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## Research Update:

# Spain-Based Mapfre Group Outlook Revised To Positive On Improved Earnings Prospects; Ratings Affirmed

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## Table Of Contents

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Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria

Related Research

Ratings List

## Research Update:

# Spain-Based Mapfre Group Outlook Revised To Positive On Improved Earnings Prospects; Ratings Affirmed

## Overview

- We expect Mapfre's earnings will improve from restructuring measures to address underperformance, as well as the group's potential buy-out of part of the activities it currently conducts in partnership with its banking partner in Brazil.
- On March 23, 2018, we raised our unsolicited long-term sovereign rating on Spain to 'A-' and assigned a positive outlook.
- As a result, we consider that industry and country risk for Spain's property/casualty insurance sector has reduced, along with Mapfre's credit risk, given the amount of government bonds in its fixed income investments.
- We are therefore revising the outlook on the group's core operating entities and holding company to positive from stable, and are affirming our ratings on them.
- The positive outlook reflects our view that we could upgrade the entities if the group sustainably improves its return on equity, notably through increased profits from operations in Latin America, the U.S., and Europe.

## Rating Action

On March 27, 2018, S&P Global Ratings revised to positive from stable its outlook on the core entities of Spain-based insurer Mapfre Group--Mapfre Global Risks, Compania Internacional de Seguros y Reaseguros S.A. and Mapfre Re, Compania de Reaseguros, S.A.--as well as the group's holding company Mapfre S.A. At the same time, we have affirmed our 'A' long-term issuer credit and financial strength ratings on Mapfre Global Risks and Mapfre Re and our 'BBB+' long-term issuer credit ratings on Mapfre S.A.

We also affirmed our 'BBB+' issue rating on Mapfre's senior unsecured debt and 'BBB-' issue rating on the group's subordinated debt.

## Rationale

The outlook revision reflects restructuring measures undertaken by the group in 2016-2017 to address underperformance in operations in Europe, the U.S., and certain Latin American countries. We also consider that Mapfre's capital

adequacy has strengthened following our upgrade of Spain (sovereign ratings unsolicited; see "Spain Long-Term Ratings Raised To 'A-' On Economic Growth And Budgetary Consolidation; Outlook Positive," published March 23, 2018, on RatingsDirect).

The recent upgrade of Spain supports our view that industry and country risk for insurance companies operating in the Spanish property/casualty (P/C) market has improved. We expect Mapfre will benefit from Spain's stronger economic growth and the improved credit quality of Spanish investments, which represent over 40% of the group's fixed income investments. The sovereign upgrade has reduced Mapfre's credit risk, in our view, which is a key component of how we assess capital adequacy.

Additionally, as a result of Mapfre's focus on profitable growth, we believe that the group's net income in 2017 would have exceeded our expectations, if not for exceptional nonrecurring items, such as the three consecutive hurricanes in the Caribbean and U.S. region and the earthquake in Mexico (net negative impact €157 million) as well as restructuring at subsidiary Mapfre Assistance (net negative impact €68 million). We consequently forecast profit growth increasing significantly to well over €800 million in 2018 and 2019 on lower expected natural catastrophe charges, minimal losses at Mapfre Assistance, and more sustainable earnings contribution from operations in Latin America, the U.S., and Europe.

Mapfre Re, the group's reinsurer, has demonstrated good control of the group's exposure to catastrophe risk: The net negative impact to the group from the September 2017 events was at the lower end of initial range the group announced in September 2017 of €150 million-€200 million. Mapfre also revised down its initial estimate of gross loss on those events.

We also believe that the group's potential buy-out of part of the activities it currently conducts in partnership with its banking partner Banco Do Brasil in Brazil would allow closer integration of the operations and would add over €50 million of net income after minorities for the group. In February 2018, Mapfre signed a preliminary agreement with Banco Do Brasil to buy the bank's 50% stake of their partnership covering all the business conducted through agents, and the motor and commercial insurance sold through the bank, and maintain exclusivity of the bank's channel distribution for these products.

Our ratings continue to reflect view of Mapfre's business and financial risk profiles, which we both assess as strong. The group boasts leading market positions and a highly ranked brand in Spain and Latin American countries, as well as a balanced business mix between P/C insurance, life insurance, and reinsurance. We balance our forecast of Mapfre's capital adequacy remaining at the high end of the 'A' confidence level over 2018-2019, with a significant reliance on soft forms of capital (minority interests, value-in-force, and unrealized gains). We expect that retained earnings will compensate for growth in capital requirements, after taking into account an average dividend payout of close to 60% of net income. We also consider that Mapfre would be able to withstand a hypothetical Spanish sovereign default, and can rate the group's

core operating entities potentially up to three notches above our rating on Spain.

## Outlook

The positive outlook indicates that we could raise the ratings in the next 18-24 months if we saw the group sustainably improve its performance in countries where it has recently expanded or underperformed, and if profitability in Spain, Brazil, and its reinsurance business remains resilient. For an upgrade, we would notably expect the group's return on equity to improve closer to 10%, thanks to forecast increased profits from operations in Latin America (excluding Brazil), the U.S., and Europe. At the same time, we would expect Mapfre's acquisitions and dividend policy not to dilute its level of capital adequacy, which we estimate will remain at least in the high 'A' range.

We could revise the outlook to stable if, contrary to our expectations, capital adequacy unexpectedly dropped materially below the threshold for the 'A' rating level. This could result from a severe combined global and domestic financial market stress. We could also revise the outlook to stable if Mapfre falls short against our base-case earnings assumptions, or if earnings diversification is not progressing compared to higher rated peers.

We could lower the ratings if we believed Mapfre would no longer pass the sovereign default test, which could result from an unexpected drop in regulatory capital, or an increase in Spanish assets relative to regulatory capital.

## Ratings Score Snapshot

	To	From
Financial Strength Rating	A/Positive/--	A/Stable/--
Anchor	a	a
Business risk profile	Strong	Strong
IICRA	Intermediate	Intermediate
Competitive position	Very strong	Very strong
Financial risk profile	Strong	Strong
Capital and earnings	Strong	Moderately strong
Risk position	Intermediate risk	Intermediate risk
Financial flexibility	Strong	Strong
Modifiers	0	0
ERM and management	0	0
Enterprise risk management	Adequate w/ strong	Adequate w/ strong

	risk controls	risk controls
Management and governance	Satisfactory	Satisfactory
Holistic analysis	0	0
Liquidity	Exceptional	Exceptional
Support	0	0
Group support	0	0
Government support	0	0

## Related Criteria

- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Criteria - Financial Institutions - General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Criteria - Financial Institutions - Banks: Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

## Related Research

- Various Rating Actions Taken On Spanish Insurers Following Sovereign Upgrade, March 27, 2018
- Spain Long-Term Ratings Raised To 'A-' On Economic Growth And Budgetary Consolidation; Outlook Positive, March 23, 2018

## Ratings List

Outlook Action; Ratings Affirmed

	To	From
Mapfre S.A. Issuer Credit Rating	BBB+/Positive/--	BBB+/Stable/--
Mapfre Global Risks, Compania Internacional de Seguros y Reaseguros S.A. Mapfre Re, Compania de Reaseguros, S.A. Issuer Credit Rating	A/Positive/--	A/Stable/--
Financial Strength Rating	A/Positive/--	A/Stable/--

Ratings Affirmed

Mapfre S.A. Senior Unsecured	BBB+
Subordinated	BBB-

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