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Research Update:

Poland-Based Insurer PZU Group Outlook Revised To Stable On Stabilizing Financial Strength; 'A-' Ratings Affirmed

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Overview

- The financial strength of Powszechny Zakład Ubezpieczeń Group (PZU Group), in our view, has stabilized over the months following the group's launch of a number of measures to prepare for increased exposure to the Polish banking sector.
- We think that the group's stabilization and greater clarity about its investments into the Polish banking sector supports the group's current creditworthiness over the medium term.
- We are therefore revising our outlook on PZU Group to stable from negative and affirming the 'A-' ratings.
- The stable outlook reflects our view that the group will continue to advance its strategy to sustain its business position and financial strength.
- Following the completed acquisition of a stake in Bank Pekao and acquiring greater clarity around the bank's future role within PZU Group, we assess the bank as moderately strategic to the group.

Rating Action

On Oct. 27, 2017, S&P Global Ratings revised its outlook on Poland-based insurer Powszechny Zakład Ubezpieczeń Group (PZU Group) and its rated core subsidiaries to stable from negative. We affirmed our 'A-' issuer credit and financial strength ratings.

Rationale

The outlook revision stems from our view that PZU Group's overall financial strength has been stabilizing over the months following the group's acquisition of a 20% stake in Poland-based Bank Polska Kasa Opieki S.A. (Bank Pekao; BBB+/Stable/A-2) on June 8, 2017. We think that PZU Group's capital and earnings remain very strong, making the group resilient against the expected stress from its large portfolio of domestic assets that would accompany any sovereign foreign currency default.

Since announcing the purchase of the 20% stake in Bank Pekao on Dec. 8, 2016, PZU Group has taken a number of measures to become financially prepared to finalize the acquisition, including fulfilling its longer-term commitments that were established in the group's strategy, which it presented in August

2016. In our view, the measures that PZU Group has undertaken regarding the acquisition financing offset the impact of the increased banking exposure in Poland. One of the core aspect was the combination of deal financing, under which some higher-risk assets were divested, somewhat alleviating the risks stemming from the higher exposure from banking investments in Poland. Additionally, the group's June issuance of Polish zloty 2.25 billion (approximately €0.53 billion) subordinated debt and strong ongoing underwriting performance are reducing the risk of slippage in the medium term.

We believe that the risk of further buildup of domestic banking exceeding the current holdings in Bank Pekao and Alior Bank S.A. and sovereign risk exposure has receded, which we believe supports PZU Group's midterm sustainability of its financial strength. We now have greater clarity on the group's future strategy regarding its investments in the Polish banking sector, which we expect to remain stable over the next 12-18 months. Furthermore, we now believe that the company is making progress with further rebalancing of its domestic investment risk exposure and is improving its portfolio diversification with investments outside Poland. We do not expect that these measures will cause additional volatility for the group over the medium term. We also believe these measures to be a sustainable part of the group's future strategy. In our view, greater investment portfolio diversification may improve the group's resilience to moderate market volatility stemming from its exposure to the Polish banking sector.

After receiving greater clarity around Bank Pekao's future role within PZU Group, we now consider Bank Pekao to be moderately strategic in the overall group context. Bank Pekao has a track record of strong capitalization and above-market operating performance. We expect that Pekao will maintain its conservative growth strategy and continue to hold sufficient capital buffers to withstand any adverse developments in its operating environment without materially affecting the stability of PZU Group. We assume Bank Pekao will remain a steady contributor to the overall group performance. Additionally, our understanding that PZU Group intends to gradually transform into a bancassurance group confirms the group's longer-term commitment to developing with the bank. This makes us believe that PZU would not divest from the bank in the medium term. We do not include any uplift in the rating of Bank Pekao from its current group status within the PZU group as it is currently assessed one notch below PZU on a stand-alone basis.

Outlook

The stable outlook on PZU Group reflects our view that the group will continue to advance its strategy to sustain its business position and the strength and stability of its capital and earnings position.

Downside scenario

In the next 12-24 months, we would likely take a negative rating action if, contrary to our current expectations:

- The group increases its exposure to the domestic sovereign or banking sector and would therefore undermine the group's ability to sustainably pass our hypothetical foreign currency sovereign stress test;
- Capital weakened for a prolonged period below the threshold for our very strong category, squeezed either by weaker-than-expected operating performance or investment losses, considerably higher dividend payouts, or expenditures for any further acquisitions; or
- We lowered our local currency sovereign credit rating on Poland.

Upside scenario

We could revise up our assessment of PZU Group's stand-alone credit profile if we observe a track record of execution of the current strategy and stable management and governance processes. However, our view of the group's creditworthiness would improve in this case only if we raised the local currency rating on Poland.

Ratings Score Snapshot

	To	From
Financial Strength Rating	A-/Stable	A-/Negative
Anchor	a	a
Business Risk Profile	Strong	Strong
IICRA	Moderate	Moderate
Competitive Position	Very Strong	Very Strong
Financial Risk Profile	Strong	Strong
Capital and 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
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, 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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Related Research

- Insurance Industry And Country Risk Assessment: Poland Property/Casualty, Oct. 11, 2017
- Insurance Industry And Country Risk Assessment: Poland Life, Oct. 11, 2017
- Polish Motor Insurers Face A Decade Of Uncertainty Due To Retrospective Bereavement Damages Claims, Oct. 9, 2017
- Bank Polska Kasa Opieki S.A., Aug. 28, 2017
- PZU Group 'A-' Ratings Affirmed After Subordinated Debt Issue; Outlook Remains Negative, July 4, 2017
- PZU Group 'A-' Ratings Affirmed After Announced New Acting CEO; Outlook Remains Negative, March 28, 2017
- Ratings On Polish Insurer PZU Group Affirmed At 'A-' Following Announced Acquisition Of Bank Pekao; Outlook Negative, Dec. 22, 2016
- Polish Insurer PZU 'A-' Rating Affirmed And Off CreditWatch; Outlook Negative, Oct. 31, 2016
- Polish Bank Pekao Outlook Revised To Stable And 'BBB+/A-2' Ratings Affirmed On Announced Disposal By UniCredit, Dec. 12, 2016

Ratings List

Ratings Affirmed; Outlook Action

To

From

Powszechny Zaklad Ubezpieczen S.A. Counterparty Credit Rating	A-/Stable/--	A-/Negative/--
Powszechny Zaklad Ubezpieczen S.A. Powszechny Zaklad Ubezpieczen na Zycie S.A. Financial Strength Rating Local Currency	A-/Stable/--	A-/Negative/--
Powszechny Zaklad Ubezpieczen na Zycie S.A. Counterparty Credit Rating Local Currency	A-/Stable/--	A-/Negative/--
PZU Finance AB (publ) Senior Unsecured*	BBB+	BBB+

*Guaranteed by Powszechny Zaklad Ubezpieczen S.A.

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