French Life Insurers Increase Prudency Amidst Taxing Market Conditions

The French life insurance market remains resilient, although the macro-economic environment has led to uncertainty. Despite the current economic pressures affecting France, the country continues to have one of the highest rates of household savings in Europe. According to data by the French central bank, Banque de France, the domestic savings rate as a percentage of gross disposable income increased to 15.0% in the third quarter of 2016, from 14.2% at year-end 2015 (see Exhibit 1).

Exhibit 1
France - Life - Domestic Savings Rates in Europe (2004-2016 Q3)

French savings products mainly comprise life insurance contracts, bank savings accounts and tax-free deposits such as Livret A (savings passbook) or fixed-term deposits (“comptes à terme”), as well as shares and bonds. Life insurance products - in particular euro-denominated contracts (similar to with-profits savings contracts in the United Kingdom) – have traditionally been the most attractive available. They account for the largest proportion of savings as they offer tax advantages, provide a guarantee on the sum insured, and have historically generated higher returns than bank offerings. However, over recent months, life insurance seems to have lost some of its appeal, and in the third quarter of 2016, demand for bank deposit savings surpassed traditional life insurance.

After three years of continuous growth between 2013 and 2015 (4.9% in 2013, 8.5% in 2014 and 5.3% in 2015), life premium revenue decreased marginally by 0.6% in 2016 to EUR 134.7 billion, according to the French Federation of Insurance (Fédération Française de l’Assurance) (FFA). By contrast, net premium collection (the difference between premiums collected and benefits paid) deteriorated significantly by 28.5% to EUR 16.8 billion, chiefly driven by the last five months of 2016, when the monthly net premium collection was on average EUR 0.5 billion, compared to EUR 2.0 billion for the same period in 2015. In
particular, A.M. Best notes that the second half of 2016 was impacted by a negative net collection in September (EUR -0.6 billion), which had not been observed since December 2013 (EUR -0.9 billion).

The life market has experienced shrinking returns in recent years, primarily stemming from the very low interest rate environment, which continues to squeeze earnings. In the hunt for higher yields, policyholders have shifted their investment appetite towards unit-linked products over the past five years. Whilst unit-linked policies accounted for 12.2% of premium revenue in 2012, they represented 20.1% of premium revenue (and 84.0% of net collection) in 2016. Policyholders may also have deferred their investment decisions, as they await the outcome of presidential elections in May 2017 in order to better understand the impact on life products of any legislation changes and tax incentives.

The Loi Sapin II, which is part of France’s new anti-corruption framework, was adopted in 2016 and may have contributed to a decrease in net premiums collected towards the end of the year. This law introduces a number of measures aimed at avoiding systemic risks and affects the insurance sector on different levels. The law imposes new stress tests upon insurers and gives powers to the financial stability body, the Haut Conseil de Stabilité Financière (HCSF), to determine a company’s reserving levels and in case of crisis, to limit or suspend withdrawals from life policies by their policyholders. A.M. Best notes that this point, in particular, appears to have been a source of concern, with approximately 70% of the French public opposing the idea of restricting access to their savings, according to an October 2016 survey by polling agency Odoxa, commissioned by Linxea.

Low Interest Rate Environment Maintains Pressure on Bonuses

Whilst the average bonus rate credited to traditional euro-denominated contracts has been on a downward trend since the early 2000s, when products were attracting above 5% bonus payments, the decrease recorded for 2016, at 50 basis points to 1.8% according to data published by the FFA, was the sharpest since 2011 (and almost twice that experienced in 2015). Since the Eurozone crisis, insurers have been operating in a challenging environment, with quantitative easing measures resulting in a prolonged period of low interest rates.

Interest rates particularly affect writers of euro-denominated contracts, who need to invest in secure and liquid assets: typically 70% to 80% of assets backing euro-denominated products are comprised of government bonds. A.M. Best notes that the average bonus rate offered to traditional insurance savings products for 2016 decreased to a greater extent than the reduction observed for the yield of French 10-year government bonds, which reduced from an average of 0.9% for 2015 to an average of 0.5% in 2016. Whilst insurers have become more conservative in their profit-sharing strategies, the ongoing low interest rate environment is expected to continue to erode investment margins, which will lead to further reductions in the yields of traditional life savings products.

Following several years of gradual decline, the average return on traditional euro-denominated contracts fell below 2% for the first time last year. The 2016 bonus rates to euro-denominated life insurance contracts published by insurers up to the beginning of March 2017 ranged from roughly 0.3% to 3.6%, compared with 1.0% to 4.0% in 2015. French life assurer Suravenir lowered bonus rates but continued to provide one of the strongest yields on the market, assisted by its significant exposure to real estate. All market participants appear to have reduced their bonus rates for traditional savings products for 2016, with some cutting them by up to 270 basis points. Some of the insurers that reported among the biggest decrease in bonus rates (including Monceau Assurances and MIF, which decreased bonuses by 82 and 70 basis points respectively), were still reporting higher than average market bonus rates (2.5% for Monceau Assurances and 2.6% for MIF), demonstrating part of the market’s willingness to
remain attractive. However, at the other end of the spectrum, bancassurers in particular, seem to have been more aggressive in cutting back their bonuses (often to below 0.5%), reflecting their stronger market shares and solid business positions.

Exhibit 2
France - Life - Average Annual Returns On Traditional Life Products (2007-2016)

Between 2011 and 2015, insurers had managed to offer solid returns to policyholders, as demonstrated by the evolution of real bonus rates (inflation-adjusted) to euro-denominated contracts. While the nominal yields on traditional life savings contracts have been decreasing since 2001, so has inflation, which reached a low rate of 0.0% in 2015. The reduction in the inflation rate implies that the average real bonus rate to euro-denominated contracts had actually increased since 2011, when it was 0.9%, to reach a five-year high of 2.3% in 2015. With inflation at 0.2% last year, the real yield of euro-denominated contracts for 2016 decreased for the first time since 2011, by 70 basis points compared to 2015. A.M. Best attributes this to an increased level of discipline by the insurers. With inflation in France expected to rise to 1.3% in 2017 and bonuses predicted to decrease further, the real yields on euro-denominated contracts are likely to fall to below 1% prospectively.

Traditional life insurance products remain competitive as Exhibit 3 shows. They still outperform yields offered by the savings passbooks such as Livret A, which reduced returns to 0.75% in 2015 (against 1.25% in 2013). Euro-denominated contracts offered the third highest nominal remuneration rate (before tax) among savings products in 2016, after shares (4.9% return for France’s CAC 40 stock market index last year) and unit-linked insurance contracts (which yielded on average 3.9%).
A.M. Best believes that the decrease in the average bonus rate of euro-denominated contracts should be viewed in conjunction with the evolution of the average profit-sharing provision, the “provision pour participation aux excédents” (“PPE”). This reserve, considered as a capital buffer in A.M. Best’s analysis of companies’ risk-adjusted capitalisation, is used by life insurers to smooth the bonus rates credited to euro-denominated contracts. Insurers have the option not to distribute surpluses to policyholders in the year they have been generated, and can set them aside in the profit-sharing provision for up to eight years, to be used to supplement returns to policyholders in difficult years.

In 2016, as part of their more disciplined profit-sharing strategies, most market participants took steps to further bolster their level of profit-sharing provision and thereby increase their financial flexibility (which A.M. Best views positively). At year-end 2016, the mathematical reserves and profit-sharing provision for the French traditional savings market reached EUR 1,329 billion (2015: EUR 1,304 billion). The level of profit-sharing provision itself increased by 16.1% to EUR 41.2 billion in 2016 (or 3.0% of total reserves for the whole market), almost double 2012’s level. Over the past five years, the insurance market has been increasing its ratio of profit-sharing provision over total mathematical reserves, resulting in stronger balance-sheets for many players. Going forward, A.M. Best expects insurers with higher levels of profit-sharing provision and stronger balance sheets to be better able to defend their business positions by using their reserves to bolster future bonuses, putting them at a competitive advantage.
In the second half of 2016, the president of the FFA announced that the French life insurance sector was considering introducing a new compulsory life reserve, called “reserve for future yields” (“provision pour rendements futurs”, or “PRF”). The purpose of this new reserve would be to smooth bonuses paid out to policyholders over time in an effort to adapt the industry to the ongoing level of low interest rates. The PRF is planned to have two key features: it would be constituted before allocations to the profit-sharing provision, with the effect of decreasing amounts available to build up the profit-sharing provision, and would not be “owned” by the policyholders. Whilst A.M. Best would view such a development as positive for the insurance industry, as it would enforce further discipline in the market, and be expected to improve companies’ balance sheet strength, its implementation is proving challenging, and is not envisaged before 2018. The relevance of such a contra cyclic mechanism could also be put at stake if interest rates were to rise prior to its implementation.

**Continuous Pressure on Margins, but no Rating Actions Anticipated**

Over the last few years, the French life sector has been adapting to the low interest rate environment by optimising its profit-sharing strategy, reducing bonus rates to traditional savings products, and actively diversifying its business mix by increasing its unit-linked product offering and protection businesses, which are less capital intensive, and less sensitive to interest rates. However, despite recent efforts, the French life insurance sector remains heavily skewed towards traditional euro-denominated contracts, which accounted for approximately 80% of the total in-force life insurance contracts at year-end 2016.

Going forward, A.M. Best believes that the operating environment will remain challenging for French life insurers. Intense competition between market participants, coupled with low interest rates, will continue to place pressure on the sector’s operating performance. At this stage though, A.M. Best does not expect to take any rating actions, as insurers continue to focus on technical discipline. Insurers are likely to reduce bonus rates credited to their euro-denominated contracts further over the next year, possibly reducing the market average to 1.5%, as profit margins continue to decrease. Some market participants may also be tempted to increase the risk profile of their assets to enhance their investment return, which could place pressure on their risk-adjusted capitalisation.

A.M. Best also notes that, while it does not anticipate such a scenario, a sharp increase in interest rates could increase lapse rates and weaken an insurer’s balance sheet. Insurers with relatively low levels of profit-sharing provisions could end up in a challenging situation. Indeed, these market participants could be the first insurers lacking the financial flexibility to maintain the attractiveness of their offerings under such a scenario.
Published by A.M. Best
SPECIAL REPORT
A.M. Best Company, Inc.
Oldwick, NJ
CHAIRMAN & PRESIDENT Arthur Snyder III
EXECUTIVE DIRECTOR Paul C. Tinnirello
EXECUTIVE VICE PRESIDENT Karen B. Heine
SENIOR VICE PRESIDENTS Alessandra L. Czarnecki, Thomas J. Plummer
A.M. Best Rating Services, Inc.
Oldwick, NJ
CHAIRMAN & PRESIDENT Larry G. Mayewski
EXECUTIVE VICE PRESIDENT Matthew C. Mosher
SENIOR MANAGING DIRECTORS Douglas A. Collett, Edward H. Easop, Stefan W. Holzberger, Andrea Keenan, James F. Snee
WORLD HEADQUARTERS
1 Ambest Road, Oldwick, NJ 08858
Phone: +1 908 439 2200
WASHINGTON
830 National Press Building, 529 14th Street N.W., Washington, DC 20045
Phone: +1 202 347 3090
MEXICO CITY
Paseo de la Reforma 412, Piso 23, Mexico City, Mexico
Phone: +52 55 1102 2720
LONDON
12 Arthur Street, 6th Floor, London, UK EC4R 9AB
Phone: +44 20 7626 6254
DUBAI*
Office 102, Tower 2, Currency House, DIFC
P.O. Box 506617, Dubai, UAE
Phone: +971 4375 2780
*Regulated by the DFSA as a Representative Office
HONG KONG
Unit 4004 Central Plaza, 18 Harbour Road, Wanchai, Hong Kong
Phone: +852 2827 3400
SINGAPORE
6 Battery Road, #40-02B, Singapore
Phone: +65 6598 8400

Best's Financial Strength Rating (FSR): an independent opinion of an insurer’s financial strength and ability to meet its ongoing insurance policy and contract obligations. An FSR is not assigned to specific insurance policies or contracts.

Best’s Issuer Credit Rating (ICR): an independent opinion of an entity’s ability to meet its ongoing financial obligations and can be issued on either a long- or short-term basis.

Best’s Issue Credit Rating (IR): an independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation and can be issued on a long- or short-term basis (obligations with original maturities generally less than one year).

Rating Disclosure: Use and Limitations
A Best’s Credit Rating (BCR) is a forward-looking independent and objective opinion regarding an insurer’s, issuer’s or financial obligation’s relative creditworthiness. The opinion represents a comprehensive analysis consisting of a quantitative and qualitative evaluation of balance sheet strength, operating performance and business profile or, where appropriate, the specific nature and details of a security. Because a BCR is a forward-looking opinion as of the date it is released, it cannot be considered as a fact or guarantee of future credit quality and therefore cannot be described as accurate or inaccurate. A BCR is a relative measure of risk that implies credit quality and is assigned using a scale with a defined population of categories and notches. Entities or obligations assigned the same BCR symbol developed using the same scale, should not be viewed as completely identical in terms of credit quality. Alternatively, they are alike in category (or notches within a category), but given there is a prescribed progression of categories (and notches) used in assigning the ratings of a much larger population of entities or obligations, the categories (notches) cannot mirror the precise subtleties of risk that are inherent within similarly rated entities or obligations. While a BCR reflects the opinion of A.M. Best Rating Services, Inc. (AMBRS) of relative creditworthiness, it is not an indicator or predictor of defined impairment or default probability with respect to any specific insurer, issuer or financial obligation. A BCR is not investment advice, nor should it be construed as a consulting or advisory service, as such; it is not intended to be utilized as a recommendation to purchase, hold or terminate any insurance policy, contract, security or any other financial obligation, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser. Users of a BCR should not rely on it in making any investment decision; however, if used, the BCR must be considered as only one factor. Users must make their own evaluation of each investment decision. A BCR opinion is provided on an “as is” basis without any expressed or implied warranty. In addition, a BCR may be changed, suspended or withdrawn at any time for any reason at the sole discretion of AMBRS.