STANDARD & POOR'S

RatingsDirect®

August 6, 2007

PZU

Primary Credit Analyst:
Tatiana Grineva, London (44) 20-7176-7061; tatiana_grineva@standardandpoors.com

Secondary Credit Analyst:
David Laxton, London (44) 20-7176-7079; david_laxton@standardandpoors.com

Table Of Contents

 594749 | 300000838

PZU

Major Rating Factors

Financial Strength Rating
Local Currency
A-/Negative/--

Strengths:

- Strong competitive position
- Very strong operating performance
- Strong capitalization

Weaknesses:

- Heightened risk of shareholder intervention into company operations
- Related uncertainty surrounding management's ability to bringing ongoing critical reforms to completion

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, very strong operating performance, and strong capitalization. The ratings are constrained, however, by the heightened risk of intervention into company operations by PZU's largest shareholder, the State Treasury of the Republic of Poland.

PZU has a strong competitive position, driven by its significant position in the Polish insurance market, unrivaled distribution capabilities, and high recognition among the Polish population. The group is to some extent exposed to the fortunes of the Polish economy, however.

PZU's operating performance is very strong, driven primarily by its strong competitive position both in life and non-life business in a growing insurance market. The strength of PZU's operating performance is also supported by its strong capitalization.

PZU's capitalization is strong, reflecting a very strong capital adequacy ratio according to Standard & Poor's Ratings Services' risk-based model, adequate reserving, and a conservative reinsurance program.

Outlook

The negative outlook reflects increased uncertainty about shareholder influence on the group. This was recently highlighted by the appointment of a new CEO and complete renewal of the management board at a time when PZU had embarked on an ambitious strategic plan to modernize its systems and culture, the successful delivery of which Standard & Poor's considers to be critical to PZU's continued market leadership and credit profile. Meanwhile, Standard & Poor's acknowledges that PZU's management remains publicly committed to the reforms initiated by PZU at the end of 2005, and has confirmed its intention to maintain the current strategic direction.

As a consequence, the outlook may be revised to stable if the above concerns are alleviated, subject to also meeting the following expectations of Standard & Poor's:

- PZU is expected to continue to demonstrate a very strong operating performance through the cycle, with an average net combined ratio of 95% and ROE well in excess of 15%; and
- PZU is expected to maintain strong capitalization, with capital adequacy within the 'AA' (very strong) range according to Standard & Poor's risk-based capital model, strong quality of capital, sufficient reinsurance protection, and adequate reserving.

Conversely, the ratings may be lowered if capital management or the dividend policy change, or if the modernization and restructuring project initiated in 2004 is halted.

Corporate Profile: The Leading Universal Polish Insurer

PZU is Poland's largest insurance group, and is the leader in both non-life and life business, with shares of the Polish market of 47% and 36%, respectively. The group is also No. 3 in pensions and No. 13 in investment funds, with market shares of 14% and 2%, respectively. The group had total assets of Polish zloty (PLN) 49.4 billion ($17.5 billion) and gross premium income of PLN15.5 billion at year-end 2006. At December 2006, PZU's shareholders were the State Treasury of the Republic of Poland (55.09%), Eureko B.V. (Eureko; core operating entities are rated A+/Positive/--; 32.12%), J.P. Morgan (3.13%), and other (9.66%).

Competitive Position: Unrivaled Market Leader In Poland

Table 1

PZU/Business Statistics (Consolidated)

	--Year ended Dec. 31--				
(Mil. PLN)	**2006**	**2005**	**2004**	**2003**	**2002**
Total nonlinked investments	43,794	39,037	35,505	31,477	26,445
Total consolidated revenue	17,282	15,577	14,098	13,471	12,176
Total net premiums written	15,285	13,340	12,417	11,806	11,781
Annual change (%)	14.6	7.4	5.2	0.2	7.3
Reported EBITDA	4,613	3,996	2,605	2,048	1,843
ROE (reported equity) (%)	30.5	33.4	28.3	27.1	30.4
Direct yield on invested assets (%)	5.1	6.0	5.4	5.6	3.4

PLN--Polish zloty.

PZU's strong competitive position is driven by the group's significant position in the Polish insurance market, both in non-life and life business lines, complemented by pension and asset management activities, as well as its very strong brand recognition and unrivaled distribution capabilities with cross-selling potential. PZU's competitive advantages are focused in the Republic of Poland, which brings some geographic concentration, but PZU is developing activities in Ukraine and Lithuania.

During 2003-2005, PZU made meaningful acquisitions in the Lithuanian and Ukrainian insurance markets. The Ukrainian market in particular, where PZU is No. 5 in non-life and No. 8 in life, offers excellent potential for profitable growth and diversification (in 2006, the non-life market grew by 6.8% and life by 40.3%). In Lithuania, the non-life market grew by 10.8% and the life market by 23.1% in 2006. PZU holds a strong position in Lithuania, with a 13.0% share of the market in non-life and 2.3% in life. Nevertheless, in Standard & Poor's view, tangible benefits from this diversification can only materialize in the medium to long term. PZU is expected to further improve its competitive position in life business, but its competitive position is otherwise expected to remain relatively stable, in line with the growth and development of the Polish market, which demonstrated dynamic growth of 21.1% in 2006 (non-life growth of 4.8%; life growth of 37.7%, primarily linked business).

Industry risk

Industry risk in Poland is regarded as modest, largely as a result of the EU accession process, which brought reform to the Polish regulatory and legal environment. Insurance regulation is now largely aligned with that in Europe. There are no significant barriers to entry in Poland, and the Western European insurers active in the accession countries are established in Poland.

Significant position in the Polish insurance market

Despite considerable competition from new entrants, PZU maintains a significant position in Poland, with 47% of the non-life market, 36% of the life market, and 41% of the overall insurance market in 2006. PZU's nearest competitors had 11% of the non-life market (Towarzystwo Ubezpieczen i Reasekuracji WARTA S.A. {Warta; unsolicited rating BBBpi}) and 12% of the life market (Commercial Union). This dominance has been marginally reducing over the past five years, however, and may continue to reduce, but is viewed as sustainable in the medium term as the group can effectively build upon its already very strong distribution network and the most well known insurance brand in Poland.

Non-life

The strongest component of PZU's competitive position is PZU S.A.'s undisputable leading position in the Polish non-life market (50.3% of PZU's gross premiums written), where it has a relatively diversified portfolio (third-party motor liability {TPML} 36.3%, other motor damage 32.9%, property 17.7%, accident and health 10.0%, and other 3.1%). There is some concentration in motor, but the company has a sustainable, significant cost advantage over its peers thanks to its agency distribution network. PZU S.A. is expected to reduce its concentration on motor business in the long term by growing its personal property and commercial lines business.

Life

The second-strongest element of PZU's competitive position is PZU Zycie's significant position in the Polish life insurance market--in group business in particular--with a 63% market share. PZU Zycie's position in individual business is relatively weak, with only an 11% share of the market, although it is improving. Similar to non-life, PZU Zycie enjoys sustainable cost advantages over its peers due to its distribution network and very well known brand. PZU Zycie will be challenged to significantly improve its market ranking for individual life, while it is expected to maintain its strong presence in group business. PZU Zycie has also recently established a cooperation agreement with one of Poland's largest providers of private healthcare, which should help the group establish a good position in this market, which is in its infancy in Poland, due to the lack of suitable private healthcare facilities.

Very strong brand recognition

PZU's brand recognition as one of the most well known institutions in Poland is extremely strong. Of the selected population sample, 84% immediately recognized the group and 98% recognized it with some prompting. The second best recognized brand in Poland is Warta, although this has a lower level of recognition (45% and 88%, respectively) (source: Pentor, July 2006).

Unrivaled distribution capabilities

PZU's distribution network is unrivaled in size and reaches every corner of Poland, with more than 700 inspectorates and about 12,000 agents. It is this network that perpetuates PZU's strong position in the smaller cities and rural areas, which is even stronger than its position in the large cities. PZU is also strong in the large cities, but it is here that the group experiences the stiffest competition. Of the total portfolio, 40.7% of business is sold by agents, 29.5% by permanent employees, 12.9% by brokers/intermediaries, and 13.4% by multi-tie agents. More than 70% of TPML business is sold through the branch network, with 35% automatically renewed by post. The total lapse ratio on the portfolio is 2%. Although bancassurance remains in the early stages of its development in Poland, PZU is already actively marketing its products (mainly life) through Bank Millennium Capital Group (unsolicited rating BBBpi), Powszechna Kasa Oszczednosci Bank Polski (S.A.) (unsolicited rating BBBpi), Deutsche Bank PBC S.A., Bank Ochrony Srodowiska S.A., Bank Gospodarki Zywnosciowej S.A., and Polbank EFG, and holds an approximate 20% share of the bancassurance market (according to PZU's estimation).

Prospective

PZU's non-life and life units will remain a key driver of the group's competitive position, revenue generation, and earnings. The Polish insurance market--and life insurance in particular, typical of emerging markets--has substantial growth potential as the overall demand for insurance is increasing and private property insurance and health insurance are underdeveloped. PZU is well positioned to participate in this growth.

Management And Corporate Strategy: Uncertain Future Direction Of PZU

The uncertainty surrounding the direction of PZU, and the impact of frequent changes of CEO on the group and senior management team, are negative contributors to the ratings. Although the new management remains fully committed to the reforms initiated by its predecessors at the end of 2005, and confirms its intention to maintain the current strategic direction, its ability to implement this restructuring is still unproven. Historically, changes in government have often led to changes in PZU's CEO, translating into a lack of continuity with initiatives started by previous CEOs.

In addition, PZU has no role in the resolution of its ownership issue, disputed by Eureko. Therefore, management will continue to operate under the continuous pressure of uncertainty, unaware of the impact that ownership resolution may have on the group's strategic direction, capitalization, financial flexibility, and on the senior management team. Previous management made progress in implementing its modernization and restructuring plans in 2004 and 2005 within PZU, and had plans to turn PZU into an even more profitable vehicle, with possible leading positions well beyond Poland. The progress achieved will assist PZU to sustain its positions in Poland in the medium term, but if continuous restructuring is halted now, the lost opportunities may limit PZU's competitive advantages in the longer term. Furthermore, the ratings are based on the assumption that capitalization will be maintained at a strong level, but the risk remains that extraordinary dividends may be paid at some time in the future. PZU would benefit from setting a clearer and more consistent dividend policy. Being left with reduced capital adequacy would hinder PZU's strong potential for growth and development outside Poland. Further delay in the IPO, which has been postponed since 2001, will deprive PZU of this additional driver in the group's restructuring, modernization, and development, and would continue to be viewed negatively by Standard & Poor's.

Publicity surrounding the ownership dispute between Eureko and the State Treasury of the Republic of Poland has been intense over the past five to six years. Outwardly, these ownership uncertainties have not affected PZU directly, as the group's core competitive position and underlying financial indicators continue to show strong improvement compared with previous years. Nevertheless, this dispute limits PZU's growth potential and strategy setting.

Any resolution of PZU's ownership dispute that ensures continuity of management and strategic direction at the group is likely to be positive for the ratings on PZU.

Strategy

PZU's five-year business and financial objectives to support the strategy have been developed by the previous management. The highlights are to:

- Grow premium income at 75% of market growth.
- Maintain the combined ratio below 92%.
- Grow embedded value by a discount rate plus one percentage point.
- Generate ROE of more than 20%.
- Expand market share to 15% in the second-pillar pension market as measured by net asset value.
- Generate 8% of the group's premium income on foreign markets.
- Cut the cost ratios: life to 6% from 10%; non-life to 10% from 15%.
- Remain the top insurer in Central and Eastern Europe.
- Automate and centralize back-office processes.
- Cut claims handling duration by one-half.

Standard & Poor's regarded this strategy, supported by strong and clear implementation plans, as fully appropriate but challenging for PZU. Although progress has been made with these plans in the past, the current management team needs to demonstrate its ability to continue this process.

Enterprise Risk Management: Of Moderate Importance For The Ratings, Given PZU's Strong Current Capitalization

PZU's enterprise risk management (ERM) program is adequate. PZU has operational risk management functions. The risk management process is classical and silo-based. PZU is mainly exposed to risks associated with its corporate governance structure, credit risk (PZU's investment portfolio is 100% exposed to the Polish economy, 70% of which exclusively to Polish government securities), interest rate risk (mismatch on the life side with liabilities in excess of 10 years), and catastrophic flood.

PZU has an adequate risk management culture. The group has initiated activities to reinforce the systems supporting risk management by implementing a new system that complies with the new Solvency II directive requirements.

Silo-based risk controls for underwriting, reserving, catastrophe, reinsurance, asset-liability management, and credit risks are consistently adequate. Modeling is used extensively within the silos, with some interactions considered (but not yet holistically).

Operating Performance: Very Strong Performance Supported By Strong Investment Income

Table 2

PZU/Operating Statistics (Consolidated)					
	--Year ended Dec. 31--				
(Mil. PLN)	**2006**	**2005**	**2004**	**2003**	**2002**
Reported EBITDA	4,613	3,996	2,605	2,048	1,843
Reported EBITDA (excl. nonrecurring items)	4,613	3,996	2,605	2,048	1,843
EBITDA (excl. realized and unrealized gains)	3,442	2,811	1,530	1,022	(192)
ROE (adjusted equity) (%)	29.1	31.6	26.3	24.6	26.9
EBITDA (excl. nonrecurring items)/total capitalization (%)	36.4	39.2	31.5	31.2	38.4
Total gross expense ratio (%)	21.7	23.0	22.8	22.8	21.7
Total administrative expense ratio (%)	12.8	14.4	14.5	13.1	13.6
Total acquisition expense ratio (%)	8.7	8.8	8.8	10.1	8.4
Non-life ROR (%)	14.6	11.3	6.9	4.3	3.8
Non-life net expense ratio (%)	30.2	30.3	29.7	27.9	25.3
Non-life net combined ratio (%)	85.7	89.8	93.9	96.6	96.9
Life post-tax return on technical reserves (basis points)	928	729	415	249	300
Direct yield on invested assets (%)	5.1	6.0	5.4	5.6	3.4
Five-year capital gains/total invested assets (%)	1.3	1.1	1.1	0.0	0.0

PLN--Polish zloty.

PZU's operating performance is very strong, driven primarily by its strong competitive position in both life and non-life in a growing insurance market and strong investment income. Non-life business was a primary contributor (75%) to technical income in 2006. The group was projected to invest PLN1.1 billion in restructuring its non-life business under the old management. This was expected to bring average cost savings of PLN350 million per year, translating into an excellent average combined ratio over the next five years (covering the current cycle) of 90.5% (83.8% in 2006 due to a lower loss ratio) and an average ROE of 27.7% (30.6% in 2006). PZU's projected investment in life business was about PLN475 million, which expected to bring cost savings to about PLN100 million-PLN115 million per year. This should result in a reduction in the cost ratio (costs/gross premiums written) to 12.1% in 2009 (14.1% in 2006, 15.8% in 2005).

Prospective

In Standard & Poor's view, PZU's very strong performance is sustainable in the medium term, with a net combined ratio of less than 93% (based on the past three-year average of 89.8%), ROE in excess of 25%, and a return on embedded value in excess of 7% over the cycle.

Investments: Lack of Diversity Due To Exclusive Exposure To Poland

Table 3

PZU/Investment Statistics (Consolidated)					
	--Year ended Dec. 31--				
(Mil. PLN)	**2006**	**2005**	**2004**	**2003**	**2002**
Life assets/total assets (%)	57.5	58.0	59.0	60.3	63.2
Realized gains/(losses)	584	474	483	655	506
Unrealized gains/(losses)	588	711	592	372	1,528

Table 3

Direct yield on invested assets (%)	5.1	6.0	5.4	5.6	3.4
Total investment return (incl. unrealized and realized) (%)	7.9	9.2	8.6	9.2	11.9
Investment in affiliates (%)	0.5	0.8	0.6	0.7	0.7
Bonds and other fixed-interest securities (%)	73.8	78.5	80.6	78.6	89.5
Equities and other variable-interest securities (%)	9.5	10.0	10.0	7.7	5.0
Property (%)	2.5	2.9	3.1	3.7	1.0
Cash and bank deposits (%)	3.9	3.0	2.5	9.2	3.8
Loans and private placements (%)	9.8	4.9	3.1	0.0	0.0
Total nonlinked investments (%)	93.3	95.6	96.5	95.8	95.6
Assets held to cover linked liabilities (%)	6.7	4.4	3.5	4.2	4.4
Liquid assets/non-life technical reserves (%)	620.3	565.3	512.3	498.4	488.9
Cash in/out (%)	143.3	140.4	135.8	132.2	128.7
Debtor days less creditor days	9.4	17.9	16.4	17.9	19.3
Operating cash flow ratio (old basis) (%)	147.3	142.0	138.6	139.1	147.6

PLN--Polish zloty.

PZU's investment portfolio is regarded as strong, although regulations limit the amount of overseas investment, thereby restricting diversity. The lack of availability of suitably long-dated investments precludes accurate asset-liability management. PZU is the biggest individual investor in Polish treasury securities, which may limit the group's actions in order to maintain stability in government bond markets in extreme situations.

Credit risk

Credit risk is low, as about 70% of total investments are held in Polish government local currency debt issues (rated 'A' or 'A-').

Market risk

Market risk is high due to almost 100% equity investment (excluding investments in group companies) being in Poland, 50% of which is in the Polish banking sector. Equities represent about 10% of invested assets, accounting for about 26% of shareholders' equity (including equalization reserves).

Asset-liability management

Although in general assets and liabilities appear to be fairly closely matched, reinvestment risk exists for liabilities with maturities in excess of 10 years at PZU Zycie, where the situation is more exposed to risk. Suitable assets match about 23% of these liabilities.

Liquidity: Consistently Strong Cash In/Out Trend

Liquidity is regarded as strong. The stress test liquidity scenario was estimated by actuaries using the 1997 Polish flood--the biggest flood in Poland in the past 50 years--and fully matched by short-term assets and T-bonds available for sale (PLN3,223 million versus PLN5,774 million). PZU does not maintain bank lines or a CP program. The need to use such facilities is minimal, however, as the group has sufficient internal liquidity and good reinsurance cover for catastrophic loss.

Capitalization: Capital Is Ample

Capitalization is strong, reflecting a very strong level of capital adequacy, adequate reserving, and a conservative reinsurance program.

Capital adequacy

According to Standard & Poor's risk-based capital model, PZU had a very strong capital adequacy ratio at Dec. 31, 2006. The model also incorporates a charge for a full retention of a one-in-250-year event. The group's capital strength comes from the non-life operations, which, on a stand-alone unconsolidated basis, had extremely strong capital adequacy at year-end 2006. PZU Zycie's capital adequacy is good and consistent with its status as a core operating entity under Standard & Poor's group methodology. Overall quality of capital is good.

Polish government debt represents more than 70% of group-invested assets. There is, therefore, some sensitivity in capital requirements for investment risk relating to any adverse change in the ratings on these instruments.

Reserves

Reserve adequacy at PZU is satisfactory. PZU uses independent consultant actuaries to verify reserve adequacy on its non-life operations. Tillinghast-Towers Perrin has recognized PZU S.A.'s reserves as sufficient and has underlined PZU's conservative approach toward reserving policy.

Reinsurance

PZU's reinsurance program provides suitable levels of coverage, with a panel of highly rated reinsurers (more than 90% of reinsurance receivables are rated 'A' and higher). The group continues to benefit from unlimited protection on TPML. Upper protection on the catastrophe excess-of-loss program is PLN1,000 million, which, in combination with the catastrophe reserves, provides cover in excess of the probable maximum loss of PLN850 million-PLN990 million (one-in-200-year event).

Financial Flexibility: No Need For Capital In The Medium Term

Table 4

PZU/Financial Statistics (Consolidated)					
	--Year ended Dec. 31--				
(Mil. PLN)	**2006**	**2005**	**2004**	**2003**	**2002**
Non-life annual change in net premiums written (%)	6.2	4.4	3.9	(2.9)	9.9
Non-life reinsurance utilization ratio (%)	2.0	5.2	7.2	7.4	6.8
Change in total assets (%)	14.5	10.5	11.5	12.8	18.6
Total adjusted equity	13,875	11,454	8,924	7,037	5,537
Annual change (%)	21.1	28.3	26.8	27.1	36.6
Total capital	13,875	11,454	8,924	7,592	5,537
New solvency measure	3.4	3.1	2.5	2.2	1.9
Reinsurance exposure ratio (%)	8.5	10.4	14.1	21.7	31.0
Reinsurance utilization ratio (%)	1.1	3.0	4.2	4.4	4.1
Net reserves/gross Reserves (%)	96.3	95.6	95.1	93.7	92.5
Basic adjusted capital (%)	93.1	92.7	91.2	88.1	79.6
Revaluation reserves (%)	2.2	1.7	1.6	2.4	8.5

Table 4

PZU/Financial Statistics (Consolidated) (cont.)					
Other (%)	4.1	4.9	6.3	8.3	10.3
Non-life unearned premium reserves/net premiums earned (%)	24.5	25.8	27.1	26.1	27.1
Non-life net technical reserves/gross technical reserves (%)	70.4	68.9	70.7	68.5	65.2
Non-life loss reserves/net premiums written (%)	38.0	40.8	45.5	44.1	38.1
Life reinsurance utilization ratio (%)	0.1	0.1	0.1	0.2	0.1

PLN--Polish zloty.

PZU's adequate financial flexibility is driven by minimal requirements for additional external funding, with sufficient capitalization to meet expected growth; a debt-free balance sheet; and sufficient reinsurance capacity.

Nevertheless, if a need for capital arises, the availability of funding from existing shareholders is likely to be low, and this is a limiting rating factor. Should the group wish to enter the debt market, any issue is likely to be heavily oversubscribed in a market where little quality corporate debt exists, although this has not been tested. The possibility of an IPO is likely to further enhance PZU's financial flexibility, but Standard & Poor's considers this possibility to be still remote at present, and has not factored this into its assessment of PZU's financial flexibility.

Ratings Detail (As Of August 6, 2007)*	
Powszechny Zaklad Ubezpieczen S.A.	
Financial Strength Rating	
Local Currency	A-/Negative/--
Counterparty Credit Rating	
Local Currency	A-/Negative/--
Related Entities	
Powszechny Zaklad Ubezpieczen na Zycie S.A.	
Financial Strength Rating	
Local Currency	A-/Negative/--
Issuer Credit Rating	
Local Currency	A-/Negative/--
Holding Company	Powszechny Zaklad Ubezpieczen S.A.
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.

Additional Contact:
Insurance Ratings Europe; InsuranceInteractive_Europe@standardandpoors.com