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## Research Update:

# Poland-Based Multiline Insurer PZU 'A-' Rating Affirmed; Outlook Stable

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## Research Update:

# Poland-Based Multiline Insurer PZU 'A-' Rating Affirmed; Outlook Stable

## Overview

- PZU Group maintains a very strong franchise as the leading Polish insurance group with better profitability versus that of local and international peers.
- In our view, the group's capital adequacy remains robust even after strong organic growth, acquisition of a stake in Bank Pekao, and relatively high dividend payments; and we assume it will stay solid in 2018-2020.
- We are therefore affirming our 'A-' issuer credit and insurer financial strength ratings on PZU Group.
- The stable outlook reflects our view that the group will maintain its very strong competitive position, thanks to good underwriting profitability in Poland, benefiting from growth opportunities in insurance, asset management, and the banking market, while maintaining capital adequacy above the 'AAA' level in 2018-2020.

## Rating Action

On Oct. 31, 2018, S&P Global Ratings affirmed its 'A-' long-term issuer credit and insurer financial strengths ratings on Poland-based multiline insurer Powszechny Zakład Ubezpieczeń S.A. and its core operating subsidiaries (PZU Group). The outlooks are stable.

## Rationale

PZU Group continues to defend its very strong competitive position as the leading insurance group in Poland with a large and diversified insurance portfolio. The group's competitive advantages--like its scale and efficiency, diverse distribution capabilities, and strong brand reputation in the Polish insurance market--translated into a strong organic premium growth rate in 2016 and 2017. In the first half of 2018, the group posted more moderate growth in insurance business, with gross written premiums up only 2.4% compared with half-year 2017. However, the consolidated combined (loss and expense) ratio was 87.2% and the life insurance margin higher than 20% in first-half 2018, which resulted in net income of Polish zloty (PLN) 1.4 billion (about €330 million). This translated into a strong return on equity that exceeded 22% and was materially better than domestic and international peers'. We expect that PZU group will continue to outperform its main peers, posting net income of

between PLN2.5 billion and PLN3.0 billion in 2018-2020.

After PZU Group acquired a 20% stake in Bank Pekao last year, following a 30% stake in Alior in 2015, the banking segment started to materially contribute to the overall net income. We note that, in the first half of 2018, profit from the banking operations represented around 20% of consolidated net income, and we expect this proportion to remain similar in through 2020. The sizable operations in asset management and banking in Poland are, in our view, enhancing the group's business profile since they represent additional profit diversification. However, we note that longer-term sustainability of the bank's profit contribution still needs to be tested throughout the business cycle alongside the evolution of the local capital requirements.

PZU Group's capital remained robust in 2017, based on our capital adequacy model and compared with Solvency II requirements. This is despite material organic growth of the insurance business, the acquisition of a 20% stake in Bank Pekao, and a moderate increase in dividend payments. The group's Solvency II ratio stood at 227% at the end of first-quarter 2018, securely above the group's target of 200%, which we expect it will maintain through 2020. The group also sustained capital exceeding that for the 'AAA' level, according to our model, as of year-end 2017, although we note that the margin above 'AAA' has narrowed. We assume that PZU Group's capital and earnings will remain at least very strong until year-end 2020.

Moreover, the recent upgrade of Poland implies an improvement in the credit quality of PZU's investment portfolio, and PZU Group continues to pass our sovereign stress test in foreign currency (see "Poland Upgraded To 'A-' On Strong GDP And Budgetary Outcomes; Outlook Stable," published Oct. 12, 2018, on RatingsDirect). In our view, the group's creditworthiness is somewhat constrained by its still relatively short track record of management and strategy for its increasingly complex group risk profile. We see that the management team has been stable since midyear 2017, which in our view is helping it progress with development and further implementation of the new business model within the group. In addition, we acknowledge that, following the acquisition of stakes in Bank Pekao and Alior, risk management practices are gradually evolving. However, a consistent risk management approach across the group is still to be demonstrated.

## **Outlook**

The stable outlook reflects our view that the group will maintain its very strong competitive position, thanks to good underwriting profitability in Poland, benefiting from growth opportunities in Polish insurance, asset management, and banking, while maintaining capital adequacy above the 'AAA' level in 2018-2020.

## Upside scenario

In the next 12-24 months, we could raise our ratings if PZU Group sustains its current strong group performance and stable group risk profile, while displaying increased stability of group management and establishing a track record of successfully and consistently executing its strategy. Our view of the group's creditworthiness would improve only if the group continues to pass our hypothetical foreign currency sovereign stress test.

## Downside scenario

Although unlikely at this stage, we might consider taking a negative rating action over the next 12-24 months if PZU Group's:

- Capital weakened for a prolonged period below the 'AAA' range according to our capital model, either due to weaker-than-expected operating performance, investment losses, or expenditures for further acquisitions that sustainably diluted its capital position.
- Performance at its banking entities deteriorated substantially, requiring material extraordinary support from the parent.

## Ratings Score Snapshot

Financial Strength Rating                    A-/Stable/--

Anchor	a
Business Risk Profile	Strong
IICRA	Moderate
Competitive Position	Very Strong
Financial Risk Profile	Strong
Capital and Earnings	Very Strong
Risk Position	Moderate
Financial Flexibility	Strong

Modifiers	-1
ERM and Management	-1
Enterprise Risk Management	Adequate
Management and Governance	Fair
Holistic Analysis	0
Sovereign Risk	0

Liquidity    Exceptional

Support	0
Group Support	0
Government Support	0

IICRA--Insurance Industry And Country Risk Assessment.

## **Related Criteria**

- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- 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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

## **Related Research**

- Poland-Based Banks Pekao And mBank Resolution Counterparty Ratings Raised To 'A-', Oct. 15, 2018
- Poland Upgraded To 'A-' On Strong GDP And Budgetary Outcomes; Outlook Stable, Oct. 12, 2018
- Poland-Based Bank Pekao 'BBB+' Rating Affirmed On The Recognition Of Potential For PZU Group Support; Outlook Stable, June 21, 2018
- Insurance Industry And Country Risk Assessment: Poland Life, Oct. 11, 2017
- Insurance Industry And Country Risk Assessment: Poland Property/Casualty, Oct. 11, 2017

## Ratings List

### Ratings Affirmed

Powszechny Zakład Ubezpieczeń na Życie S.A.

Powszechny Zakład Ubezpieczeń S.A.

Issuer Credit Rating A-/Stable/--

Powszechny Zakład Ubezpieczeń na Życie S.A.

Towarzystwo Ubezpieczeń Wzajemnych Polski Zakład Ubezpieczeń Wzajemnych

Powszechny Zakład Ubezpieczeń S.A.

Financial Strength Rating A-/Stable/--

PZU Finance AB (publ)

Senior Unsecured BBB+

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