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## **Groupama troubles question viability of mutuals in light of Solvency II**

By Rodrigo Amaral

**Developments at French insurance group Groupama in the past few months have reignited concerns about the ability of mutual insurance companies to raise new capital, especially as the Solvency II directive is set to raise capital requirements for the industry.**

Groupama has gone through a change of CEO and is reportedly mooting the sale of some of its most prized assets after a dramatic reduction of solvency levels that risks triggering action from the Autorité de Contrôle Prudentiel (ACP), France's insurance supervisory body.

The group saw its solvency levels shrink due to costs incurred following the expansion of foreign activities, the drop in value of its equity portfolio and its high exposure to southern European debt. The situation deteriorated so badly during the course of this year that long-serving CEO Jean Azéma was replaced in October by Thierry Martel, previously the Head of Insurance Operations in France.

As mutual insurers cannot issue equity to boost capital levels, Groupama is looking at alternative solutions to rebuild its solvency buffers. The regional mutual **banks ???** that own the group injected a reported €500m in November, but the amount has been deemed insufficient to meet current capital requirements.

It is expected that the firm will try to sell its stakes in companies like Silic, a property investment firm that is 44% owned by Groupama, and GAN Assurances, a coveted brokerage network.

Groupama is the sixth largest insurer in France and as a result the outcome of its current problems is a concern for corporate insurance buyers in the country. **But the most pessimistic may also ponder to what extent the Groupama affair reflects on the future of the mutual insurance industry as the implementation of Solvency II approaches and other mutuals will have to raise their capital levels.**

Cyrille Chartier-Kastler, the Chairman of Facts & Figures, a consultancy firm in the outskirts of Paris, explained that French insurers have two main roads to raise capital levels.

The first, and most favourable in his view, is to issue subordinated debt. The second is to draw investments from a new partner by setting up a holding company as a 'société anonyme', which is roughly the equivalent to a British plc, to manage the insurance business.

*Mr Chartier-Kastler believes the first option tends to be most favoured by mutuals because it prevents the de-mutualisation of the firm and keeps the control of the business in the hands of the original owners.*

*But given current market conditions, issuing subordinated debt looks far less appealing for insurers. "As of today, they would have to offer returns of around 5-7%, which means profitability levels would have to be quite high in the future," he said.*

*Joining with a new partner implies that the new entrants will take certain control of the company by making pressure for high return rates for their investments.*

*Either solution could prove difficult to achieve if current market conditions continue. With savings-based lines struggling in European markets and a resilient soft market making it difficult for insurers to boost revenues, mutuals could find it hard to offer juicy returns either for fixed income investors or potential partners.*

*In fact, Franck Coisson, a Partner of Insurance at Wight Consulting in Paris, said that given market conditions even non-mutual insurance companies are unlikely to be able to tap financial markets if they want to raise capital.*

*If mutual insurers struggle to raise capital, they would feel even more tempted to downsize some of their activities, getting out of capital-intensive business lines. **Mr Chartier-Kastler said that liability lines with a long tail are those most likely to be tuned down, as they are heavily penalised by Solvency II. Among the areas most at risk in France are civil liability for construction and health-linked activities, he said. As seems to be the case with Groupama, some mutuals could feel tempted to sell some of their activities altogether. Others may consider a merger with other firms.***

*However, Mr Coisson pointed out that recent merger activity in the mutual insurance sector has been driven by the search for better profit to capital ratios rather than concerns about capital levels.*

*The good news is that most mutuals will have some time to identify the best solutions and hope for improved market conditions to make those subordinated bonds more palatable.*

*Groupama needs to raise its capital levels before this year is over, as it needs to reach limits before it sends its next set of results to ACP. **But other companies will have until 2014, when Solvency II is set to kick in, to meet the new requirements. And this deadline, said Mr Chartier-Kastler, may extend if the European Commission further delays the implementation of the capital adequacy-based regime, or lighten its requirements. This is not out of the question, he argued, given the issues that have been raised about the directive of late.***