

Research Update:

PZU Group Outlook Revised To Positive On Advancing Strategy And Evolving Enterprise Risk Management; Affirmed At 'A-'

June 14, 2019

Overview

- PZU Group has demonstrated a track record of successful execution of its strategy, showing strong operating performance, which compares well with peers in 2018 and 2019.
- We also believe PZU Group is gradually enhancing its risk management practices and stabilizing its risk profile, notably the resilience of its balance sheet and discipline in capital allocation.
- We are revising our outlook on PZU Group to positive from stable and affirming the 'A-' ratings.
- The positive outlook reflects that PZU Group is well positioned to make use of its very strong footing in the Poland insurance, banking, and asset management sectors to source strong earnings and further build its track record of consistent earnings, stability, and sector outperformance.

Rating Action

On June 14, 2019, S&P Global Ratings revised its outlook to positive from stable on Poland-based multiline insurer Powszechny Zakład Ubezpieczeń S.A. and its core operating subsidiaries, Powszechny Zakład Ubezpieczeń na Życie S.A. and Towarzystwo Ubezpieczeń Wzajemnych Polski Zakład Ubezpieczeń Wzajemnych (all together, PZU Group). We affirmed our 'A-' long-term issuer credit and financial strength ratings.

Rationale

The outlook revision reflects our view that PZU Group has demonstrated a track record of successful execution of its strategy, including the continuation of its insurance outreach and since the acquisition of a stake in Bank Pekao since mid-2017, as well as its expansion into banking business. This enables the group to report a net income of Polish zloty (PLN) 3.2 billion

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(approximately €750 million) for full year 2018 with further stable development in first-quarter 2019. This translated into a strong return on equity of around 22% and was materially better than domestic and international peers'. The group's leading position in the Polish insurance market remains intact and continues to grant greater flexibility around pricing in insurance business. Despite more moderate growth in 2018 and in first-quarter 2019, the group's insurance business has sustained stronger performance than that of its peers, even compared with its own historic performance standards. The group posted a consolidated combined (loss and expense) ratio of about 88% and life insurance margin of above 20% in the full year 2018 and first-quarter 2019. Moreover, enforcing greater discipline in capital allocation and performance standards for the banking assets has led to increasing contributions from banks to the overall group earnings over 2016-2018, jumping to 20% of the group's net income, from 9% previously.

We also believe PZU Group's risk management capabilities, with an increasingly complex group risk profile, are gradually maturing. In our view, this strengthening may lead to further improvement in coherence and consistence of risk management standards across the group. We believe this could support management's capability to deal with various parts of the business while it grows more complex and in size.

In our view, PZU Group is solidifying its track record of conservative risk management culture, exhibited through the group's key strength of prudent insurance underwriting and reserve management. This underpins its overall conservative financial management, including strong balance-sheet management and a history of strong earnings. We consider that the group will maintain a conservative risk culture, also under the new group structure after its expansion into the banking business. Since acquisition of a 20% stake in Bank Pekao in June 2017, PZU Group has been gradually enhancing its risk management practices across the group. We particularly view positively the developments of a group-wide 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.

We also see that top management and group strategy have been stable since mid-2017, which we believe will help to further the development and implementation of the new business model.

Outlook

The positive outlook reflects that PZU Group is well positioned to leverage its very strong footing in Poland's insurance, banking, and asset management sectors to source strong earnings and solidify its track record of consistent earnings stability and sector outperformance.

Upside scenario

We could upgrade the 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 PLN2.6 billion, with a non-life combined ratio of around 93% and a life business margin at around 20%;
- Sustains a stable risk profile while building on its risk controls to support contributions from its banking investments, while successfully adapting to changes in business cycle and regulatory changes;
- Maintains capital adequacy levels consistently at, or above, the 'AA' benchmark while continuing to sustainably 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 fails to sustain its current strong group performance while its risk profile deteriorates below our expectations. This could result from increased risk exposures that lead to higher capital and earnings volatility, or if there is a material balance sheet loss event that reduces capital and brings into question the effectiveness of PZU Group's risk management.

Ratings Score Snapshot

Powszechny Zaklad Ubezpieczen S.A.

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

- Criteria | Insurance | General: Insurer Hybrid Capital Instruments With Nonviability Contingent Capital (NVCC) Features, July 24, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Insurance | General: Insurers: Rating Methodology, May 7, 2013
- Criteria | Insurance | General: Enterprise Risk Management, 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
- Criteria | Financial Institutions | Banks: Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 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 Alior Bank S.A. Rated 'BB/B'; Outlook Stable, Jan. 16, 2019
- Insurance Industry And Country Risk Assessment: Poland Property And Casualty, Dec. 11, 2018
- Insurance Industry And Country Risk Assessment: Poland Life, Dec. 11, 2018

Ratings List

Ratings Affirmed

PZU Finance AB (publ)

Senior Unsecured*	BBB+
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Ratings Affirmed; Outlook Action

	To	From
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Powszechny Zaklad Ubezpieczen na Zycie S.A.

Powszechny Zaklad Ubezpieczen S.A.

Issuer Credit Rating	A-/Positive/--	A-/Stable/--
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Powszechny Zakład Ubezpieczeń S.A.

**Towarzystwo Ubezpieczeń Wzajemnych Polski Zakład
Ubezpieczeń Wzajemnych**

Powszechny Zakład Ubezpieczeń na Życie S.A.

Financial Strength Rating A-/Positive/-- A-/Stable/--

*Guaranteed by Powszechny Zakład Ubezpieczeń S.A.

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