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Research Update:

Polish Insurer PZU 'A-' Rating Affirmed And Off CreditWatch; Outlook Negative

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Overview

- Under its new management team and revised strategy, Polish insurance group PZU would, in our opinion, survive the stress associated with a default of the sovereign's foreign currency obligations.
- We are therefore affirming our 'A-' long-term ratings on PZU and its core operating entities and removing the ratings from CreditWatch negative.
- Our negative outlook on PZU mirrors that on the long-term local currency sovereign rating on Poland.

Rating Action

On Oct. 31, 2016, S&P Global Ratings affirmed its insurer financial strength and counterparty credit ratings on Poland-based insurer Powszechny Zakład Ubezpieczeń S.A. (parent company of PZU group) and its rated core subsidiaries at 'A-'. The outlook is negative.

We removed all ratings from CreditWatch with negative implications, where we had placed them on Dec. 18, 2015.

Rationale

The affirmation and removal from CreditWatch reflect our view of the group's revised business strategy announced in August 2016 after a change in the management board, as well as our view of the group's future banking strategy in Poland. After our review of this strategy, we believe that PZU will continue to pass our hypothetical sovereign foreign currency default stress test. We therefore rate PZU one notch higher than our foreign currency sovereign rating on Poland (foreign currency BBB+/Negative/A-2; local currency A-/Negative/A-2).

In our view, the group's revised strategy doesn't substantially deviate from the previous one for 2015-2020, but does reflect the current domestic and foreign operating environment. The strategy focuses on:

- Profitability of insurance activities, coupled with simultaneous growth in selected market segments such as health;
- Yearly reduction of costs by about Polish zloty (PLN) 400 million (about \$100 million), which will be achieved gradually in the next three years; and
- Creation of a large banking group in Poland.

In addition, PZU announced a new dividend policy, under which it plans to distribute between 50% and 100% of net income (compared with around 85% in the past). The policy envisages that the maximum profit allocation to organic growth will be 20% and the cap on funding mergers and acquisitions will be 30%.

Based on PZU's new strategy, we believe that PZU would survive the stresses associated with a default of the sovereign on its foreign currency obligations as the group sustainably passes our hypothetical foreign currency sovereign default stress test. The ratings therefore remain one notch above our foreign currency sovereign rating on Poland. The buffers required to pass the foreign currency stress test increased following the implementation of Solvency II in Poland on Jan. 1, 2016. Additionally, in our view, changed regulation gives the company more flexibility around investment allocation. In our opinion, the likelihood that PZU will continue to pass the foreign currency stress test is further assured by additional measures it has undertaken, like the new dividend policy. We believe this indicates that the insurer is unlikely to default on its insurance liabilities under a sovereign foreign currency stress scenario. In our view, the margin at which PZU passes the stress test allows the group to execute its current business strategy. However, PZU does not pass our local currency stress test. Therefore, the ratings on the group are constrained by our 'A-' local currency long-term rating on Poland.

Although the banking strategy is high on PZU's agenda, the group is showing more caution in this area. PZU remains the largest shareholder of Alior Bank (not rated), with 29.22%. We do not expect it to significantly increase its investment in Alior bank in the coming two years. That said, we incorporate in our base case some potential further increase in Polish banking exposure, in line with the group's strategy.

PZU's management and governance remain satisfactory, in our view, despite major changes to the board. New board members are seasoned finance experts with extensive international experience gained mainly at leading financial institutions. Moreover, in our opinion, the actions undertaken in the past few months show that management is well placed to execute the revised business strategy. In addition, we think that overall corporate governance at PZU, despite some initial challenges, remains sound.

Outlook

The negative outlook on PZU mirrors that on the long-term local currency ratings on Poland.

Downside scenario

In the next 12-24 months, we would be likely to lower our rating on PZU if:

- We lowered our local currency sovereign rating on Poland; or
- Capital materially weakened on a prolonged basis, or the company did not pass our sovereign foreign currency stress test, for example due to a

significant increase in Polish banking asset exposure or other Polish sovereign exposure.

Upside scenario

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

- We raised our local currency ratings on Poland; and
- We revised upward our assessment of PZU's indicative group credit profile to 'a+'. This could occur if PZU maintained at least very strong capital and earnings and continued to outperform peers in terms of profitability.

Ratings Score Snapshot

	To	From
Financial Strength Rating	A-/Negative	A-/Watch Neg
Anchor	a	a
Business Risk Profile	Strong	Strong
IICRA	Moderate	Moderate
Competitive Position	Very Strong	Very Strong
Financial Risk Profile	Very Strong	Very Strong
Capital and Earnings	Very Strong	Very Strong
Risk Position	Intermediate	Intermediate
Financial Flexibility	Strong	Strong
Modifiers	0	0
ERM and Management	0	0
Enterprise Risk Management	Adequate	Adequate
Management and Governance	Satisfactory	Satisfactory
Holistic Analysis	0	0
Sovereign Risk	-1	-1
Liquidity	Exceptional	Exceptional
Support	0	0
Group Support	0	0
Government Support	0	0

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria And Research

Related Criteria

- General Criteria: Group Rating Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- General Criteria: Rating Government-Related Entities: Methodology And

Assumptions - March 25, 2015

- Criteria - Insurance - General: Enterprise Risk Management - May 07, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology - May 07, 2013
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model - June 07, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions - November 19, 2013

Ratings List

Ratings Affirmed; CreditWatch Action

	To	From
Powszechny Zaklad Ubezpieczen S.A.		
Powszechny Zaklad Ubezpieczen na Zycie S.A.		
Counterparty Credit Rating	A-/Negative/--	A-/Watch Neg/--
Financial Strength Rating	A-/Negative/--	A-/Watch Neg/--
PZU Finance AB (publ)		
Senior Unsecured*	BBB+	BBB+/Watch Neg

*Guaranteed by Powszechny Zaklad Ubezpieczen S.A.

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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