06 May 2020 | Affirmation

Fitch Affirms Etiqa Entities' IFS at 'A'; Outlook Stable

Fitch Ratings-Hong Kong-06 May 2020:

Fitch Ratings has affirmed the Insurer Financial Strength (IFS) Ratings of Malaysia-based Etiqa group's core operating entities - Etiqa General Insurance Berhad (EGIB), Etiqa Life Insurance Berhad (ELIB), Etiqa General Takaful Berhad (EGTB), Etiqa Family Takaful Berhad (EFTB) and Etiqa Insurance Pte. Ltd. (EIPL) - at 'A' (Strong). The Outlook is Stable.

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 ratings assumptions described below. These assumptions were used by Fitch to develop pro forma financial metrics for Etiqa group's core operating entities that Fitch compared with both rating guidelines defined in our criteria and previously established rating sensitivities for the Etiqa group's core operating entities.

The affirmation reflects the group's 'Favourable' business profile and 'Very Strong' capitalisation. It also takes into account its 'Very Strong' financial performance and earnings, based on the group's consistent profitability and stable underwriting results.

Fitch regards group capitalisation as 'Very Strong'. The score on Fitch's Prism Factor-Based Model (FBM) is within median guidelines for the entities' rating category. Consolidated financial leverage fell to 0% by end-2019 from 5% in 2018, as EFTB redeemed a MYR300 million callable Tier 2 subordinated sukuk in May 2019. Fitch expects the entities' operations to continue to be managed at the group level, underpinned by surplus growth and sound capital and risk management. Fitch estimates that the pro forma consolidated capital score would remain well into 'Very Strong' by end-2019 under the rating-case scenario.

MAHB delivered return on equity and pretax return on assets of 10.9% and 2.7%, respectively, for 2019, which compare well with the median guidelines for its rating category. This is underpinned by consistent underwriting performance in the non-life and general takaful businesses, as well as sustained mortality profits from the life and family takaful segments. Fitch estimates EGIB's and EGTB's pro forma combined ratios would remain within the ratio guidelines for IFS 'A' rated non-life insurers under the rating-case scenario.

Fitch regards the group's business profile as 'Favourable' compared with that of all other Malaysian insurance companies due to its 'Favourable' competitive positioning, 'Moderate' business-risk profile and 'Most Favourable' diversification. As such, Fitch scores Etiqa's business profile at 'a' under its credit-factor scoring guidelines.

Fitch regards the five group entities as core subsidiaries of Maybank Ageas Holdings Berhad (MAHB), and hence assigns a group rating. The entities are wholly owned by MAHB, and operate in Etiqa's key market segments of Malaysia and Singapore. They share the Etiqa brand and show significant synergies and cross-reporting in their processes, management and resources. Fitch expects MAHB to have adequate financial and capital strength to support its core operating entities if needed.

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 rating 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 16%, applied to securitised products, including asset-backed securities (ABS), current non-investment-grade assets, as well as 12% of 'BBB' assets;

- Both upward and downward pressure on interest rates, with spreads widening (including high yield by 400bp) coupled with notable declines in government rates;

- Capital-market access is limited for issuers at senior debt levels of 'BBB' and below;

- Impairment of alternative investments by 10%;

- Decline in value of investment property by 10%;

- A COVID-19 infection rate of 5% and a mortality rate as a percentage of the infected of 1%; and

- For the non-life and reinsurance sectors, a negative impact on the industry-level accident-year loss ratio from COVID-19-related claims of 3.5 percentage points, partially offset by a favourable impact from the auto line averaging 1.5 percentage points.

RATING SENSITIVITIES

The rating remains sensitive to any material change in Fitch's rating-case assumptions with respect to the coronavirus pandemic. Periodic updates to our assumptions are possible given the rapid changes in government action in response to the pandemic, and the pace with which new information is available on the medical aspects of the outbreak. A discussion of our expectations of the impact on ratings 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 ratings assumptions with respect to the impact of the coronavirus;

- changes in the status of any subsidiary as a core operating entity of the Etiqa group;

- deterioration in the entities' capitalisation, with MAHB's Prism FBM score to below 'Very Strong', and EGIB's, ELIB's or EIPL's statutory risk-based capital (RBC) ratios falling below 200% persistently, and EGTB's or EFTB's statutory RBC ratio falling below 180% for a sustained period;

- significant decline in the entities' financial performance, with EGIB's or EGTB's 'combined ratio' consistently above 100%, or a sharp decline in ELIB's and EFTB's lapse rates or mortality profit

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 impact of the coronavirus;

- A positive rating action is prefaced by Fitch's ability to reliably forecast the impact of the coronavirus pandemic on the financial profiles of Malaysia's and Singapore's insurance industries and Etiqa's operating entities;

- sustained significant improvement in business profile in terms of the group's operating scale and regional presence;

- maintaining sound profitability;

- Prism FBM score maintained at well into 'Very Strong' at the consolidated level.

Stress Case Sensitivity Analysis

- Fitch's stress case assumes a 60% stock-market decline, two-year cumulative default rate of 22%

for securitised products, including ABS and high-yield bonds, high-yield bond spreads widening by 600bp and more prolonged declines in government rates, impairment of alternative investments and loans by 16.5%, heightened pressure on capital-market access, a COVID-19 infection rate of 15% and mortality rate of 0.75%, a decline in the value of investment property by 16.5%, and an adverse non-life industry-level loss ratio impact of 7 percentage points (pp) for COVID-19 claims partially offset by a favourable 2pp for the motor line.

- The implied rating impact under the stress case would be a downgrade of no more than one notch.

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.

Etiqa Family Takaful Berhad; Insurer Financial Strength; Affirmed; A; RO:Sta
Etiqa Life Insurance Berhad; Insurer Financial Strength; Affirmed; A; RO:Sta
Etiqa General Takaful Berhad; Insurer Financial Strength; Affirmed; A; RO:Sta
Etiqa Insurance Pte. Ltd.; Insurer Financial Strength; Affirmed; A; RO:Sta

Etiqa General Insurance Berhad; Insurer Financial Strength; Affirmed; A; RO:Sta

Contacts:
Primary Rating Analyst
Anthony Lam, CFA
Associate Director
+852 2263 9631
Fitch (Hong Kong) Limited
19/F Man Yee Building 60-68 Des Voeux Road Central
Hong Kong

Secondary Rating Analyst
Jeffrey Liew,
Senior Director
+852 2263 9939

Committee Chairperson
Terrence Wong,
Senior Director
+852 2263 9920

Media Relations: Peter Hoflich, Singapore, Tel: +65 6796 7229, Email:
peter.hoflich@thefitchgroup.com
Leslie Tan, Singapore, Tel: +65 6796 7234, Email: leslie.tan@thefitchgroup.com

Additional information is available on www.fitchratings.com

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

Applicable Model
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
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