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## French Mutual Insurers Are Feeling The Many Forces Of Consolidation

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# French Mutual Insurers Are Feeling The Many Forces Of Consolidation

Changes are profoundly reshaping the French health insurance sector, and Standard & Poor's believes more consolidation is coming--especially in the mutual sector. We believe such changes--encompassing regulatory, prudential, and conduct-of-business changes--will lead to increasing standardization of product offers, and tend to reduce the differentiation benefits for operating as a mutual, insurance company, or protection institution (see definitions in the box below). In the regulatory arena, French health insurance is seeing changes such as the introduction of Solvency II, as well as the generalization of health covers, with new legislation requiring all companies to provide health insurance to their employees. Increased competition from traditional insurers seeking more exposure to less interest-rate-sensitive insurance products is putting even more of a squeeze on small and medium players.

## Overview

- The French mutual sector is undergoing a consolidation wave as a result of a spate of regulatory changes and increasing competition from other players.
- Solvency II inflates the reporting and capital burden for small players, while IT system and staff requirements are calling into question the viability of small players in a highly competitive environment.
- Such changes, which reduce the differentiation benefit of being a mutual, are likely to reshape the health insurance marketplace in the next five years.
- We expect increased cross-segment consolidation, more competitive products and pricing, as well as an increased emphasis on cost control.

## Mutuals, Protection Institutions, And Mutual Insurance Societies

Non-stock insurance companies in France fall into three categories: Mutual insurance societies ("sociétés d'assurance mutuelles"), protection institutions ("institutions de prévoyance"), and mutuals ("mutuelles"). This report focuses on the third segment, the mutuals.

The first segment is regulated under the French insurance code, alongside stock insurance companies, and comprises groups of legal entities that write all lines of business, life, accident & health, and property/casualty—such as Covéa, Groupama, MACIF, MAIF, and MATMUT. The second segment comprises non-profit companies regulated under the French social security code and that write mostly group term, group disability, and group health business for private-sector companies. They are part of larger groups that also include companies managing pension schemes for private-sector companies—companies such as AG2R, Malakoff-Médéric, Humanis, and Klésia. Finally mutuals, the third segment, are regulated by a special code for mutuals, and are commonly referred to as "Mutuelles 45," and include such companies as Harmonie, MGEN, and Mutuelle Générale.

Over the past 10 years, provisions pertaining to insurance regulation in the mutual and social security codes have been gradually aligned to those of the insurance code. With Solvency II transposed in local law in March 2015, the mutual and social security codes now basically refer to the insurance code as the source for regulation of insurance operations.

Following a steady reduction in the number of mutuals over the past 10 years, the past few years have seen many mergers among mutuals and consolidation with players outside the mutual segment. We expect this trend to continue as the mutual segment still features many small players seeking to pool efforts or join larger groups, in order to cope with stringent reporting and capital requirements, and remain commercially and financially viable.

**Table 1**

France's Mutual Insurers: Gross Premiums Written And Solvency Ratios					
	--Gross premiums written 2014--				
	Total (mil. €)	Individual health (%)	Group health (%)	Other (%)	Solvency I ratio 2014 (including unrealized gains)
Harmonie Mutuelle	2,374	53.9	44.2	1.9	350.0
Groupe MGEN*	1,758	80.1	2.1	17.7	656.0
La Mutuelle Générale	1,094	35.6	42.3	22.1	485.0
Eovi Mcd Mutuelle	819	66.0	34.0	0.0	430.0
MNH	639	40.2	59.5	0.3	N.A.
Adréa Mutuelle	590	60.5	38.1	1.4	608.0
Unéo*	578	99.9	0.0	0.1	291.0
Viasanté Mutuelle (AG2R La Mondiale)	578	71.5	28.5	0.0	693.0
MNT*	573	77.0	0.7	22.3	344.0
Maaf Santé (Groupe Covéa)	494	97.2	2.8	0.0	439.0
Macif Mutualité	464	60.6	11.4	28.0	324.0
Micils (Apicil)	386	40.6	47.1	12.3	312.0

\*Premium split relates to gross premiums written in 2013. N.A.--Not available. Source: L'Argus de l'Assurance.

## A Strong Focus On The Health Sector

All insurers, including the mutuals, operate in the health insurance field in France as complementary cover providers (complémentaire santé). They pay the complementary health and medical costs that policyholders incur on top of the state cover layer (Caisse d'Assurance Maladie). Insurers' covers are made through individual or group contracts. Historically, each mutual typically has focused on a limited client segment, and has been mainly active in the individual contract field. Protection institutions, focusing on insuring enterprise-wide health and protection schemes, mostly write group contracts. Traditional insurers mostly write individual covers. We value the total health insurance market where insurers operate at approximately €32 billion in premiums.

Protection institutions, and broadly the groups in which they have evolved, the so-called the social protection groups ("groupes de protection sociale"), have developed sectorwide expertise. As groups managed by employee and employer unions, they grew to manage the compulsory second-tier pension schemes in France (ARRCO-AGIRC). They also developed protection (term, workers compensation) insurance activities for the employees of an entire private industrial or service sector, where they would be designated as its sole insurer (the so-called designation clauses or "clause de désignation") and where all companies in the sector would compulsorily be covered under the sector's insurance contract. They also developed large group health contracts (not subject to designation clauses) with

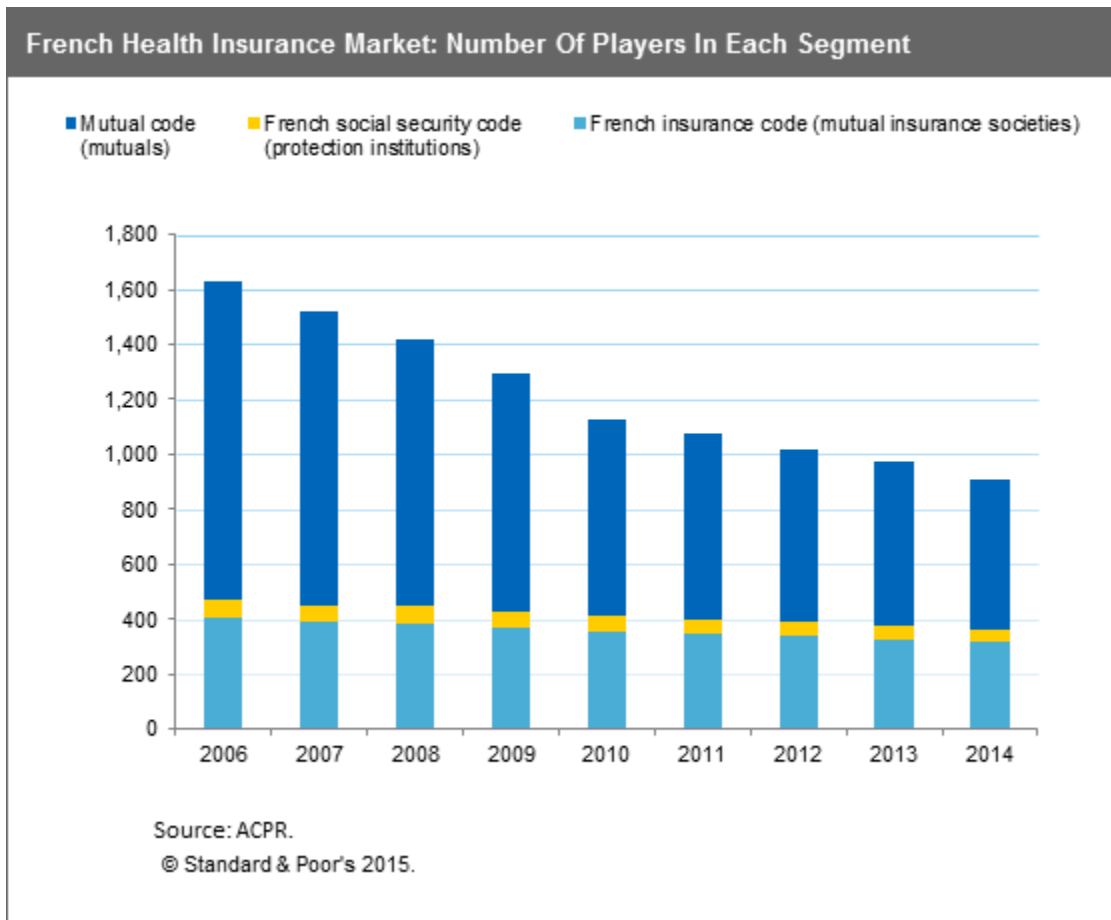
enterprises within the industrial/service sectors they cover.

Mutuelles 45 are by law restricted to the provision of accident & health and life insurance, whether in the form of health insurance, incapacity insurance, long-term care, or term life insurance products. Health insurance represents almost 90% of their premiums on average, and is a segment where historically they have held over 50% market share. However, competition from both traditional insurance companies (approximately 25% market share) and institutions de prévoyance (about 18% market share) is slowly eroding this position.

## **Pressure From Many Directions**

It is to combat the combined pressure of regulation and increased competition that consolidation has been a major trend in the mutual sector during the past 10 years, with the number of mutuals decreasing to 550 in 2014 from 1,158 in 2006, according to the French supervisory body ACPR (Autorité de Contrôle Prudentiel et de Résolution). Years 2014 and 2015 have witnessed an accelerated pace of consolidation as the regulatory burden has become larger and deadlines for implementation draw closer. Despite this, the market remains highly fragmented. Even though recently visible mergers and partnership announcements are leading to the emergence of health insurance giants, the top 20 players make only up 50% of the market. By comparison, the top 20 protection institution segment players comprise 98% of the segment's overall health premiums.

Chart 1



The increasing alignment of reporting and regulatory requirements for mutuals and protection institutions to those of insurance companies triggered the first wave of consolidation in the late 90s. The preparation for Solvency II has accelerated the trend. Small, pure mutual players had little diversification benefit, and because of their non-profit orientation they had developed strategies that were oriented less toward risk management than for traditional insurers.

The merger of the French mutual supervisory body for mutuals within that of insurers, which later led to the creation of the ACPR, further accelerated consolidation, as it brought increased scrutiny and transparency requirement. Such scrutiny particularly trimmed the ranks of the so-called "substituted" mutuals, which do not retain business by means of full cession to other mutual players.

Broader commercial efforts to retain clientele have also been a factor. That's because most small mutuals were built around a certain category of customer, generally focused on a single profession and region. Now that the "multi-professional" model is gaining the lion's share of business, many single-profession mutuals have been looking to join the larger, multi-professional groups.

More recently, newly enforced regulation leading to a general health insurance cover (commonly referred to as ANI for Accord National Interprofessionnel; see section below) has also been a catalyst for consolidation. The trend is touching

all tiers in the mutual segment, larger and smaller players alike, culminating over the past two years with flagship moves such as the Harmonie Mutuelle and Mutuelle Générale de l'Education Nationale (MGEN) partnership, which boasts €4.3 billion in premiums or close to 15% of the French complementary health insurance market.

The insurance codes alignments, as well as the creation of get-together vehicles for mutual or mutual-like insurance companies, have torn down the walls between the various segments (mutuals, institutions de prévoyance, and insurance companies): for example, moves by Mutuelle Générale (a mutual group) and Malakoff Médéric (a protection institution) to create a group generating €4.6 billion in premiums. Via Santé/AG2R-La Mondiale is another example of cross-segment moves, integrating a mutual focusing on individual health insurance into the AG2R LM group, which includes savings and retirement businesses (72% of 2014 revenues) and group health (11% of 2014 revenues).

We expect consolidation in the sector to continue, helped by the increasing popularity of the long-standing SGAM (Société de groupe d'assurance mutuelle) grouping scheme and UMG (Union Mutuelle de Groupe), as well as the newly added SGAPS (Société d'assurance de groupe de protection sociale). Such schemes allow the grouping of mutual-like companies under common top management, aligned strategies, and financial solidarity terms, and where members determine the level of integration and financial support. They also allow the groupings to apply for prudential group supervisory treatment under Solvency II. Examples of SGAMs where we currently rate members are Covéa (A+/Stable) and AG2R-La Mondiale (A-/Stable). When determining our rating for a member of a SGAM, we take a view of the extent of financial support mechanisms and fungibility of capital, which currently are very different among the existing groupings in the French market.

## **Accord National Interprofessionnel (ANI)**

The Accord National Interprofessionnel (ANI), which comes into force in January 2016, has been a headline concern for mutual companies, as it is likely to lead to big change to their product offerings. We believe the areas of this legislation which will have the most impact are:

- The requirement for all private-sector companies to provide health insurance cover to their employees, which will prompt a move to group policies from individual ones.
- The end to "clauses de désignation," whereby specific sectors would negotiate their coverage as a group.
- The potential for civil servants (including teachers, for instance) to move from their existing mutual to the mutual of their partner.

We believe that the first point represents a significant risk for the Mutuelles 45 because more than two-thirds of their business comes from individual contracts, which are falling from favor as group contracts gain. Indeed, this is one force behind the consolidation of mutuals and protection groups, as protection groups have more experience in the group health field.

We believe the end to "clauses de désignation" could represent an opportunity for the market, as it opens up competition in the group term and workers compensation lines, where individual protection is most common. This could result in a move of business away from institutions de prévoyance to the benefit of other players. Despite the weighting toward individuals in the business mix, mutuals have a similar market share in group business to institutions

de prévoyance. They therefore have the capacity to respond to the competition. However, group health insurance has historically been less profitable than individual, with a combined ratio on average 10 percentage points higher than that of individual business. As competition increases in this segment, these combined ratios could weaken further.

It is as yet unclear whether the level of cover under these new group policies, especially for the smallest businesses, will be equivalent to the cover under an individual health insurance contract. This may open up opportunities for the sale of "top-up" products, to bring group cover to an equivalent level as individual, although this may be easier to purchase from the original provider rather than a third party.

A further challenge for the Mutuelles 45 is their lower experience in other lines of business than for other insurers. For small companies looking to buy health cover for the first time, the potential to buy competitively priced packages of various insurance covers from a single provider could be an attractive option, leading them to move away from mutuals toward more diversified insurers.

## **Solvency II**

The implementation of Solvency II, and in particular the requirements for risk assessment and reporting, has penalized the smaller mutuals. In general, the sector is well-capitalized under the Solvency I regime, particularly including unrealized gains on investments (see table 1).

However, it remains uncertain how the mutual sector as a whole would fare under Solvency II's standard formula given its limited disclosure. Health insurance is short-tail in nature, which should generally be positive for solvency ratios. Nevertheless, in general, the poor underwriting profitability of the sector could weigh on capital coverage ratios. Mutuals significantly supplement underwriting results with investment income, which is unlikely to rise given today's low interest rates, also putting pressure on solvency ratios. Low interest rates place greater emphasis on underwriting quality, but the highly competitive environment might make that difficult as well. The pressure on solvency ratios therefore prompts the search for further diversification benefits.

Meanwhile, an option for additional finance has opened up to mutuals. In February 2015, France adopted legislation that gives mutuals the ability to issue "certificats mutualists," a form of debt carrying no entitlement to underlying assets or voting rights. The certificates can only be bought by members or policyholders, including mutual companies that form part of the same group. Certificates can only be sold on to the issuer under certain conditions. While these certificates broaden the financing options for mutuals, we believe that the amounts involved are likely to be small, due to the restricted nature of potential subscribers. In addition, the remuneration of the certificates is determined annually based on operating performance, which limits certainty about the potential yield.

Solvency II has also led to increased competition in the key markets of the Mutuelles 45, as it pushes traditional insurance companies to look to lower capital-intensive forms of business (that is, to move away from traditional, guaranteed business). The traditional life insurance contract remains relatively expensive in terms of capital, and even more so in a low interest rate environment where investment margins are low. We've therefore seen an increase in competition from traditional insurers in some business lines where mutuals have historically been very strong, such as health.

We have determined, based solely on the developments described herein, that no rating actions are currently warranted. Only a rating committee may determine a rating action and, as these developments were not viewed as material to the ratings, neither they nor this report were reviewed by a rating committee.



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