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Research Update:

Polish Insurer PZU Group Lowered To 'A-' Following Downgrade Of Poland; Ratings Remain On CreditWatch Negative

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Overview

- On Jan. 15, 2016, we lowered our ratings on Poland by one notch.
- In our view, the deterioration of Poland's creditworthiness heightens country risk for the Poland-based insurer PZU Group.
- We are therefore lowering our long-term ratings on PZU Group and its core operating entities to 'A-' from 'A'.
- The ratings on PZU Group remain on CreditWatch negative, reflecting the ongoing uncertainties around the group's ability to pass a hypothetical foreign currency sovereign default stress test.

Rating Action

On Jan. 21, 2016, Standard & Poor's Ratings Services lowered its insurer financial strength and counterparty credit ratings on Poland-based insurer Powszechny Zakład Ubezpieczeń S.A. (parent company of PZU Group) and its rated core subsidiaries to 'A-' from 'A'.

The ratings remain on CreditWatch with negative implications where we placed them on Dec. 18, 2015.

Rationale

The rating action follows our lowering of the long-term ratings on Poland (foreign currency BBB+/Negative/A-2; local currency A-/Negative/A-2).

Under our criteria, our ratings on an insurer are constrained by our view of country risk (see "Ratings Above The Sovereign—Corporate And Government Ratings: Methodology And Assumptions" published Nov. 19, 2013, on RatingsDirect). In our view, the downgrade of Poland increases exposure of PZU Group toward country risk.

In our opinion, the downgrade of Poland implies increased risk in PZU Group's investment portfolio. We estimate that more than 90% of the PZU Group's investments and policyholder liabilities are held by entities domiciled in Poland. The PZU Group's assets comprise mostly government debt, given the relatively underdeveloped debt capital markets in Poland. We estimate that around 60% of the group's assets are held in Polish treasury bonds—more than 2.5x total shareholder funds. The remainder is invested in Polish money market

securities and equity instruments in Poland.

We continue to rate PZU Group one notch higher than our foreign currency sovereign rating on Poland. However, the ratings remain on CreditWatch negative, reflecting ongoing uncertainties over the group's ability to pass the hypothetical foreign currency sovereign default stress test under our criteria for rating companies above the sovereign (see "Polish Insurer PZU Group 'A' Ratings On Watch Negative After CEO Resignation And Uncertainties On Future Strategy," published Dec. 18, 2015.)

In our view, the sovereign downgrade triggers the group's risk-mitigation plan, which contemplates re-allocating assets into investments outside the country. We see some potential uncertainty over execution of the mitigation plan, and as such some uncertainty over PZU's ability to pass the hypothetical foreign currency sovereign default stress test. Moreover, the CreditWatch negative status also reflects a lack of clarity regarding the group's future strategy, particularly surrounding its participation in Polish banking sector consolidation.

We view PZU's indicative group credit profile (GCP) as unchanged at 'a'. The ratings on PZU continue to reflect a very strong competitive position in Poland where the group has a leading position in the insurance market and a very strong financial risk profile based on very strong capital and earnings. We continue to assess PZU as having an important role in the Polish economy and a strong link with the Polish government. However, this assessment provides no rating uplift.

CreditWatch

The CreditWatch status reflects the possibility that we could lower our ratings on PZU Group by one notch if the group fails to pass our sovereign default stress test, as we would cap the ratings at the level of the Polish foreign currency sovereign rating. It also factors in our uncertainties around the group's execution of its risk-mitigation plan and possible business strategy changes following the appointment of a new CEO. We expect to resolve the CreditWatch placement during the next 90 days, during which we believe we will obtain more clarity over the execution of the risk-mitigation plan, a new CEO is likely to be confirmed, and strategic directions defined.

A potential downgrade would most likely be limited to one notch. We could lower the ratings if management fails to execute its risk-mitigation plan, management actions increase PZU's exposure to sovereign risk, or a significant increase in Polish banking assets causes the group to fail our foreign currency sovereign default stress test.

We could affirm the ratings following successful execution of the risk-mitigation plan, and if we believe that any business strategy changes taken after succession of a new CEO are not likely to undermine PZU's ability to pass our foreign currency sovereign default stress test.

Ratings Score Snapshot

	To	From
Financial Strength Rating	A-/Watch Neg	A/Watch Neg
Anchor	A	A
Business Risk Profile	Strong	Strong
IICRA	Moderate	Moderate
Competitive Position	Very Strong	Very Strong
Financial Risk Profile	Very Strong	Very Strong
Capital and Earnings	Very Strong	Very Strong
Risk Position	Intermediate	Intermediate
Financial Flexibility	Strong	Strong
Modifiers	0	0
ERM and Management	0	0
Enterprise Risk Management	Adequate	Adequate
Management and Governance	Satisfactory	Satisfactory
Holistic Analysis	0	0
Sovereign Risk	-1	0
Liquidity	Exceptional	Exceptional
Support	0	0
Group Support	0	0
Government Support	0	0

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign-Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded

	To	From
Powszechny Zaklad Ubezpieczen S.A.		
Powszechny Zaklad Ubezpieczen na Zycie S.A.		
Counterparty Credit Rating	A-/Watch Neg/--	A/Watch Neg/--
Financial Strength Rating	A-/Watch Neg/--	A/Watch Neg/--
PZU Finance AB (publ)		
Senior Unsecured*	BBB+/Watch Neg	A-/Watch Neg

*Guaranteed by Powszechny Zaklad Ubezpieczen S.A.

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