

Polish Insurance Group PZU's Core Entities Outlook Revised To Negative; 'A-' Ratings Affirmed

Rationale

On June 5, 2006, Standard & Poor's Ratings Services revised its outlook on non-life insurer Powszechny Zaklad Ubezpieczen S.A. (PZU S.A.) and life insurer Powszechny Zaklad Ubezpieczen na Zycie S.A. (PZU Zycie), core entities of Poland-based composite insurance group PZU, to negative from stable. At the same time, the 'A-' long-term counterparty credit and insurer financial strength ratings were affirmed.

The outlook revision follows the unexpected dismissal of Cezary Stypulkowski, former CEO of PZU since 2003, and what this means for financial strategies and restructuring plans.

The ratings are supported by the group's strong competitive position and very strong operating performance. The ratings are constrained, however, by PZU's limited ability to invest in assets of stronger credit quality or appropriate duration.

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. However, the group is to some extent exposed to the fortunes of the Polish economy.

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 a low cost base compared with peers'.

Regulations limit the amount of overseas investment, thereby restricting the diversity of PZU's portfolio. Lack of availability of suitably long-dated investments precludes accurate asset-liability management.

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Publication Date

June 5, 2006

Outlook

The uncertainty surrounding the future direction of PZU and the impact of the new CEO on the group and senior management team supports the negative outlook. Even if the new management remains fully committed to the reforms initiated by PZU at the end of the past year, and confirms their intention to maintain the strategic direction unchanged, the risk remains of political intervention into the operations of PZU at any time. The consequences of which may be disruptive and unpredictable.

If these concerns are alleviated, the outlook will be revised to stable subject to meeting Standard & Poor's Ratings Services additional expectations:

- PZU is expected to continue to demonstrate 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' range (according to Standard & Poor's risk-based capital model), strong quality of capital, sufficient reinsurance protection, and adequate reserving.

The ratings could be lowered if the investment strategy, capital management or dividend policy changed, and continuation of the modernization and restructuring project initiated in 2004 by the former CEO is halted.

Ratings List

	To	From
Powszechny Zaklad Ubezpieczen S.A. (PZU S.A.)		
Counterparty credit rating	A-/Negative/—	A-/Stable/—
Insurer financial strength rating	A-/Negative	A-/Stable
Powszechny Zaklad Ubezpieczen na Zycie S.A.		
Counterparty credit rating	A-/Negative/—	A-/Stable/—
Insurer financial strength rating	A-/Negative	A-/Stable

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation area, select Find a Rating, then Credit Ratings Search.

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