

Research Update:

Polish Insurer PZU's Core Entities Affirmed At 'A-'; Outlook Remains Positive

October 11, 2019

Overview

- PZU Group maintains a market leading position in Polish life and non-life insurance, enhanced by its asset management and bank operations.
- PZU's capital adequacy under our risk-based capital model remains extremely strong and its insurance operating performance solid, but its relatively recent banking investments have a comparably shorter history of stable and resilient group earnings contributions.
- We are affirming our 'A-' ratings on PZU Group's core operating entities.
- The positive outlook indicates that we could raise the ratings if the group maintains resilient earnings, a stable risk profile, and strong capital adequacy, alongside favorable management and governance.

Rating Action

On Oct. 11, 2019, S&P Global Ratings affirmed its 'A-' long-term issuer credit and financial strength ratings on the core operating entities of Poland-based multiline insurance group PZU (see the ratings list below). The outlooks on all entities remain positive.

Outlook

The outlook is positive because PZU Group is well positioned to leverage its strong footing in Poland's insurance, banking, and asset management sectors to solidify its track record of robust, stable earnings, and sector outperformance.

Upside scenario

We could upgrade PZU Group within the next 12-18 months if the group:

- Continues to post resilient earnings. This could arise if net income after tax consistently exceeded Polish zloty (PLN) 2.6 billion (around €600 million), with a non-life combined (loss and

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expense) ratio of around 93% and a life business margin of around 20%;

- Sustains a stable risk profile, strengthening risk controls to support contributions from its bank investments, while successfully adapting to changes in the business cycle and regulation;
- Maintains capital adequacy at the 'AA' benchmark or higher, while continuing to pass our hypothetical foreign currency sovereign stress test; and
- Management and governance processes remain stable.

Downside scenario

We could revise the outlook to stable if the group failed to sustain its strong performance and its risk profile deteriorated below that consistent with the ratings. This could result from increased risk exposures that led to higher capital and earnings volatility, or a material loss that reduced capital and raised uncertainty about the effectiveness of PZU Group's risk management.

Rationale

PZU Group is the largest financial conglomerate in Poland, with the leading position in life and non-life insurance, with sizable asset management and banking operations. The group benefits from its stable and strongly performing life and non-life operations in Poland. Earnings from bank affiliates are improving and are gradually stabilizing.

We consider that PZU's large scale, strong brand and reputation, diverse product offerings, and large distribution network support the strength of its insurance operations. As of June 30, 2019, the combined ratio was 89.2% and the life margin (combined underwriting and investment margin) above 20%. Despite some easing of market prices for motor insurance, we think PZU's diversified non-life portfolio should help continue to safeguard the group's more superior non-life underwriting results. The life insurance operations remain stable, with resilient underwriting performance. We expect that ongoing business digitalization to continue protecting PZU's cost advantage, derived from its large scale in Poland.

According to our risk-based capital model, PZU's capitalization remains above the 'AAA' level, supported by a solvency II ratio of 225% in the first quarter of 2019. We expect that PZU will continue to focus on profitable growth in insurance business in Poland while building a track record of stable contributions from its banking investments. We expect the group's dividend policy will keep supporting its capital position. Furthermore, we expect the banking operations to remain self-sufficient, generating enough capital to finance moderate organic business. We anticipate that PZU's capitalization to stay at least above the 'AA' level over 2019-2020 and earnings firmly above PLN2.6 billion, with the non-life combined ratio at around 93%.

PZU continues to build a track record of increasing and more stable earnings contributions from its bank investments. In particular, we view positively the development of a groupwide risk framework, which we think may progressively converge risk management across the entities. Having the framework fully embedded would, in our view, further strengthen the overarching controls at PZU Group, subsequently improving the resilience of its balance sheet.

Ratings Score Snapshot

| | |
|----------------------------------|-----------------|
| Business Risk Profile | Strong |
| Competitive position | Very strong |
| IICRA | Moderately high |
| Financial Risk Profile | Strong |
| Capital and earnings | Very strong |
| Risk exposure | Moderately high |
| Funding structure | Neutral |
| Anchor* | a- |
| Modifiers | 0 |
| Governance | Neutral |
| Liquidity | Exceptional |
| Comparable ratings analysis | 0 |
| Financial Strength Rating | A- |

*Although PZU's insurance operations remains very solid, its relatively recent banking investments have a comparably shorter history of stable and resilient group earnings contributions.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- 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
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

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Ratings Affirmed

Powszechny Zakład Ubezpieczeń na Życie S.A.

Powszechny Zakład Ubezpieczeń S.A.

Issuer Credit Rating

| | |
|----------------|----------------|
| Local Currency | A-/Positive/-- |
|----------------|----------------|

Powszechny Zakład Ubezpieczeń na Życie S.A.

**Towarzystwo Ubezpieczeń Wzajemnych
Polski Zakład Ubezpieczeń Wzajemnych**

Powszechny Zakład Ubezpieczeń S.A.

Financial Strength Rating

| | |
|----------------|----------------|
| Local Currency | A-/Positive/-- |
|----------------|----------------|

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