MOODY'S
INVESTORS SERVICE

CREDIT OPINION
9 March 2017

Update

Rate this Research

RATINGS

AG Insurance

Domicile	Belgium
Long Term Rating	A2
Type	Insurance Financial Strength - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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AG Insurance

Semi-Annual Update

Summary Rating Rationale

Moody's A2 insurance financial strength rating on AG Insurance reflects the company's leading market position in Belgium, its diversified business profile as well as its good capitalisation which means that the company would be resilient to potential stresses on its assets and its liabilities.

These strengths are partly offset by a reliance on third party distribution channels and some constraints on profitability, especially in the non-life segment where competitive pressures could limit further improvements in the combined ratio. In its life business, AG Insurance has been proactive in reducing guarantees granted in life policies so as to mitigate the pressure on the company's financial margins. Moreover, we expect AG Insurance to be able to cope with the low interest rate environment given its good asset liability management, with a low duration gap limiting the reinvestment risk.

AG Insurance is the leading insurance company in Belgium with a 21% market share in 2015 according to Assuralia, the association of Belgian insurance companies. The business mix of the company consists of property and casualty (30%) and life and savings (70%) based on 2016 gross written premiums. The products are mostly sold through brokers and BNP Paribas Fortis network. Since May 2009 BNP Paribas Fortis, a subsidiary of the BNP Paribas Group, has held a 25% share in AG Insurance, next to Ageas Group which retained a controlling 75% stake in the company via Ageas Insurance International N.V., the holding company for all Ageas Group's insurance operations.

Credit Strengths

Credit strengths of AG Insurance are:

» Strong market position and relative market shares in Belgium in both segments life (#1) and non-life (#2)

» Business risk profile with good diversification between individual life, group life and non-life activities

» Good capitalisation and ALM matching to absorb potential stresses on assets and liabilities

Credit Challenges

Credit challenges of AG Insurance are:

» Maintaining market share in the context of a mature and competitive domestic market

» Manage interest rate risk and reinvestment risk in the current low interest rate environment while maintaining good asset quality and ALM discipline

Rating Outlook

AG Insurance carries a stable outlook.

What to watch for:

» Non-life combined ratios

» Life sales and margins

» Increase in investment risk

What Could Change the Rating - Up

The following factor could put upward pressure on the rating:

» Material improvement in the profitability with a normalised return on capital above 8%

» A significant improvement in capitalisation and financial flexibility

What Could Change the Rating - Down

The following factors could put downward pressure on the rating:

» Deterioration in profitability with a normalised return on capital below 4%

» Significant deterioration in capitalisation

» Deterioration in financial leverage metrics below Moody's expectations for A-rated insurers

» Significant deterioration in asset quality

Key Indicators

Exhibit 1

AG Insurance[1][2]	2015	2014	2013	2012	2011
As Reported					
Total Assets	74,006	74,260	67,432	66,956	60,112
Total Shareholders' Equity	6,810	6,488	5,025	5,429	3,302
Net income (loss) attributable to common shareholders'	512	522	447	433	(430)
Gross Premiums Written	5,187	5,444	5,394	6,403	5,934
Net Premiums Written	5,126	5,367	5,323	6,346	5,869
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	96.2%	95.6%	108.7%	89.5%	164.0%
Reinsurance Recoverable % Shareholders' Equity	3.2%	4.1%	3.9%	3.6%	21.0%
Goodwill & Intangibles % Shareholders' Equity[3]	18.7%	19.5%	22.6%	20.7%	24.5%
Shareholders' Equity % Total Assets	8.5%	8.0%	6.9%	7.5%	4.6%
Return on avg. Capital (1 yr. avg ROC)	5.3%	6.1%	5.8%	-	-
Sharpe Ratio of ROC (5 yr. avg)	-	-	-	-	-
Financial Leverage[3]	23.8%	25.2%	25.0%	24.8%	27.6%
Total Leverage[3]	36.6%	37.9%	39.9%	38.3%	44.8%
Earnings Coverage (1 yr.)[3]	9.9x	7.6x	6.6x	6.7x	-1.9x

[1] Information based on IFRS financial statements as of Fiscal YE December 31
[2] Certain items may have been relabeled and/or reclassified for global consistency
[3] Information based on IFRS financial statements of Ageas SA/NV as of Fiscal YE December 31

Detailed Rating Considerations

Moody's rates AG Insurance A2 for insurance financial strength, which is in line with the rating indicated by Moody's insurance financial strength rating scorecard.

Ratings

Exhibit 2

Category	Moody's Rating
AG INSURANCE	
Rating Outlook	STA
Insurance Financial Strength	A2

Source: Moody's Investors Service

Insurance Financial Strength Rating

The key factors currently influencing the rating and outlook are:

MARKET POSITION AND BRAND: Aa - SUSTAINED LEADERSHIP AND FRANCHISE

AG Insurance is the leading insurance franchise in Belgium, ranking number one in life and number two in non-life. Despite the challenging period experienced by the Ageas Group in 2008 and 2009, AG Insurance has maintained a leading position demonstrating its franchise stability. Furthermore, the exclusive distribution agreement concluded until 2020 between AG Insurance and BNP Paribas Fortis, the largest bank in Belgium, enables the insurance company to maintain access to a very large client base, especially in the retail life segment, although as in many European markets competition between banking and insurance savings products is increasing.

DISTRIBUTION: Baa - PREDOMINANTLY THROUGH INDEPENDENT CHANNELS

Bancassurance is the largest source of sales of AG Insurance but the company also maintains significant alternative distribution capacity including independent brokers and direct sales (especially in the employee benefits segment). An agreement with BNP Paribas confirmed the exclusive distribution relationship with BNP Paribas Fortis until 2020. Moody's considers AG Insurance's control of

this distribution channel to be low, since these entities do not belong to the same group. The high weight of sales through brokers also contributes to a relatively low control of the distribution strategy, notwithstanding the preferred position with brokers that the company has been able to maintain. Therefore, Moody's considers AG Insurance's distribution strategy to be more consistent with a Baa-rating.

PRODUCT RISK AND DIVERSIFICATION: A - BENEFITTING FROM A GOOD DIVERSIFICATION, OFFSET BY RELATIVELY HIGH PRODUCT RISK IN LIFE

AG Insurance's portfolio is well-diversified with a 70% / 30% split between life and non-life business based on 2016 gross written premiums. In addition, the company's non-life book shows a relatively low risk profile as about 64% of non-life premiums come from short-tailed lines like Motor and Home, with the remainder primarily coming from health and third-party liability. Nonetheless, Moody's notes that AG Insurance is also exposed to workers' compensation insurance, a long-tailed line of business.

Furthermore, AG Insurance's life book shows a relatively high risk profile, given the high proportion of traditional life reserves, which historically include high options and guarantees in the Belgian market. Although guarantees on new business have been reduced significantly in the past few years (new business guaranteed rate in Individual Life reduced gradually to 0.25% as of November 2016 from 2% in August 2012) and the company built a Low Interest Rate Reserve to finance part of the high guarantees granted in the past, at year-end 2016 the average guaranteed rate on the existing book remains at around 2.5%. More positively, Moody's notes that the parent Ageas maintains a tight matching between consolidated assets and liabilities and expects AG Insurance to manage its portfolio with a duration gap close to zero.

The company has been trying to reduce life product risk by increasing the proportion of unit-linked (UL) products, however the demand for these products has historically been limited in Belgium and the size of UL on AG Insurance's balance sheet is still relatively modest at about 13% of Life gross technical liabilities as of YE2015. Adversely, after a 4% decline in 2015, sales of guaranteed products rose by 14% in 2016, representing more than 90% of total life sales ("Life gross inflows") in 2016 (YE2015: 87%).

ASSET QUALITY: A - GOOD ASSET QUALITY WITH MODEST RE-RISKING

The quality of the assets is good supported by the low level of reinsurance recoverable and relatively low level of goodwill and intangibles on balance sheet, both at AG Insurance level and at Ageas group level. The exposure to high risk assets as a percentage of shareholders' equity as at YE2015 was essentially stable at 96.2% (YE2014: 95.6%), which is still in line with an A rating. The exposure to property and to below IG / unrated bonds and loans in proportion to shareholders' equity is slightly higher vs. YE2014; Moody's expects this modestly rising trend to persist, in a context where yield on new money being reinvested on fixed income (YE2016: 1.71%) has not exceeded the average guaranteed rate (YE2016: 2.49%) since the end of 2014.

Positively, the average quality of the bond portfolio - representing around 79% of the YE2015 investment portfolio- remains strong (c.83% of debt securities rated A or above), with some geographic concentration to highly-rated economies (Belgium, Germany, France, Austria).

CAPITAL ADEQUACY: A - GOOD LEVEL OF CAPITALISATION

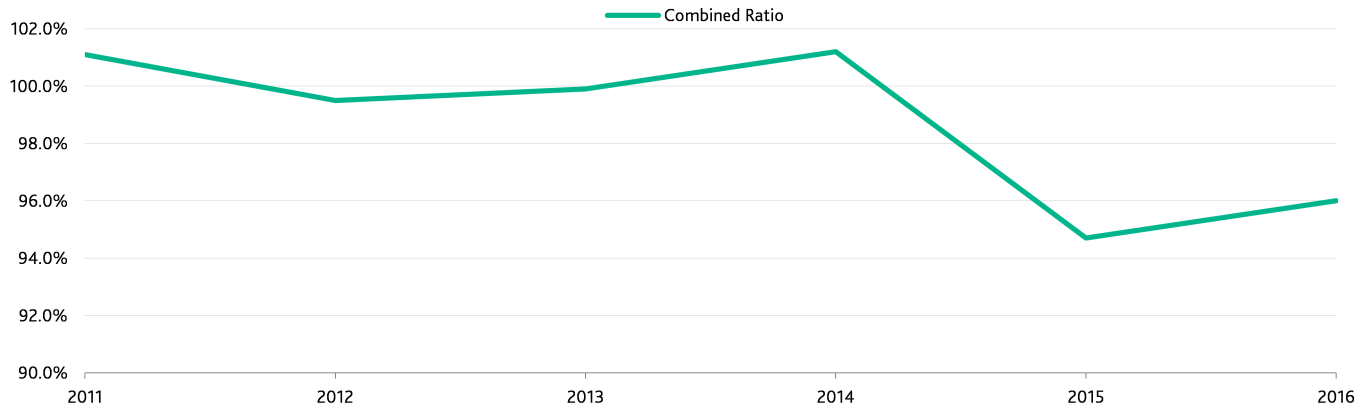
Moody's continues to view AG Insurance's capitalisation as robust and consistent with the risk profile of the company. At YE2016 the insurer reported a Solvency II coverage ratio of 201% on its partial internal model adjusted for non-life insurance risks (YE2015: 234%). The ratio does not include transitional measures other than those applying to grandfathering of AG Insurance's subordinated debt.

Given the significance of long-term guarantees and corporate bonds on AG Insurance's balance sheet, Moody's expects capitalisation to be most sensitive to movements in the yield curve, to wider credit spreads and to changes in the ultimate forward rate, although a disciplined ALM and a good quality of assets invested suggest that such sensitivities would not be overly material. Overall Moody's believes that AG Insurance holds an adequate buffer to absorb potential liability shocks and is likely to show good resilience should it face further stress in the financial markets.

PROFITABILITY: A - CONSTRAINED PROFITABILITY BOTH IN P&C AND LIFE

In the non-life segment the 2016 operating result slightly decreased to EUR175 million (2015: EUR190 million). AG Insurance reported positive underwriting profitability with a combined ratio (COR) of 96% (2015: 94.7%; 2014: 101.2%). While the 2016 headline COR was higher, year-on-year, this partly reflected the impact of higher claims deriving from exceptionally adverse weather in Q2 2016 in Belgium (3.2 pct. points) and from losses on the March terrorist events in Brussels (2.1 pct. points). Notwithstanding these one-off events which negatively affected the loss ratio, Moody's notes that an expense ratio consistently above 35% over the last few years (2016: 37.7%) remains a few percentage points above European peers.

Exhibit 3



Source: Ageas Reports & Moody's

In the life segment, the operating result was fairly stable in recent years (2016: EUR436 million; 2015: EUR432 million; 2014: EUR431 million; 2013: EUR 433 million) although Moody's believes that the company's financial margin will remain limited in the current low interest rate environment. The life operating margins remained equally fairly stable; guaranteed life reported a 2016 result of 86bps (2015: 86bps), which was adequate given the low interest rate environment and lies within the issuer's 85-90bps target range. Unit-linked products reported a modest 31bps (2015: 32bps), which is below the 40-45bps target and reflected limited appetite for market-rate products.

Moody's expects AG Insurance to be able to cope with the low interest rate environment and to manage its exposure to high guarantees granted in life policies in the past on the basis of (1) proactivity demonstrated in decreasing guarantees on new business when facing increasing pressures from lower interest rates, (2) reduced returns to policyholders on policies including profit-sharing mechanisms and (3) disciplined asset liability management, with notably a duration gap close to zero, thereby limiting reinvestment risk.

LIQUIDITY AND ALM: A - IMPROVED ALM DISCIPLINE

Notwithstanding the substantial level of liquid assets within the company and a guaranteed rate on new business lowered to 25bps since November 2016, Moody's views AG Insurance's liquidity and ALM as consistent with a A-rating. Moody's believes that the company is intrinsically exposed to a decrease in interest rate reflecting the high guarantees granted to policyholders in the past, which results in an avg. guaranteed rate of 2.49% at year-end 2016. Nonetheless, AG Insurance has managed this risk by building a Low Interest Rate Reserve for past guarantees and by closely matching its technical liabilities, which should from now on limit the negative impacts of prolonged low rates.

The company is also exposed to the risk that an increase in interest rates could at the same time impact negatively the market value of the fixed income portfolio and create a liquidity shock for the company via potential lapses, although some high guarantees and surrender penalties mechanisms currently limit this risk.

RESERVE ADEQUACY: A - SOME EXPOSURE TO LONG-TAIL RISK

In the context of the relatively short-tailed nature of the non-life insurance businesses, AG Insurance's loss reserve development tables show evidence of reserving modestly above mid-point, which is consistent with an A rating. Nonetheless, the company remains exposed to some medium- or long-tail lines such as workers' compensation and motor bodily injury.

FINANCIAL FLEXIBILITY: Baa - ADEQUATE FINANCIAL FLEXIBILITY

Adjusted financial leverage for Ageas SA/NV was relatively low for its rating level at 23.8% at YE2015 (YE2014: 25.2%) but total leverage, excluding equity credit given to hybrid debt, is significantly higher at 36.6% at YE2015 (YE2014: 37.9%). Our leverage calculations include a financial liability related to a put option that Ageas granted to BNP Paribas Fortis on the 25% stake in AG Insurance that BNP Paribas Fortis owns (option to sell this stake to Ageas in the six month period starting 1 January, 2018). Excluding this put option the financial leverage ratio amounts to 18.4% (from 23.8% including this liability) and the total leverage to 32.4% (from 36.6% including this liability). Please refer to Ageas SA/NV Credit Opinion for more details on the Group's financial flexibility.

AG Insurance has senior debt of EUR0.94 bn mostly secured to property, EUR0.9 bn of hybrid debt issued to external investors, EUR0.45 bn of hybrid debt issued to Ageas Group and BNP Paribas and EUR6.8 bn of shareholders' equity. We expect the company's financial leverage and earnings coverage metrics to remain consistent with AG Insurance's rating level in the medium term.

Furthermore, although the financial flexibility of the Ageas Group may be influenced by the litigation risk that the holding company is facing, AG Insurance's most recent issuance of external hybrid debt (EUR400 million in March 2015) suggests that the operating company may have an adequate access to capital markets on a standalone basis. AG Insurance has partly used the proceeds from this issuance to redeem EUR0.1 bn of a hybrid debt (Hybrone securities) in June 2016.

Rating Methodology and Scorecard Factors

Exhibit 4

Financial Strength Rating Scorecard	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adjusted Score
Business Profile								Aa	A
Market Position and Brand (20%)								Aaa	Aa
- Relative Market Share Ratio	X								
Distribution (5%)								Baa	Baa
- Distribution Control				X					
- Diversity of Distribution			X						
Product Focus and Diversification (10%)								Baa	A
- Product Risk - P&C			X						
- Product Risk - Life					X				
- Product Diversification	X								
- Geographic Diversification					X				
Financial Profile								A	A
Asset Quality (10%)								Aa	A
- High Risk Assets % Shareholders' Equity			96.2%						
- Reinsurance Recoverable % Shareholders' Equity	3.2%								
- Goodwill & Intangibles % Shareholders' Equity[3]	18.7%								
Capital Adequacy (15%)								Aa	A
- Shareholders' Equity % Total Assets		8.5%							
Profitability (15%)								Baa	A
- Return on Capital (5 yr. avg)				X					
- Sharpe Ratio of ROC (5 yr. avg)					X				
Liquidity and Asset/Liability Management (5%)								A	A
- Liquid Assets % Liquid Liabilities			X						
Reserve Adequacy (5%)								Aa	A
- Adv./(Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd avg)		X							
Financial Flexibility (15%)								A	Baa
- Financial Leverage[3]		23.8%							
- Total Leverage[3]			36.6%						
- Earnings Coverage (5 yr. avg)[3]			5.8x						
Operating Environment									
Aggregate Profile								A1	A2

[1] Information based on IFRS financial statements as of Fiscal YE December 31
[2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis
[3] Information based on IFRS financial statements of Ageas SA/NV as of Fiscal YE December 31

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