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PZU Group

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Related Criteria And Research

PZU Group

Please note that the ratings covered by this full analysis apply only to core entities of the PZU Group, which are listed below. These ratings do not apply to any noncore or nonrated entities of the group. Ratings assigned to noncore entities of the group are published individually.

Major Rating Factors

Operating Companies Covered By This Report
Financial Strength Rating
Local Currency
A/Stable/--

Strengths:

- Strong competitive position.
- Strong operating performance.
- Strong capitalization.

Weaknesses:

- Concentration of investments in Polish government securities.
- Ongoing need to modernize.

Rationale

The ratings on Polish non-life insurer Powszechny Zaklad Ubezpieczen S.A. (PZU S.A.) and Polish life insurer Powszechny Zaklad Ubezpieczen na Zycie S.A. (PZU Zycie) reflect the companies' status as core entities of Poland-based composite insurance group PZU. The ratings are supported by the group's strong competitive position, strong operating performance, and strong capitalization, in Standard & Poor's Ratings Services' view. These strengths are partly offset, however, by concentration of investments in Polish government securities and an ongoing need to modernize.

PZU has a strong competitive position, owing to its significant position in the Polish insurance market, unrivaled distribution capabilities, and high brand recognition among the Polish population. Moreover, PZU has successfully transformed its strong competitive position into a strong operating performance consistently above the market average. This is reflected in a five-year average return on equity (ROE) of about 20% in 2011, a five-year combined ratio of about 95%, and a new business margin of 2.0% (based on present value new business premiums) in 2011. Our base-case assumption for 2012 and 2013 includes premium growth of 3%-5% and maintenance of PZU's leading market position in Poland, a combined ratio of about 97%-98%, a net income of about Polish zloty (PLN) 2.4 billion (about €570 million), and an ROE of 18%-20%.

PZU's capitalization is strong, in our view, reflecting extremely strong capital adequacy. We anticipate that capital adequacy will remain at least very strong, even against the group's plans for a high dividend payout of 50%-100% of net profits and its international expansion goals. Further supporting factors are strong capital quality, adequate reserving, and a conservative reinsurance program.

Rating constraints, in our view, are that PZU invests predominantly in Polish government securities, and that regulation limits the amount of overseas investments. Consequently, we believe that PZU's abilities to invest in assets of appropriate duration for its life insurance liabilities and to diversify its investment portfolio are restricted.

We also think that PZU still needs to modernize, including its information-technology systems and its product and customer-relationship management. However, in our view, the current management has demonstrated its execution ability and is well placed to continue implementing these initiatives, which are paramount to PZU maintaining its competitive position.

The ratings on PZU are based on our assessment of the group's stand-alone credit profile (SACP). However, we also regard PZU as a government-related entity (GRE) because the Ministry of the Treasury of the Republic of Poland (foreign currency A-/Stable/A-2; local currency A/Stable/A-1) is its main shareholder. In our opinion, there is a "moderately high" likelihood that the government of Poland would provide timely and sufficient extraordinary support to PZU in the event of financial distress. This assessment is based on our view of PZU's "important" role for and "strong" link with the Polish government. Nevertheless, the ratings on PZU do not benefit from any uplift because of its GRE status, according to our GRE methodology, because our assessment of PZU's SACP is in line with the local currency rating on Poland.

Outlook

The stable outlook reflects our expectation that PZU will maintain its strong competitive position and generate a strong operating performance through the cycle.

A negative rating action on the local currency ratings on Poland could trigger similar rating actions on PZU due to its large exposure to sovereign debt and its geographic business focus on Poland.

We could raise the ratings on PZU if we raised the local sovereign rating on Poland and PZU meets our expectations on competitive position and operating performance, with capital adequacy in the 'AA' range.

Corporate Profile: The Leading Universal Insurer In Poland

PZU is Poland's largest insurance group and leads the non-life and life insurance markets, with market shares of 32.6% in non-life and 43.4% in regular life in 2011. The group is also No. 3 in pensions. PZU's assets totaled PLN51.2 billion and its gross premiums income was PLN15.3 billion at year-end 2011.

PZU's main shareholder is Poland's Ministry of the Treasury, which has a share of 35.2%. Although the Ministry of the Treasury has gradually reduced its shareholdings in PZU, we believe it will remain the main shareholder and maintain a controlling stake. PZU was floated on the Warsaw Stock Exchange on May 12, 2010.

Government Support And GRE Methodology Impact

The 'A' rating on PZU reflects our assessment of the group's SACP. We consider PZU to be a GRE. In accordance with our criteria for GREs, our view of a "moderately high" likelihood of timely and sufficient extraordinary support for PZU in the event of financial distress is based on our assessment of PZU's:

- "Important" role for the government, owing to PZU's dominant position as Poland's largest insurance company and its strong market penetration in nonurban regions; and
- "Strong" link with the government, owing to the state's large controlling shareholding of 35.2% in PZU and PZU's investments in government securities, which makes it the largest single investor in Polish sovereign debt.

Although we consider PZU to be a GRE, the ratings do not benefit from any uplift because our assessment of PZU's SACP is in line with the local currency rating on Poland.

Competitive Position: Unrivaled Market Leader In Poland

Table 1

PZU Group--Competitive Position*					
	--Year-ended Dec. 31--				
(Mil. PLN)	**2011**	**2010**	**2009**	**2008**	**2007**
Total invested assets	48,937	46,923	49,792	55,890	50,245
Total revenue	17,628	16,415	17,441	17,156	17,291
Gross premiums written	15,279	14,544	14,363	14,563	15,462
Annual change in gross premium written (%)	5.1	1.3	(1.4)	(5.8)	0.1
Property/casualty gross premiums written	8,527	8,032	8,022	8,433	8,196
Property/casualty: Annual change in gross premiums written (%)	6.2	0.1	(4.9)	2.9	4.2
Life gross premiums written	6,752	6,513	6,341	6,130	7,266
Life: Annual change in gross premiums written (%)	3.7	2.7	3.4	(15.6)	(4.3)

*Consolidated 2007 under Polish accounting standards. 2008-2011 under International Financial Reporting Standards. PLN--Polish zloty.

PZU's strong competitive position stems from the group's significant foothold in the Polish insurance market, both in the non-life and life business segments, complemented by pension and asset-management activities. The company's competitive position also stems from very strong brand recognition as well as its unrivaled distribution capabilities and cross-selling potential.

The competitive advantages of operating in Poland result in some geographic concentration, but PZU continues to develop a presence in Ukraine and Lithuania. In 2002-2005, PZU made meaningful acquisitions in the Lithuanian and Ukrainian insurance markets. Nevertheless, we believe tangible diversification benefits from these operations can only materialize in the medium to long term.

Significant position in the Polish insurance market

PZU maintains a significant position in Poland, with large market shares in 2011 in non-life (32.6%) and life regular premium (43.4%). PZU is at least twice as large as its closest competitors in non-life and life insurance, which, in our view, further underpins its strong market dominance. However, considerable competition from new market entrants over recent years has led to ongoing losses in market share. We also believe PZU has accepted market share losses to maintain profitability that is consistently better than the market average.

Non-life

The strongest component of the group's competitive position is PZU S.A.'s undisputed leadership in the Polish non-life insurance market, which makes up 56% of the group's gross premiums written (GPW) for 2011. PZU S.A.'s primary insurance portfolio comprises third-party motor liability (TPML; 34.8% of 2011 non-life GPW), other motor damage (27.7%), property (20.8%), accident and health (5.9%), and other (10.9%). There is some concentration in motor, but we believe the company has sustainable and significant scale and cost advantages, compared with peers, as a result of its agency distribution network. We believe that PZU S.A. can maintain its market dominance in 2012 and 2013 with a market share not below 30%.

Life

The second pillar of PZU's competitive strength is PZU Zycie's significant position in the Polish life insurance market. PZU Zycie maintains a relatively stronger position in group life than in individual life. Like the non-life entity, PZU Zycie enjoys sustainable cost advantages over its peers, due to its distribution network and well-known brand. We believe PZU Zycie will find it difficult to significantly increase its share of individual life insurance business, but we expect it to maintain its strong and defendable presence in the highly profitable group business, which we believe is a key competitive advantage. PZU Zycie also started writing health insurance policies in 2002, with good growth rates so far, albeit on a relatively small scale. We believe that PZU Zycie could establish a good position in health insurance in Poland if the market were more liberalized and private insurers were allowed to manage public health funds.

Very strong brand recognition

We believe PZU's brand recognition as an insurance company in Poland is extremely strong compared with that of competitors. We believe PZU's very strong brand recognition will remain a competitive advantage over the next few years.

Unrivaled distribution capabilities

PZU has the largest and most extensive distribution network in Poland compared with peers', with more than 400 outlets and more than 10,000 agents. The agency network is a key factor supporting PZU's stronger position in smaller cities and rural areas than in the large cities. PZU has a strong presence in large cities, where it also experiences the most competition. Bancassurance distribution has gained importance in the Polish life insurance market, and PZU continues to actively market its products through a number of banks.

Prospective

We believe PZU can maintain its strong competitive position in the Polish insurance market in life and non-life and will be able to transfer this into a strong operating performance. In our view, the Polish insurance market, and life insurance in particular, continues to have substantial growth potential because the overall demand for insurance is increasing and the private property and health insurance sectors are still underdeveloped to some extent compared with western European insurance markets. PZU is, in our view, well positioned to participate in this growth, and we believe the company will continue to secure its market leadership and dominance. We expect its market share in life and non-life to remain flat or decrease, owing to PZU's underwriting discipline and the continuously intense competition in the Polish insurance market.

Management And Corporate Strategy: Capable Management, But Expansion Into Central And Eastern Europe Appears Challenging

Following many significant changes in management, PZU's current management team was put in place in December 2007 and since then strategic positioning has visibly improved. PZU has demonstrated consistency and execution capabilities, in our view. PZU has a clearly defined strategy: It is focused on being a leading insurer in Central and Eastern Europe (CEE) by expanding in Poland, and by entering CEE markets that offer significant growth opportunities. We also believe that corporate governance after PZU's successful IPO in 2010 has further improved.

However, we believe that PZU's goal to diversify geographically via acquisitions in CEE might be difficult to achieve in the current environment, owing to a lack of meaningful opportunities.

Operational management

We believe that PZU's operational management is effective and sound and that its management team is capable of implementing the group's modernization program, as demonstrated so far by the successful reduction of administration costs by 8% in 2011. Moreover, about 4,000 full-time employees had been laid off by year-end 2011 since 2007, in line with the goal to reduce overhead costs and streamline processes. Operational management, in our view, also benefits from PZU's enlarged group management board. We believe this will also create a more holistic management approach because all of the group's lines of business are now represented on the board.

Financial management

PZU's financial risk tolerance is relatively low, in our view, compared with its risk-bearing capacity. We consider its financial management to be conservative. PZU focuses on enhancing ROE and fosters growth only if bottom-line results are not negatively affected. Moreover, with regard to its risk appetite, PZU remains committed to maintaining a solvency ratio of 250% under Solvency I, and capital adequacy based on Standard & Poor's capital model, in line with the 'AA' rating range.

Accounting

PZU's annual report and financial statements for 2008-2011 were prepared in accordance with International Financial Reporting Standards, while those for previous years were prepared according to Polish generally accepted accounting principles. We have analyzed PZU's operating performance for the life business using unaudited supplementary embedded-value information, based on European Embedded Value (EEV) principles. The difference in accounting policies has not raised any rating concerns.

Enterprise Risk Management: Low Importance For The Ratings, Given PZU's Strong Capitalization And Focus On Poland

We regard PZU's enterprise risk management (ERM) as adequate, reflected in an adequate risk management culture and adequate controls for its main risks: insurance, market, asset-liability management (ALM), credit, and operational risk. PZU remains exposed to natural catastrophes in Poland, such as floods, and remains concentrated in Polish sovereign debt. ERM is of low importance for the ratings, given our view of PZU's currently strong capitalization and its geographic focus on Poland.

PZU's risk-management culture is adequate, in our view. In 2011, the company further developed its risk-management culture and implemented an independent risk department and a chief risk officer function in order to build a more holistic risk-management system. Moreover, PZU is using these measures to respond to the EU's proposed Solvency II requirements.

We regard the individual risk controls for underwriting, reserving, catastrophes, reinsurance, market and ALM, and credit risks as consistently adequate. PZU uses modeling extensively within the individual risk-management areas.

The group's strategic risk management is, in our view, partly constrained by only recent developments toward a more holistic view and management of the group's risk profile. However, we believe that these measures could lead to improvements in strategic risk management if PZU managed to log a longer track record of successful execution of the implemented risk management structure.

Operating Performance: Consistently Strong

Table 2

PZU Group--Operating Statistics*

	--Year-ended Dec. 31--				
(Mil. PLN)	**2011**	**2010**	**2009**	**2008**	**2007**
EBIT	2,957	3,088	4,602	2,931	4,477
Return on equity (%)	18.3	20.3	24	12.6	23.9
Return on revenue (%)	19.2	13.1	20	27.4	23.4
Life return on revenue (%)	24.7	31.7	39.8	30.9	35.9
Property/casualty return on revenue (%)	25.1	32.3	28	32.3	15.6
Property/casualty net loss ratio (%)	67.7	75.1	69.3	63.2	60.3
Property/casualty total net expense ratio (%)	27.7	29.6	29.7	28.1	28.3
Property/casualty net combined ratio (%)	95.3	104.7	99	91.3	88.6

*Consolidated 2007 under Polish accounting standards. 2008-2011 under International Financial Reporting Standards. PLN--Polish zloty.

PZU's operating performance is strong, in our view, primarily because of its strong competitive position in life and non-life business in an expanding market, and strong investment income. This has channeled into a very strong five-year average ROE of about 20% in 2011 and net income of consistently more than PLN2 billion over the past five years. PZU's strong operating performance is also supported by lower distribution costs than peers' and strong investment results in a comparably favorable interest rate environment in Poland; the 10-year government bond yield was about 5.4 % after the second quarter of 2012. Nevertheless, PZU's net investment yield, including all capital gains, was affected by the equity downturn, which has created some volatility in the group's earnings, standing at 3.3% in 2011 compared with 5.75% in 2010.

PZU's life business remains the primary contributor to operating profit, at 64% in 2011, benefiting from high profit margins, mainly in group life, which we believe will continue to generate strong and sustainable profits. We think operating performance benefits in particular from accident riders embedded in the life policies, which in our view are a strong source of bottom-line profitability. However, on an embedded-value basis, the new business margin of 2.0% based on present value of new business premiums in 2011, appears relatively smaller, but is affected by the shorter nature of the accident rider business and bancassurance deposit products that generate high volumes but relatively lower profitability. When taking this into account, we believe that the new business margin will remain strong.

We believe that PZU's non-life performance in 2011 recovered in a more favorable claims and price environment after a large number of natural catastrophes in 2010, including a large number of snow and flood claims, which affected underwriting performance with a net effect of PLN369 million or 4.8 percentage points in the combined ratio. As a consequence, the combined ratio improved to 95.3% from 104.7%. Moreover, half-year results in 2012 indicate a continued strong performance, with a reported combined ratio of 90.5%. Corporate motor business broke even in 2011, before we expected.

Prospective

We believe that PZU can continue to transform its market dominance into a strong operating performance. Our base-case assumption for 2012 and 2013 includes a combined ratio in the range of 97%-98%, net income of about PLN2.4 billion, and an ROE of 18%-20%.

Investments: Lack Of Diversity, Due To Exclusive Exposure To Poland

Table 3

PZU Group--Investment Statistics*					
	--Year-ended Dec. 31--				
(%)	**2011**	**2010**	**2009**	**2008**	**2007**
Net investment yield	4.1	3.8	4.4	4.6	4.7
Net investment yield including realized capital gains/(losses)	3.9	4.4	5.1	3.4	6.1
Net investment yield including all capital gains/(losses)	3.3	5.8	6.5	1	5.7
Portfolio composition					
Cash and cash equivalents	3.7	7.1	9.4	15.0	4.1
Bonds	72.6	75.0	77.9	75.6	81.2
Common stock	10.7	12.2	9.6	6.5	7.9
Real estate	2.9	2.7	2.4	2.1	2.4
Mortgages	10.2	3.0	0.7	0.9	4.0
Investments in affiliates	0.0	0.0	0.0	0.0	0.4
Other investments	0.0	0.0	0.0	0.0	0.1
Total portfolio composition	100.0	100.0	100.0	100.0	100.0

*Consolidated 2007 under Polish accounting standards. 2008-2011 under International Financial Reporting Standards. PLN--Polish zloty.

We consider PZU's investment portfolio to be strong, although regulations limit the amount of overseas investments not denominated in Polish zloty, restricting the diversity of investments, which we view as a ratings constraint. The lack of suitably long-dated investments precludes accurate ALM for the life insurance business. PZU is the largest individual investor in Polish treasury securities, which may limit its ability to maintain stable investment returns in government bond markets in extreme situations.

Credit risk

Credit risk is low, in our view. About 76% of PZU's total investments are government and supranational bonds, of which in turn about 98% are in Polish government local currency debt issues rated 'A' or 'A-'.

Market risk

We view market risk as manageable. PZU is exposed to interest rate movements and changes in equity market values. Under a stress scenario, a 100 basis-point increase would be a loss of PLN646 million, and a 10% decrease of equity market values would be a loss of PLN223 million based on EEV sensitivities. This, in our view, indicates a relatively low market-risk exposure, given PZU's strong capitalization and strong operating performance capabilities.

Asset-liability management

Assets backing non-life liabilities appear to be fairly closely matched. However, significant reinvestment risk exists for life liabilities with maturities of more than 10 years because of a greater exposure to mismatching risk.

Liquidity: Consistently Strong Cash Inflows And Outflows

We regard PZU's liquidity as strong. Our liquidity stress test incorporates an assumption of a flood similar to that of 1997 and 2010, the biggest in Poland over the past 50 years. We estimate that, under this scenario, PZU's potential liabilities (PLN4.294 billion) would be fully matched by short-term assets and available-for-sale treasury bonds (PLN9.072 billion). PZU does not maintain bank lines or a commercial paper program. We see PZU's need to use such facilities as minimal because we think the group has sufficient internal liquidity and good reinsurance cover to mitigate the potential losses from catastrophes.

Capitalization: Strong, Supported By Extremely Strong Capital Adequacy

PZU's capitalization is strong, in our view, reflecting extremely strong capital adequacy. We anticipate that capital adequacy should remain at least very strong, even against the group's high dividend payout plans of 50%-100% and its international expansion goal. Further supporting factors are strong capital quality, adequate reserving, and a conservative reinsurance program.

Capital adequacy

PZU's risk-based capital adequacy was extremely strong as of Dec. 31, 2011. Capital adequacy also incorporates a charge for a net aggregate one-in-250-year non-life catastrophe event. The group's capital strength stems from both the non-life and life operations. We anticipate that capital adequacy will be at least very strong over the next 12-18 months. Quality of capital was strong and unchanged at year-end 2011: Shareholder equity represented about 63% of total adjusted capital. We expect the quality of capital to remain strong.

Reserves

We regard PZU's reserves as adequate. PZU uses independent consulting actuaries to review the reserve adequacy of its non-life business.

Reinsurance

PZU's reinsurance program remains stable, with relatively low reinsurance utilization standing at 3.3% for non-life and 1.9% for the overall business at year-end 2011. However, we believe PZU's reinsurance program provides suitable cover.

The panel of reinsurers is highly rated, and more than 96% of ceded reinsurance premiums are rated 'A' or higher. The group continues to benefit from unlimited protection on TPML. The upper limit on PZU's catastrophe excess-of-loss program for 2011 is PLN1.2 billion, which provides cover for the probable maximum loss resulting from a one-in-250-year event.

Financial Flexibility: No Need For Additional Capital In The Medium Term

Table 4

PZU Group--Financial Statistics*					
	--Year-ended Dec. 31--				
(Mil. PLN)	**2011**	**2010**	**2009**	**2008**	**2007**
Economic capital available	12,703	12,691	11,182	19,983	16,743
Total assets	52,129	50,671	53,176	59,359	52,654
Reinsurance utilization (%)	1.9	1.4	1.1	0.9	1.2

*Consolidated 2007 under Polish accounting standards. 2008-2011 under International Financial Reporting Standards. PLN--Polish zloty.

PZU's strong financial flexibility, in our view, derives from its minimal requirements for additional external funding, limited capital needs to fund business growth, strong underlying earnings, a virtually debt-free balance sheet, and sufficient reinsurance capacity.

Moreover, we believe PZU's listing on the Polish stock exchange and the resulting broader shareholder base have increased investors' attention on PZU. Should the group wish to enter the Polish debt market, we believe any issue is likely to be oversubscribed in a market where little quality corporate debt exists.

Related Criteria And Research

- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Group Methodology, April 22, 2009
- Interactive Ratings Methodology, April 22, 2009

Ratings Detail (As Of September 28, 2012)	
Operating Companies Covered By This Report	
Powszechny Zaklad Ubezpieczen S.A.	
Financial Strength Rating	
Local Currency	A/Stable/--

Ratings Detail (As Of September 28, 2012) (cont.)	
Counterparty Credit Rating	
Local Currency	A/Stable/--
Powszechny Zaklad Ubezpieczen na Zycie S.A.	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
Domicile	Poland

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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