

## Research Update:

# Qualitas Compania Upgraded To 'mxAAA' On Stronger Capital; Qualitas Controladora And Subsidiary Ratings Affirmed

October 28, 2021

## Overview

- Quálitas' consistent capital strengthening, through its retained profits will result in a more stable and predictable capitalization for the next two years. In this sense, Quálitas' capitalization will be higher and above our 'AA' category benchmark, according to our capital framework. Therefore, we revise our capital and earnings assessment on Quálitas to strong from satisfactory.
- In addition, we're raising our long-term national scale issuer credit and financial strength ratings to 'mxAAA' from 'mxAA+' and affirming its short-term issuer credit rating of 'mxA-1+' on Quálitas Compañía de Seguros S.A.B. de C.V. (Quálitas Compañía).
- At the same time, we're affirming our global scale 'BB+' long-term credit issuer rating on the non-operating holding company, Qualitas Controladora S.A.B. de C.V. (QualCon), reflecting the degree of structural subordination to policyholders' obligations. Finally, we're affirming our long-term 'BBB-' issuer credit and financial strength ratings on its U.S.-based insurance subsidiary, Qualitas Insurance Co. (QIC).
- Despite Quálitas' improved capitalization, our 'BBB' foreign currency rating on Mexico limits the group's creditworthiness, because we don't believe Quálitas could withstand a sovereign default because of its high exposure to Mexico in terms of its business volume and investment portfolio.
- The negative outlook on QualCon and QIC reflects that on Mexico, which constrains Quálitas' group creditworthiness. On the other hand, the stable outlook on Quálitas Compañía remains stable, reflecting the outlook on national scale rating on the sovereign.

**PRIMARY CREDIT ANALYST****Rodrigo Cuevas Covarrubias**

Mexico City

+ 52 55 5081 4473

Rodrigo.Cuevas  
@spglobal.com**SECONDARY CONTACT****Ricardo Grisi**

Mexico City

+ 52 55 5081 4494

ricardo.grisi  
@spglobal.com

## Rating Action

On Oct. 28, 2021, S&P Global Ratings raised its national scale issuer credit and financial strength ratings on Quálitas Compañía to 'mxAAA' from 'mxAA+'. We also affirmed our short-term national

scale issuer credit rating on this entity at 'mxA-1+'. At the same time, we affirmed our 'BB+' global scale issuer credit rating on QualCon and our 'BBB-' global scale issuer credit and financial strength ratings on QIC. The outlook on QualCon and QIC remains negative, while the outlook on Quálitas Compañía remains stable.

## Rationale

**Quálitas' consistent capital strengthening, through its cumulative profits, will result in a more stable and predictable capitalization for the next two years.**

In this sense, we expect the company's capital to remain constant in the next two years thanks to its strong earnings capacity and changes in its capital management policy. Although Quálitas' net income will return in 2021 and 2022 to its five-year average--due to the rebound in the auto insurance claims and a more stable net premium earned--the company will maintain solid profitability, supporting capital generation. Moreover, Quálitas recently announced changes to its dividend policy--the payout ratio will be 50%-90% of previous year's net income, instead of its capital surplus. This will provide greater certainty over the company's dividend payments. We also expect Quálitas to cancel less stocks from its repurchase program in the next two years. Therefore, Quálitas' capitalization will remain above our 'AA' category benchmark, according to our capital framework. However, our assessment is partly limited, given that we forecast Quálitas' total adjusted capital (TAC) will be less than \$1 billion or its equivalent in Mexican pesos. We consider relatively that small TACs are more vulnerable to large one-time events than our capital model can capture. Finally, we revise our capital and earnings assessment on Quálitas to strong from satisfactory.

**But Quálitas' group credit profile and ratings remain limited to the 'BBB' foreign currency rating on Mexico.**

Quálitas Compañía is the group's main operating subsidiary, which operates only in Mexico's auto insurance segment. Additionally, Quálitas Compañía's investment portfolio is highly concentrated in Mexican government debt. Therefore, we consider Quálitas' group creditworthiness is limited by Mexico's sovereign foreign currency ratings, reflecting our view that the company wouldn't have the capacity to withstand a sovereign default. We rarely rate an insurer above the long-term foreign currency sovereign rating if the majority of the company's business volume or investment portfolio are allocated in the country of domicile, given that insurers are affected by many of the same economic factors that cause sovereign stress. Furthermore, our rating on QualCon is two notches below the group's credit profile (GCP), reflecting the degree of structural subordination to policyholders' obligations. Finally, our rating on QIC reflects its highly strategic subsidiary status. Therefore, the rating on QIC is one notch below Quálitas' GCP.

QualCon is the non-operating holding company and parent of Quálitas Compañía and QIC, that latter of which focuses on the Mexico-U.S. cross-border business. QualCon also has smaller insurance operations in El Salvador, Costa Rica, and Peru.

**Quálitas' strong brand recognition and efficient distribution channels will allow the company to grow in 2022-2023 and continue generating solid profitability.**

Despite Mexico's GDP contraction during 2020 because of the pandemic, Quálitas was able to keep its gross written premium (GWP) slightly below the 2019 level and to increase its bottom-line results nearly 27%. The slip in GWP was due to a contraction of the loss ratio, because of the drop in country's mobility due to the lockdowns during the pandemic. Higher results stemmed from Quálitas' agent distribution channel, which has been one of its key strengths. However, we believe that Quálitas has the challenge to continue growing in a depressed auto industry in 2021-2022. On the other

hand, we expect Quálitas' profitability to return to historical levels, reflected in a combined ratio of 93%-95%, and return on revenues and return on equity of about 12% and 20%, respectively. However, we consider that Quálitas' lack of business diversification is a disadvantage, compared with peers with broader business diversifications. This limits our competitive position assessment on it.

Finally, we expect Quálitas to continue expanding its operations outside Mexico, which will diversify its insurance portfolio. However, we don't expect this to occur until the share of the Mexican operations drops to less than 80% of the total portfolio.

**We expect Quálitas to maintain its conservative investment strategy and underwriting discipline.** Quálitas' investment portfolio is mainly allocated in the Mexican government debt (65%), investment-grade corporate bonds (10%), investment in equity (15%) and speculative-grade corporate bonds (10%). On the other hand, we also expect the company to continue limiting its exposure to multiannual policies (25% of the total portfolio) and remain cautious on underwriting new risks in the future, such as health insurance. Finally, in our opinion, Quálitas has an experienced senior management, a suitable management and governance structure, and an appropriate risk management framework for its underwritten risks.

## Outlook

The negative outlook on QualCon and QIC reflects that on the foreign currency sovereign rating. The negative outlook on Mexico indicates the possibility of a downgrade over the coming year due to a potentially weaker fiscal profile, given off-budget risks mostly from Petróleos Mexicanos (PEMEX) amid a comparatively low non-oil tax base and fewer fiscal buffers.

The outlook on the national scale rating on Quálitas Compañía is stable. We now consider Quálitas Compañía's creditworthiness is stronger than those of other insurers that we rate in México, and the outlook on it reflects the national scale outlook on the sovereign.

## Upside scenario

We could revise in the next two years our outlook on QualCo and QIC to stable if we revise our outlook on Mexico to stable. Quálitas Compañía already has the maximum possible rating on Mexico's national scale.

## Ratings Score Snapshot

	To	From
Business Risk Profile	Satisfactory	Satisfactory
IICRA*	Intermediate Risk	Intermediate Risk
Competitive Position	Satisfactory	Satisfactory
Financial Risk Profile	Strong	Satisfactory
Capital & Earnings	Strong	Satisfactory
Risk Exposure	Moderately low	Moderately low
Funding Structure	Neutral	Neutral

	To	From
Modifiers	0	0
Governance	0	0
Liquidity	Adequate	Adequate
Comparable Ratings Analysis	Neutral	Neutral
Support	0	0
Group Support	0	0
Government Support	0	0

\*Insurance Industry And Country Risk Assessment. NB: Support does not consider Ratings Above Sovereign criteria.

## Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

## Ratings List

### Ratings Affirmed

#### Qualitas Controladora S.A.B. de C.V.

Issuer Credit Rating	BB+/Negative/--
----------------------	-----------------

#### Qualitas Insurance Co.

Issuer Credit Rating	BBB-/Negative/--
Financial Strength Rating	BBB-/Negative/--

### Upgraded

	To	From
<b>Qualitas Compania de Seguros, S.A. de C.V. y Subsidiarias</b>		
Financial Strength Rating		
CaVal (Mexico) National Scale	mxAAA/Stable/--	mxAA+/Stable/--

**Upgraded; Ratings Affirmed**

	To	From
<b>Qualitas Compania de Seguros, S.A. de C.V. y Subsidiarias</b>		
Issuer Credit Rating		
CaVal (Mexico) National Scale	mxAAA/Stable/mxA-1+	mxAA+/Stable/mxA-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.