STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

PZU Group

Primary Credit Analyst:
Anvar Gabidullin, CFA, London (44) 20-7176-7047; anvar.gabidullin@standardandpoors.com

Secondary Contact:
Johannes Bender, Frankfurt (49) 69-33-999-196; johannes.bender@standardandpoors.com

Table Of Contents

PZU Group

SACP* Assessments					SACP*			Support			Ratings
Anchor	a	+	Modifiers	0	=	a	+	0		=	Financial Strength Rating
Business Risk			ERM and Management	0		Liquidity	0	Group Support	0		A/Stable/--
Strong											
Financial Risk			Holistic Analysis	0		Sovereign Risk	0	Gov't Support	0		
Very Strong											

*Stand-alone credit profile.
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

Rationale

Business Risk Profile: Strong

- Powszechny Zaklad Ubezpieczen (PZU) is Poland's largest insurance group and leads the non-life and life insurance markets, with market shares of 33% in non-life and 43% in regular life in 2014.
- Its competitive position is very strong, primarily because of its substantial market share and capacity to outperform its peers.
- Its industry and country risk exposure largely comes from Poland; we consider it moderate, mainly based on Poland's elevated financial system risks.

Financial Risk Profile: Very Strong

- Capital and earnings are likely to remain very strong, even though we expect the company to distribute a high proportion of its earnings through dividends.
- PZU's conservative investment strategy and reinsurance cover against the group's natural catastrophe exposure in Poland support our view of its intermediate risk position.
- The group's earnings generation capacity, proven access to the capital markets, and a low leverage on its balance sheet lead us to assess its financial flexibility as strong.

Other Factors

- We combine the above-mentioned factors to derive an anchor of 'a' for PZU.
- The anchor is constrained by the group's high exposure to Polish government securities rated 'A'--these comprised about 60% of total investments in 2014, as well as competitive pressures on PZU's currently very strong incumbent position in the Polish market .
- Management and governance, as well as enterprise risk management, support the ratings.
- PZU's adoption of a credible risk-mitigation plan means that it passes our hypothetical foreign currency sovereign default stress test under our criteria for rating companies above the sovereign; as a result, we rate PZU one notch above the 'A-' foreign currency sovereign ratings on Poland.

Outlook: Stable

The stable outlook on Polish insurer Powszechny Zaklad Ubezpieczen (PZU) reflects its very strong incumbent position in its domestic market, noting that it does face some competitive pressures from market peers. In our view, the group is likely to sustain its very strong, market-leading competitive position in Poland, which should enable it to achieve our base-case earnings assumption and maintain very strong capital and earnings.

Downside scenario

We would likely lower our rating on PZU if management actions increased PZU's exposure to sovereign risk, causing it to fail the foreign currency stress test, or if we lowered Poland's local currency sovereign rating (this is currently unlikely as the rating is on a positive outlook). We could also lower the ratings if we were to take a more negative view of the execution risk of the mitigation plan. This could result from a material weakening in capital, higher-than-expected exposure to Polish assets, or a failure to execute the plan in the event of deteriorating sovereign creditworthiness. Finally, we could lower the rating if we revised PZU's indicative GCP to below 'a', which could happen if its capital adequacy or competitive position were to weaken as a result of repeated earnings underperformance compared to the rest of the market.

Upside scenario

As long as PZU continues to pass the foreign currency stress test, we could raise the ratings if:

- We raised the local currency ratings on Poland; and
- We revised upward our assessment of PZU's indicative GCP to 'a+'. This could occur if PZU maintains at least very strong capital and earnings, strengthens its market share, and continues to outperform peers in terms of profitability.

Base-Case Scenario

Macroeconomic Assumptions

- Real GDP growth will be 3.0% in 2015 and 3.3% in 2016 in Poland.
- Investment returns will remain broadly stable because we expect the income from Polish treasuries to be stable over the next two years.

Company-Specific Assumptions

- PZU will increase its gross premium written by 2%-3% in 2015-2017, broadly in line with the Polish market.
- We expect the company to post combined (loss and expense) ratios of 91%-95% and return on equity of 18%-22% in 2015-2017.
- We expect net income of about Polish zloty (PLN) 2.8 billion to PLN3.2 billion in the next three years.

Key Metrics

Key metrics

PLN mil.	2016f	2015f	2014	2013	2012	2011	2010
Gross premiums written	c. 17,700	c. 17,300	16,885	16,480	16,243	15,279	14,544
Change in Gross Premiums Written (%)	2.0 - 3.0	2.0 - 3.0	2.5	1.5	6.3	5.1	1.3
Net income (attributable to all shareholders)	2,800 - 3,200	2,800 - 3,200	2,968	3,295	3,254	2,344	2,439
Return on revenue (%)	15.0 - 20.0	15.0 - 20.0	15	19	13.9	18.4	13.1
Return on shareholders' equity (%)	18.0 - 22.0	18.0 - 22.0	22.6	24.1	24	18.3	20.3
P/C: net combined ratio (%)	91.0 - 95.0	91.0 - 95.0	94.7	87.8	92.3	95.2	103.3
S&P Capital Adequacy	At least Very Strong	At least Very Strong	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong	Extremely Strong

f--Forecast.

Company Description: Leading Composite Insurance Group In Poland

PZU is Poland's largest insurance group and leads the non-life and life insurance markets. It wrote 33% of non-life business in Poland market in 2014, boosted from 31% in 2013 by the acquisition of Link4; this is equivalent to 54% of its gross premium written (GPW) of PLN16.9 billion. In regular life, its market share was maintained at 43% in 2014, which makes up 46% of its GPW. PZU also ranks No. 3 in the Polish pension market and, following its recent acquisition from RSA, has market-leading insurance operations in the Baltic states, as well as the Ukraine (each less than 1% of its total GPW).

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

We regard PZU as a government-related entity, chiefly because the Polish treasury is its main shareholder. We consider that 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. However, this assessment provides no rating uplift because we cap the ratings on PZU at the local currency rating on Poland.

Ratings Above The Sovereign: Stress Test

PZU ratings are one notch above the 'A-' foreign currency sovereign ratings on Poland because PZU passes our hypothetical foreign currency sovereign default stress test under our criteria for rating companies above the sovereign. PZU does not pass our local currency stress test, and therefore its ratings are constrained by the 'A/Positive' local currency ratings on Poland.

We assess the potential impact of a hypothetical Polish sovereign default on PZU's consolidated balance sheet, based on a stress scenario. In our foreign currency stress scenario, we assume that, were Poland's creditworthiness to come under strain, PZU would execute a risk-mitigation plan that we consider credible, and thus retain positive regulatory capital. We also expect PZU to retain a liquidity ratio in excess of 100% under this stress scenario. According to our criteria, passing the sovereign foreign currency stress test indicates that PZU is unlikely to default on its insurance liabilities should Poland default.

The risk-mitigation plan contemplates re-allocating assets into investments outside the country and reducing the assets invested in Poland to 76% of the investment assets of PZU S.A. and PZU na Zycie S.A. (excluding assets covering investment products and non-quoted own investments) if the sovereign rating on Poland deteriorates materially. We expect PZU will implement this risk-mitigation plan gradually, should sovereign credit conditions in Poland deteriorate.

Business Risk Profile: Strong

We regard PZU's business risk profile as strong, reflecting its very strong competitive position and moderate insurance industry and country risk assessment.

Insurance industry and country risk: Moderate

Elevated financial system risks in Poland weigh on our view of the country risk to which PZU is exposed. We base our assessment of intermediate industry risk in Poland on generally good premium growth prospects for the sector in line with GDP growth, its favorable underwriting profitability, moderate levels of product risk, and our moderately strong assessment of the sector's institutional framework. We do not expect our overall industry and country risk assessment to change in 2015-2017 because of PZU's large domestic exposure. In our view, PZU will lack meaningful opportunities to achieve its goal of diversifying geographically via acquisitions in Central and Eastern Europe (CEE).

In our view, there is substantial growth potential in the Polish insurance market, and the life sector in particular, because the overall demand for insurance is increasing and the private property and health insurance sectors are still relatively underdeveloped compared with Western European insurance markets. We see PZU as well positioned to participate in this growth, and we expect the company will secure its market leadership and dominance.

Competitive position: Very strong

PZU has a significant market-leading position in the Polish insurance market, unrivaled distribution capabilities, a well-diversified business mix, and strong brand recognition among the Polish population. It also has the largest and most extensive distribution network in Poland, with over 400 outlets and more than 9,100 agents. PZU's agency network enables it to maintain a stronger position in smaller cities and rural areas than its peers. Bancassurance distribution is gaining prominence in the Polish life insurance market, and PZU continues to actively market its products through a number of banks.

The competitive advantages of operating in Poland are tempered by some geographic concentration; that said, PZU continues to develop a presence in the Baltic States and the Ukraine. In 2014, PZU completed acquisitions of subsidiaries in Lithuania, Latvia, and Estonia from RSA Group, establishing material foothold in these markets. That said, we consider that the tangible diversification benefits from these operations will materialize only in the long term. PZU aims to grow its international business to over 8% of total premium by 2020 from about 4% in 2014.

PZU is at least twice as large as its closest competitors in the non-life and life insurance markets in Poland, which, in our view, further underpins its strong market dominance. However, considerable competition, particularly from local subsidiaries of large multi-national insurance group has caused erosion of its market share as PZU maintained its focus on maximizing profitability at the expense of market share; its profitability is consistently better than the market average. That said, the group is now gaining share in select market segments. Its revamped PZU 3.0 strategy targets increasing in its non-life market share to over 35% and its life market share to over 43% by 2020. As part of the new strategy, PZU is also looking to build out its asset management capabilities, attracting third-party funds and growing its market share to over 11% of the mutual fund market.

PZU's non-life business is diversified by line of business and includes motor third-party liability (34% of 2014 non-life GPW), other motor damage (25%), property (23%), accident and health (10%), and other (8%). It has some concentration in motor, but we consider that the company's agency distribution network gives it significant and sustainable scale and cost advantages, compared with peers. PZU's competitive strength also depends on its subsidiary PZU Zycie, which has a significant position in the Polish life insurance market. PZU Zycie's position in the highly profitable group life line is stronger than its position in individual life; we see group life as a key competitive advantage for the group. PZU Zycie also started writing health insurance policies in 2002. Its growth rates have been good so far, but it operates on a relatively small scale. A third pillar of the PZU 3.0 strategy is development of its health division including potential acquisitions of hospitals and healthcare facilities.

We consider PZU well placed to transform its very strong competitive position into an above-average operating performance in the Polish insurance market. Under our base-case scenario, we anticipate that PZU will maintain its market-leading position in Poland and that GPW at the group level could grow by 2%-3% annually through 2015-2017.

Table 1

PZU Group Competitive Position					
	Year ended Dec. 31				
(mil. PLN)	**2014**	**2013**	**2012**	**2011**	**2010**
Gross premiums written	16,885	16,480	16,243	15,279	14,544
Change in Gross Premiums Written (%)	2.5	1.5	6.3	5.1	1.3
Net premiums written	16,535	16,223	16,006	14,994	14,344
Change in Net Premiums Written (%)	1.9	1.4	6.7	4.5	1.0
Net premiums earned	16,429	16,249	16,005	14,890	14,214
Total assets under management	60,018	57,740	51,736	48,314	46,923
Growth in Assets Under Management (%)	3.9	11.6	7.1	3.0	(5.8)
P/C: reinsurance utilization - premiums written (%)	3.8	2.9	2.7	3.3	2.5
Business Segment (% of GPW)					
Life	46.24	47.00	45.89	44.19	44.78
P/C	53.76	53.00	54.12	55.81	55.22

PLN--Polish zloty.

Financial Risk Profile: Very Strong

Capital and earnings: Very strong

PZU's capital adequacy exceeded our 'AAA' benchmark in 2014, according to our capital model. However, we expect the group's high dividend payouts of 50%-100% of earnings and potential international expansion to partially erode its capital adequacy buffer. Although the group plans to make strategic acquisitions in other CEE markets outside of Poland, we do not anticipate any major acquisitions in the next two or three years due to a lack of suitable targets. Therefore, we expect capital adequacy to continue to exceed our requirements at the 'AA' level in 2015-2017. We also expect PZU to have sufficient capital to pass our foreign currency sovereign stress test, taking into account the risk-mitigation plan it has adopted.

Table 2

PZU Group Capitalization Statistics					
	Year ended Dec. 31				
(mil. PLN)	**2014**	**2013**	**2012**	**2011**	**2010**
Common shareholders' equity	13,168	13,128	14,269	12,870	12,800
Change in common shareholders' equity (%)	0.3	(8.0)	10.9	0.5	13.6

PLN--Polish zloty.

Table 3

PZU Group Earnings Statistics					
	Year ended Dec. 31				
(mil. PLN)	**2014**	**2013**	**2012**	**2011**	**2010**
Total revenue	18,963	18,883	18,913	18,003	16,489
EBIT adjusted	2,838	3,594	2,635	3,305	2,152
Net income (attributable to all shareholders)	2,968	3,295	3,254	2,344	2,439

Table 3

PZU Group Earnings Statistics (cont.)					
Return on revenue (%)	15.0	19.0	13.9	18.4	13.1
Return on shareholders' equity (reported) (%)	22.6	24.1	24.0	18.3	20.3
P/C: net expense ratio (%)	28.9	26.4	26.6	27.5	29.3
P/C: net loss ratio (%)	65.8	61.3	65.8	67.7	73.9
P/C: net combined ratio (%)	94.7	87.8	92.3	95.2	103.3
Life: Net expense ratio (%)	15.2	14.9	16.1	18.9	18.9

PLN--Polish zloty.

Risk position: Intermediate

In our view, PZU's risk position reflects intermediate risks, based on a conservative investment strategy and reinsurance cover against the group's natural catastrophe exposure in Poland. About 73% of its investments comprise fixed-income securities (including loans). The average rating on the bond portfolio is 'A', due to the large exposure to Polish government securities. We anticipate PZU will continue to reduce its exposure to Polish government securities, although we expect it to remain material in 2015-2017.

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 in interest rates would trigger a PLN279 million reduction to its equity position, and a 20% decrease in equity market values implies a loss of about PLN561 million, based on disclosed sensitivities. This, in our view, indicates a relatively contained market-risk exposure, given PZU's very strong capital and earnings capabilities.

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

Table 4

PZU Group Risk Position					
	Year ended Dec. 31				
(mil. PLN)	**2014**	**2013**	**2012**	**2011**	**2010**
Total invested assets	60,018	57,740	51,736	48,314	46,923
Net investment income	1,645	1,867	2,083	1,942	1,830
Net investment yield (%)	2.8	3.4	4.2	4.1	3.8
Net investment yield including realized capital gains/(losses) (%)	3.7	3.6	5.3	4.0	4.4
Portfolio composition (% of General account invested assets)					
Cash and short term investments (%)	10.8	13.8	9.0	3.7	7.1
Bonds (%)	63.3	62.7	69.3	72.6	75.0
Equity investments (%)	10.8	10.9	12.3	10.7	12.2
Real Estate (%)	5.1	4.0	2.6	2.9	2.7
Loans (%)	9.3	8.5	6.7	10.2	3.0
Other investments (%)	0.6	0.0	0.0	0.0	0.0

PLN--Polish zloty.

Financial flexibility

PZU has strong financial flexibility, in our view, because it needs only limited capital to fund its business growth. The group also has strong earnings generation capacity, proven access to capital markets, a low leverage on its balance sheet, and sufficient reinsurance capacity.

We consider that PZU's listing on the Warsaw Stock Exchange in 2010 and the resulting broad shareholding base have increased investors' awareness of PZU. In 2014, PZU successfully issued an inaugural public five-year senior unsecured bond totaling EUR500 million (about PLN2 billion) and testing investor appetite. In our view, if the group pursues further plans to raise subordinated capital from the Polish debt market, we anticipate that any issue is likely to receive sufficient appetite in a market where few quality corporate issuances exist.

Table 5

PZU Group Financial Flexibility					
	Year ended Dec. 31				
	2014	**2013**	**2012**	**2011**	**2010**
EBITDA fixed-charge coverage (x)	12.91	58.28	63.50	67.23	36.69
Financial leverage including pension deficit as debt (%)	5.36	2.41	0.91	16.11	3.13

Other Assessments

PZU's enterprise risk management (ERM) and management and governance practices are neutral factors for the rating.

Enterprise risk management: Adequate

Our assessment of ERM as adequate reflects our neutral assessment of its risk management culture and risk controls for its main risks: insurance, market, asset-liability management (ALM), credit, and operational risk. In our view, the group's strategic risk management has improved in recent years, but is still somewhat constrained by its continued developments toward a more holistic view and management of the group's risk profile. While the group's internal model is not yet comprehensive, its use for managing market risk in particular has expanded over the past 12 months. The group is also keeping abreast of implementation requirements for Solvency II. Over time, we expect the group to demonstrate a track record of successfully managing the business under an integrated risk management framework. The importance of ERM to the rating is low, reflecting PZU's very strong capital and earnings and its geographic focus on Poland.

Management and Governance: Satisfactory

PZU's management and governance is satisfactory, in our view. This reflects the group's clear strategic planning, strong track record of executing its strategy, particularly since the existing management team was appointed in 2007, and conservative financial management, including strong balance sheet management and a history of strong earnings.

PZU has published a revamped 3.0 strategy for group's development through 2020, which incorporates strengthening its market share in its core domestic insurance market, and also becoming a market leader in asset management and private health care. We see corporate governance as having improved since PZU's successful IPO in 2010. We consider that PZU's operational management is effective, as demonstrated by the continued optimization of administration costs. PZU focuses on enhancing profitability and fosters growth only if bottom-line results are not harmed.

Liquidity: Exceptional

We regard PZU's liquidity as exceptional, owing to the strength of available liquidity sources, mainly premium income, and its liquid asset portfolio. PZU does not maintain bank lines or a commercial paper program. We see PZU's need to use such facilities as minimal because we consider the group has sufficient internal liquidity and good reinsurance cover to mitigate potential large losses.

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Rating Government-Related Entities: Methodology and Assumptions, March 25, 2015
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of April 27, 2015)	
Operating Companies Covered By This Report	
Powszechny Zaklad Ubezpieczen S.A.	
Financial Strength Rating	
Local Currency	A/Stable/--
Counterparty Credit Rating	A/Stable/--
Senior Unsecured	A-
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. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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