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Credit Opinion: Net Insurance SpA

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Rome, Italy

Ratings

Category	Moody's Rating
Rating Outlook	NEG
Insurance Financial Strength	Baa3

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Key Indicators

Net Insurance SpA[1]

	2011	2010	2009	2008	2007
Total Assets (EUR Mil.)	413	397	390	303	276
Shareholders' Equity (EUR Mil.)	31	38	45	34	35
Net Income (EUR Mil.)	2	3	4	2	11
Gross Premiums Written (EUR Mil.)	81	98	138	68	59
of which Life (EUR Mil.)	54	65	72	6	0
of which Non-Life (EUR Mil.)	27	34	66	62	59
Net Premiums Written (EUR Mil.)	53	67	72	37	34
High Risk Assets % Shareholders' Equity	143.8%	84.0%	62.2%	75.4%	78.6%
Reinsurance Recoverables % Shareholders' Equity	494.3%	391.1%	305.7%	322.2%	280.1%
Goodwill & Intangibles % Shareholders' Equity	2.1%	1.3%	1.1%	1.7%	2.0%
Capital % Total Assets	6.4%	8.8%	11.0%	10.3%	11.7%
Return on Capital (1 yr.)	6.0%	6.1%	10.1%	5.3%	40.1%
Sharpe Ratio of ROC (5 yr.)	90.2%	115.5%	---	---	---
Adv/(Fav) Dev. % Beg. Reserves (1 yr.)	-117.4%	-106.7%	-104.3%	-102.8%	-93.7%

[1] Information based on IFRS financial statements

Opinion

SUMMARY RATING RATIONALE

Net Insurance S.p.A. - "Net", Baa3 insurance financial strength rating (IFSR), negative outlook - is a company specialised in job loss insurance in Italy, a niche line with a industry Gross Written Premiums (GWP) of around EUR 215 million in 2011. Through Net Insurance Life S.p.A., a 100% owned subsidiary, Net sells life pension products, which made up for close to half of the group's Gross Premiums Earned (GPE) in 2011.

Moody's rating continues to reflect Net's leading position in job loss segment, its good level of technical expertise in the P&C segment and Moody's expectation with regards to the company's maintenance of its conservative reinsurance programme and capital management policy in the medium term. At the same time, the rating is influenced by Net's relatively small size in the Italian insurance market and the nature of its business which is partially dependent on status of the job market in Italy.

Moody's also notes Net's exposure to regulatory/legal risk given the company's focus on the job loss market, which is based on a very specific legal framework. In particular job loss insurance products in Italy protect the retail lender against the inability of the borrower to repay the loan upon occurrence of specific events (e.g. job loss, death). Purchase of this protection product is compulsory for anyone taking out a personal loan guaranteed by their salary in Italy. As per the Italian law governing the Cessione del Quinto (CDQ) and Delegazione di Pagamento (DP) products, these loans are secured by a preferential claim of 20% on the policyholder's salary. Furthermore, the amounts to repay the loans are debited directly by the bank from the borrower's salary on a monthly basis. The CDQ and DP are the most senior claims on the borrower.

Moody's views as beneficial from a diversification purpose the recent shift towards the underwriting of life insurance for pensioners that started in 2009. However, Moody's continues to take a relatively conservative stance with respect to this new business due to lack of track record on policyholders' risk profile and its high growth rate recorded in 2009 and 2010.

Credit Strengths

- Leading position in the Italian job loss insurance market

- Conservative reinsurance programme and capital management

- Strong management team with considerable technical expertise in P&C

- Strong shareholders' base, including Swiss Reinsurance Company (A1 IFSR, positive), Unione di Banche Italiane S.c.p.A. (Baa2 LT bank deposits rating, negative), Banca Monte dei Paschi di Siena S.p.A. (Baa3 LT bank deposits rating, negative) and Banca Etruria (not rated)

Credit Challenges

- To maintain a resilient insurance underlying operating performance despite weak economic conditions in Italy

- Restoring the profitability of the P&C segment on a sustainable basis

- Growing the life business without impairing the company's risk profile

- Limited track record in life insurance

- Exposure to legal and regulatory changes in job loss insurance

Rating Outlook

The rating carries a negative outlook. The negative outlook reflects the weak economic environment in Italy which limits the growth potential of the company in its core established products.

What to Watch for:

- Italy's sovereign credit quality

- Operating performance of the P&C business

What Could Change the Rating - Up

The outlook could move to stable in the event of

- Improving economic environment in Italy

- Improving profitability in both non-life and life business segments on a long term basis

- Conservative risk management, capital management policy, as well enhanced asset and liability management

- Profitable diversification in new lines of business

What Could Change the Rating - Down

- A further downgrade of Italy's sovereign rating

- Sustained depressed operating performance: P&C combined ratio above 100%

- A material deterioration of Net's risk profile, capitalisation and asset quality

- An aggressive market entry by a major Italian financial institution in the money-loss sector which could erode significantly Net's current market position

- A material regulatory change in the Italian Law governing the CDQ and DP products

Recent Results

Net Insurance's consolidated gross written premiums declined by 14% to EUR 100.8 million in 2011 (2010: EUR 117.7 million), driven by lower premiums in both life and non-life. Consolidated net income decreased to EUR 2.1 million in 2011 (2010: EUR 2.5 million), negatively impacted by higher losses on investments. Consolidated total assets amounted to EUR 412.5 million, representing a 4% YoY increase.

On 8 February 2012, Moody's confirmed with a negative outlook the Baa3 IFSR, reflecting our view that recent actions undertaken by the management in 2011 will be adequate to readdress the weakening profitability experienced by Net Insurance since 2009. As a result we expect a reversal of the profitability trend seen in the recent past. Notwithstanding our expectation of improving underwriting results, we anticipate continuous pressure on the company's investment result given the volatile financial conditions in Europe. We also expect a deterioration of the company's asset quality and capital adequacy in 2012, as the sovereign turbulence and banking sector pressure continue to take their toll on credit quality.

DETAILED RATING CONSIDERATIONS

Moody's rates Net Insurance Baa3 for insurance financial strength, which is in line with the rating indicated by Moody's insurance financial strength rating scorecard. The Baa3 rating also captures the potential regulatory risk associated with the job loss insurance market, its concentrated business model and the risk associated to the new but strongly growing life business, as well as the company's level of risk management and corporate governance compared to higher rated peers.

Insurance Financial Strength Rating

The key factors currently influencing the rating and outlook are:

Factor 1 - Market Position and Brand: Ba

Net is the leading player in job loss segment Italy with around 50% market share in 2011. Nonetheless, given the company' size and the small dimension of this market segment, on a global basis Net's franchise is more consistent with a Ba rating level.

Factor 2 - Distribution: Baa

Net Insurance benefits from a multi-distribution strategy with a mix of proprietary and third-party distribution channels, increasingly via banks which represented around 70% of premiums in 2011. Overall distribution capabilities of Net Insurance are viewed as adequate.

Factor 3 - Product Focus and Diversification: Ba

Net's product mix has significantly changed since 2009, following the launch of a new life product dedicated to pensioners and the premiums' reclassification in respect to the life element of the CdQ products. Life premiums - of which the vast majority (around 90%) relates to pensioners business - represented 51% of total net earned premiums in 2011. Non-life premiums, mostly job loss policies (Cessione del Quinto (CDQ) and Delegazione di Pagamento (DP)), represented the other half. Net also writes a small amount of premiums in other lines of business such as fire and A&H.

Moody's views job loss insurance business as relatively low risk given the restricted conditions of these loans: (i) by law, the loan repayment is capped at 20% of the net monthly salary for CdQ and 50% for DP and is directly debited by the bank from the borrower's salary on a monthly basis; (ii) generally high job security in the public sector and high recovery rates in the private sector, and (iii) the ability of the insurer to access the private sector employee's severance indemnity - trattamento di fine rapporto, "TFR" - to offset any claim. Nevertheless, given the back-drop of higher unemployment rate in Italy, the product risk of the CdQ has more recently increased. As a result the company has been changing its client mix, by reducing its exposure to private clients, who had primarily led to a spike in claims in both 2008 and 2009.

Moody's views product risk in the life products as moderate given the profile of policyholders for the pensioners' business. The average age of a policyholder is 67 years-old whilst the average length of a policy is 8 years. Moody's remains cautious regarding the high growth rate of this product since its launch in late 2008.

Overall, we adjusted the score of product focus and diversification to Ba to reflect the lack of historical track record in life and the potential pressure that could come from changes in Italian regulation affecting the CdQ.

Factor 4 - Asset Quality: Baa

Moody's views Net's asset risk as moderate given the high concentration in Italian government bonds in the portfolio. High risk assets increased to 144% of shareholders' equity at the end of 2011 (2010: 84%), as a result of higher exposure to equities, which represented 7% of the invested assets in 2011, compared to 3% in 2010. Asset quality has deteriorated in 2012 as pressure on the Italian sovereign and banking sector continue to take their toll on credit quality.

Moody's views reinsurance recoverables as a percentage of equity as very high, at about 494% in 2011, more consistent with a Caa rating level. Net has also in place a 50% quota-share reinsurance on the life business. Nevertheless, despite the concentration associated with reinsurance companies, Moody's notes the good quality of Net's reinsurance programme which is led by Swiss Re.

Factor 5 - Capital Adequacy: Baa

The group' solvency ratio weakened in 2011 to 160% from 204% in 2010, mainly due to higher unrealised losses on investments (EUR 10.3 million) and dividend payout of EUR 3 million related to the 2010 financial year. Consequently, consolidated shareholders' equity decreased by 19% to EUR 30.6 million in 2011 (2010: EUR 37.7 million). We expect continuous pressure on Net Insurance capitalisation in 2012 mostly as a result of unrealised losses on the fixed income portfolio.

Factor 6 - Profitability: Baa

Return on capital (RoC) was 6% on 1-year basis in 2011, although it remained good at 13.5% on a 5-year average as it continues to benefit from the strong result in 2007. The deterioration since 2010 was driven by the increase in the level of claims in 2010 and the first part of 2011.

The adjusted combined ratio improved to 92.0% in 2011 compared to 100.6% in 2010. The improvement reflects management actions initiated in 2011 to readdress the weakening profitability. Specifically the company has taken several initiatives including, inter alia: (i) a change in client mix, by reducing its exposure to private clients, who had primarily led to a spike in claims in both 2008 and 2009; (ii) a shift in distribution towards the banking channel, with banks providing an important first customer screen; (iii) strengthened the underwriting policies and claims recovery efforts and (iv) adopting actions to reduce claims originated by operational inefficiencies. As a result of these actions we expect the company's combined ratio to return to a level below the 100% in the near term.

Factor 7 - Liquidity and ALM: Baa

Moody's views that Net Insurance liquidity and ALM capabilities could be somewhat pressurised by the concentration of Italian government bonds, representing close to 40% of total invested assets at year-end 2011. Nevertheless, Moody's notes that the Group increased further its liquid assets and cash holdings, to EUR 21.2 million in 2011 from EUR 9.6 million in 2010 (EUR 4.7 million in 2009).The life liabilities profile of the company has two natures: i) the mortality risk of the life component of the job loss business, and ii) the mortality risk related to the new production for pensioners.

Factor 8 - Reserve Adequacy: A

There is little or no evidence of net reserve deterioration over the past five years. Reserving practices are very conservative in light of the nature of the business.

The life liabilities are established following the Italian regulatory rules which remain conservative.

Factor 9 - Financial Flexibility: Baa

The company does not have financial debt to serve, excluding marginal pension adjustment. However, the score reflects the fact that, as a non-listed company, Net Insurance has no ability to source capital as access to capital markets are constrained.

Rating Factors

Net Insurance SpA

Financial Strength Rating Scorecard [1]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	[2]Adjusted Score
Business Profile								**A**	**Ba**
Market Position and Brand (20%)								**Baa**	**Ba**
Relative Market Share Ratio				**X**					
Distribution (5%)								**Baa**	**Baa**
Distribution Control				**X**					
Diversity of Distribution			**X**						
Product Focus and Diversification (10%)								**Aa**	**Ba**
Product Risk - P&C		**X**							
Product Risk - Life	**X**								
Product Diversification	**X**								
Geographic Diversification					**X**				
Financial Profile								**A**	**Baa**
Asset Quality (10%)								**Baa**	**Baa**
High Risk Assets % Shareholders' Equity				**143.8%**					
Reinsurance Recoverables % Shareholders' Equity							**494.3%**		
Goodwill & Intangibles % Shareholders' Equity	**2.1%**								
Capital Adequacy (15%)								**A**	**Baa**
Shareholders' Equity % Total Assets			**6.4%**						
Profitability (15%)								**A**	**Baa**
Return on Capital (5 yr. avg)	**13.5%**								
Sharpe Ratio of ROC (5 yr. avg)					**90.2%**				
Liquidity and Asset/Liability Management (5%)								**Aa**	**Baa**
Life Liquid Assets % Life Liquid Liabilities		**X**							
Reserve Adaquecy (5%)								**Aaa**	**A**
Adverse Reserve Development % of Beginning Reserves	**-108.4%**								
Financial Flexibility (15%)								**A**	**Baa**

Adjusted Financial Leverage	**N/A**								
Total Leverage	**N/A**								
Earnings Coverage (5 yr. avg)	**N/A**								
Operating Environment (0%)								**Aaa - A**	**Aaa - A**
Aggregate Profile								**A2**	**Baa3**

[1] Information based on IFRS financial statements [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

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