's gross domestic product (GDP) grew by 1.7% in 2011, although this is forecast to fall to no more than 0.5% in 2012. Unemployment is projected to remain relatively high at 9.9% in 2012.

Data from the insurance association, Fédération Française des Sociétés d'Assurances (FFSA), shows GPW for the non-life segment increased 4.6% to an estimated EUR 47.9 billion in 2011. This is a record level for the non-life market, with rate increases mainly accounting for the increased premiums.

Virtually every line of business – with the exception of commercial property, which remained static – contributed to non-life growth (see **Exhibit 2**). Motor, the largest line of business at 40% of non-life GPW, experienced a near 4% increase in premiums to

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Exhibit 1
France Non-Life & Life – Key Market Statistics (2007-2011)

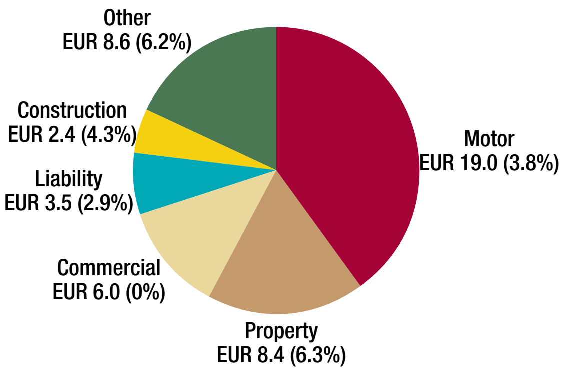
Indicator	2007	2008	2009	2010	2011
Population (Millions)	61.97	62.30	62.64	62.80	63.09
Gross Domestic Product (EUR Billions)	1,887.28	1,931.46	1,889.66	1,931.40	1,995.34
Change in Real GDP (%)	2.23%	-0.20%	-2.63%	1.38%	1.72%
Inflation (%)	1.61%	3.16%	0.10%	1.74%	2.29%
Unemployment Rate (%)	8.37%	7.81%	9.50%	9.80%	9.68%
Insurance Penetration (%)					
Life & Health	8.05%	7.17%	8.19%	8.32%	7.12%
Non-Life	2.31%	2.31%	2.38%	2.37%	2.40%
Total	**10.36%**	**9.48%**	**10.57%**	**10.69%**	**9.52%**
Insurance Premiums Written (EUR Billions)					
Life & Health	152.00	138.40	154.70	160.60	142.10*
Non-Life	43.60	44.70	45.00	45.80	47.90*
Total	**195.60**	**183.10**	**199.70**	**206.40**	**190.00***
Change in Premium Volume (Total) %	-0.76%	-6.39%	9.07%	3.36%	-7.95%

*Estimated
Sources: International Monetary Fund, World Economic Outlook Database, April 2012; Fédération Française des Sociétés d'Assurances

Exhibit 2

France – Non-Life Insurance: Gross Premiums Written by Line of Business and Percentage Growth (2011)

(EUR Billions)



Numbers in parentheses show year-on-year change in GPW.
Source: Fédération Française des Sociétés d' Assurances, A.M. Best research.

EUR 19 billion. The second-largest class of business, household property, enjoyed a 6% uplift in GPW to EUR 8.4 billion.

The increases in non-life GPW are, in part, a result of higher rates. Insurers are exercising greater underwriting discipline, as the continued uncertainty in the Eurozone has resulted in historically low government bond yields. A.M. Best considers the need to focus on maintaining underwriting profitability to be paramount.

Some insurers began to lift rates in 2009 for certain personal lines of business. For years, the motor sector has suffered from unprofitable underwriting, given increasing damage repair and bodily injury costs. In 2011, motor insurers implemented rate increases of approximately 4%, and rates are expected to increase in line with inflation for medical costs and spare parts in 2012.

Natural hazards in 2010, including windstorm Xynthia in February, had an adverse impact on the property sector. As a result of the higher claim experience recorded in 2010, property rates for homeowners increased in 2011 and were expected to increase in 2012. The effects of the economic slowdown in France also started to affect this line of business, with theft claims increasing on the back of increased burglaries.

Rates for commercial and industrial risks have been relatively stable, reflecting competition for these classes. However, where rates are flat or soft, insurers are attempting to improve technical profitability by altering terms and conditions and ending multiyear contracts, particularly for property and large commercial risks. There is a greater focus on deductibles, limits, exposure and exclusions.

According to Groupement des Entreprises Mutuelles d'Assurance (GEMA), the mutual sector grew its non-life GPW by 5% to EUR 12.5 billion in 2011. Mutuals have not been immune from the challenging market conditions, whereby consumers are tightening their belts. However, the majority of mutuals sell directly to the policyholder, and these lower expense and acquisition costs, together with their specific ownership structure, have enabled mutuals to offer more competitive pricing. A.M. Best believes the increase in GPW reported by French mutuals has been driven by a desire to increase market share in a favourable rate environment. While technical profitability for mutuals remains acceptable, this will present a challenge for non-mutual insurers.

The momentum for rate increases appears to have continued in 2012, according to first-quarter data from the FFSA. In *Tableau de bord de l'assurance* May 2012, the association stated that the French non-life market grew by approximately 4% compared with the first quarter of 2011.

French Non-Life Insurers' Performance in 2011

As stated above, insurers are under increasing pressure to focus on underwriting profitability. The ongoing uncertainty within the Eurozone, together with the prospect of Solvency II, has led French insurers to de-risk their balance sheets, and insurers can no longer rely on investment returns. According to the FFSA, investment income for non-life insurers in 2011 fell to EUR 4.3 billion, down from EUR 6 billion in 2010. Before the global economic downturn, investment income reached EUR 7.6 billion (for 2006 and 2007).

In 2011, solvency and profitability levels for French non-life insurers were negatively affected by the difficult economic conditions. Nevertheless, results remained good. Data from the FFSA show capital and surplus in 2011 represented 62.3% (EUR 43.6 billion) of premiums. When including unrealised investment gains, this ratio reached 91%, which was down from the 103% reported in 2010 but exceeded 2008's level of 89.9%. Any deterioration in the Eurozone macroeconomic fundamentals is likely to have a negative effect on solvency, with the risk of increased credit spreads reducing insurers' unrealised gains.

The French non-life insurance sector has improved its underwriting profitability in the past two years. The sector's combined ratio improved in 2010 and 2011. It fell from 104.7% in 2009 to 104.0% in 2010, and to 100.5% in 2011 (see **Exhibit 3**). However, natural catastrophes remain among the most significant threats to this trend. Notable events have included severe flooding in Var in the summer of 2010. In December 2011, windstorm Joachim struck the north of France and was followed by windstorm Andrea, which caused damage in various areas of the country in January 2012.

The French government intends to pass legislation to reform the natural catastrophe insurance system, known as *Régime Cat Nat* (Nat Cat scheme). The reform will not bring any changes to the current articulation of the scheme, in which the French national reinsurer, Caisse Centrale de Réassurance (CCR), plays a major role, but it should ensure coverage is based on an exhaustive list of named perils. Rates will vary in relation to risk exposures for local authorities and companies above a certain size, with the aim to foster risk prevention. Under the current regime, there is a Nat Cat flat percentage surcharge for natural catastrophe risks on all property contracts, regardless of the property insured.

Mergers, Acquisitions and Overseas Expansion

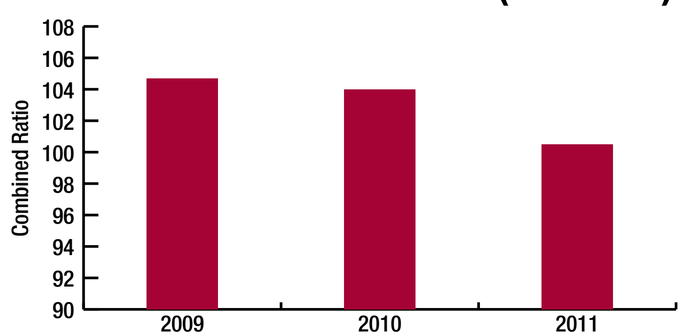
France's non-life insurance market has been subject to merger and acquisition (M&A) activity recently. Much of this has centred on Groupama, which has suffered financial difficulties, culminating in a EUR 3 billion investment write-down in 2011. Groupama has come under pressure to sell subsidiaries and investments after this hit to capitalisation, which resulted from high exposure to equities and sovereign debt within peripheral Eurozone countries.

Sales have included its Spanish subsidiary Groupama Seguros y Reaseguros to Grupo Catalana Occidente, and its property/casualty (P/C) brokerage business Gan Eurocourtage to Allianz France. In July 2012, Groupama announced its intention to sell its Polish insurance branch, Proama, to Generali PPF Holding.

A number of French insurers are attempting to grow outside of France, seeking risk diversification and faster growth through M&A deals. For example, Covéa acquired U.K. insurer Provident Insurance in June 2011. In April 2011, the French SGAM purchased an 81% stake in Banca Popolare di Milano's life operation, which controls BPM's P/C business, BPM Assicurazioni.

Exhibit 3

France Non-Life – Combined Ratio (2009-2011)



Source: Fédération Française des Sociétés d'Assurances

In addition to pursuing growth in other European countries, French insurers also see opportunities in emerging markets in Africa, given its relative proximity and common language. French insurers such as Axa, as part of a wider emerging markets strategy, are focusing on western African countries including Ghana, the Ivory Coast and Senegal, although they face competition from Moroccan insurers.

Conclusion

Technical profitability in the French market has improved considerably since 2009, when the overall market's combined ratio reached 104.7%. A combination of rate increases in 2011 and a more benign claims environment has driven the large improvement in technical profitability. A.M. Best expects rate increases to continue in 2012 and 2013, albeit at lower levels than those achieved in 2010 and 2011.

The sector has shown good underwriting discipline in what has been a challenging investment environment, which is unlikely to improve in the foreseeable future. Any deterioration in Eurozone macroeconomic fundamentals is likely to have a negative effect on the market's overall capitalisation. The effects of the economic slowdown have already had consequences for insurers, with an increase in burglaries noticeable for retail property lines of business. However, as in other European countries, the slowdown may result in an overall reduction in claims as a result of reduced economic activity.

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