

RAEX-Europe confirmed the reliability rating of Balcia Insurance SE at 'BB+' according to the international scale. The rating outlook changed from negative to stable.

RAEX-Europe confirmed the reliability rating of Balcia Insurance SE at 'BB+' (Sufficient level of reliability) according to the international scale. The rating outlook is changed from negative to stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

JUSTIFICATION OF THE RATING:

The Agency has confirmed the rating of Balcia Insurance SE at '**BB+**' and has also changed the **outlook from negative to stable**. The decision was mainly due to the overall systematic recovery in the structure of financial results as well as the direction of the strategy implementation. The technical result has recovered slightly, while the bottom-line profitability indicators have also improved. This is mainly due to a y-o-y faster pace of decline in claims than premiums, especially in the Compulsory Motor Third Party Liability Insurance (CMTPL) insurance sector. Also, investment and financial income has also been positive. On the other hand, the company weathered well the effects of the pandemic maintaining a fairly adequate combined loss ratio under the circumstances and we anticipate GWPs to grow towards year-end 2021. We saw a hike in geographic diversification, expected to increase even further in 2021, as the insurer plans to expand in Latvia, which reduces systemic risk for the company. The overall macro profile remains solid, and the company's activities fall in line with its designed strategy and business plan.

The **macro profile** of the company is still positive and stable as the insurer operates in countries with an adequate level of our weighted average Insurance Sector Risk (ISR) score, which translates into low systematic risk exposure for the company. The countries where Balcia operates remained the same in 2020, but **geographic diversification** improved slightly as GWPs are more evenly distributed among the top-3 countries, Poland, Lithuania and France. The regional share of the insurance portfolio as of 2020 measured by the amount of GWPs was as follows: Poland (46,1%), Lithuania (28,5%), France (18,1%), Germany (4,5%), Italy (2,2%), Latvia (0,6%) and Spain (0,04%). The Polish and Lithuanian insurance markets had penetration and density figures of 2,7% and USD 418 and 2% and USD 380, respectively reflecting a stage of development on these markets. The same can be said of Latvia, which posted figure of 2,8% for penetration and USD 490 for density. On the other hand, Germany, France and Italy, are considered to have very mature insurance sectors, as well as a stable economy and a solid financial system, strong regulatory frameworks and robust institutions; while Latvia is still a developing market, which presents interesting opportunities for Balcia.

The insurer's **risk management** practices remain adequate covering the specific needs of the company. There is a number of financial risk management procedures in place with clear quantitative tests such as sensitivity analyses and defined coverage ratios. The company, however, has opportunities to improve claims development risk, as well as underwriting risks in the CMTPL segment, as we have observed an increase in the combined ratio, and it has been consistently above 100%.

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The **customer base** of Balcia stayed very stable in 2020. The top-10 clients of the company accounted for 21,8% of the total client base in terms of GWPs as of the end of 2020. Moreover, the share of each client in the top-10 was also very similar to 2019, as only two new clients entered this group. Moreover, the length of partnership with each of these entities is at least four years, which reduces the risk of the seeking services of a direct competitor. All of these customers belong to the CMTPL segment. Even though this segment carries lower concentration risk as one single contract has many underlying potential insured events, the margin for this type of product is lower as competition is intense. All of the top-10 clients are from Lithuania.

The **reinsurance policy** of Balcia has remained unchanged. The quality of reinsurers remains favorable as 82% of the reinsurance partners have credit ratings higher than 'A-' in international scale, while a share of 18% is rated 'BBB'. In addition, the concentration of transferred GWPs subsided as the reinsurer with the highest share of total outbound transferred premiums by the end of 2020 was Swiss RE Europe S.A. with a share of 25%. Moreover, all of the highest risk exposures are reinsured. The largest paid claim (net of reinsurance) for the past five years remains at around 13% of equity altogether, which corresponds to the settlement of two guarantees in Spain. Moreover, there was no reinsurance involved in these two claims. However, the 10 highest risks currently incurred by the company are partially reinsured.

The level of **accounts payable** increased in 2020 up to 13% of total assets in 2020; however, this was mostly related to the amount of EUR 19 m due to shareholders for interim dividends, most of which will be used as additional capital for the company in 2021. In fact, the amount due to insurance creditors remained quite stable, while that owed to reinsurers creditors declined substantially as a result of a reduction in business with a reinsurer of truck portfolio in Lithuania. On the other hand, **accounts receivable** to total assets remained fairly stable at 9,3%, the main decline was from receivables from reinsurance activities. Both these figures continue to reflect relatively low indebtedness and reduced credit risk

The company's **solvency capital** requirement ratio increased further in 2020 and stood at 149%, while the minimum capital requirement ratio posted a figure of 309%. The improvement was mainly due to a decline in insurance assets due to the pandemic, while the company's capital has remained quite stable. The healthiness of the solvency margins gives the opportunity for the company to expand more aggressively when the European economy starts the recovery path. The company's Solvency and Financial Condition report 2020 continues to reflect that the capital coverage will be sufficient in the mid-term perspective.

The **investment portfolio** changed slightly but remained with adequate liquidity and favorable quality. As of the end of 2020, the company divested from its investments in real estate and subsidiaries, while the share of investments in sovereign obligations increased. On the other hand, we saw an increase in funds allocated to short- and long-term banks deposits, issuance of loans, as well as bonds from corporations. In terms of liquidity, we calculate that about 90% of the total investment portfolio was considered as highly liquid. However, the share of investment grade investments decreased from 92% in 2019, down to 88% in 2020 as a result the increase of funds allocation in loan issuance. Same as in 2019, the largest investment remains in Polish sovereign debt with a concentration of 36% of the overall portfolio (rated 'A-' by Fitch, 'A-' by S&P and 'A2' by Moody's). In addition, the return on investment of the company, increased substantially in 2020 up to 16,3% mainly propelled by the finalization of the sale of the remaining 10% stake in BTA Baltic Insurance Company. The investment approach from the company is conservative as shown by 88% of investments in instruments rated above 'BBB'.

The overall **financial result** of the company improved in 2020, both the operating result and the bottom line saw improvements. The technical result turned positive in 2020 and stood at EUR 86 k as a consequence of a decline in incurred claims by 30% y-o-y, while net earned premiums

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decreased at a slower pace, by shrinking by 22%. The decline was mainly characterized by a combination of the negative effect from the pandemic and, at the same time, the restructuring of the insurance portfolio of the company in 2020. This included divesting from the property insurance sector in France and other changes in Germany and Poland mainly revolving around the restructuring of the customer segmentation and underwriting risks. As a result, CMTPL premiums decreased by 26%, CASCO premiums declined by 16% and property insurance premiums sank by 70% y-o-y in 2020. In regard to claims, as mentioned previously, we also saw an overall decline in all segments, while the only increase in net paid claims was observed in the CASCO sector as these hiked by 7% y-o-y.

As a result of the improved structure of the **technical result**, we observed a combined loss ratio of 99,9% in 2020, according to our internal calculation. This was a combination of a net loss ratio of 66,3% and an expense ratio of 33,6%. These figures reflect that the underwriting strategy has improved, while cost management has remained stable. In regard to each insurance segment, the CMTPL went from 106,4% up to 108,9%, while the CASCO segment saw a decline from 77% to 67% in 2020. The net loss ratio for CMTPL insurance was 70,7% and the expense ratio stood at 38,1%, while the same indicators for CASCO declined down to 67% and 22% respectively. We anticipate the technical result indicators to improve going forward as the company has revamped the strategy towards more profitable business lines and a complete administration of the insurance life cycle in Poland.

The bottom-line profitability of the insurer continued to pick up in 2020 due to several reasons. Firstly, the technical result, as mentioned previously, was positive, while the investment result reflected strong interest income and, mainly, a substantial gain from the sale of the 10% stake in BTA Baltic Insurance Company. This divestment created an income of EUR 19,3 m. As a result, ROA posted a figure of 10,3% while ROE stood at 46,1%.

The company's **insurance portfolio** has remained quite stable. As expected from our previous review and the insurer's strategy, the property insurance segment share dropped down to 3,7% of the overall portfolio in 2020. As of the same date, the CMTPL insurance segment stood at 77,7% and CASCO at 13,4%, being the motor insurance segments the dominant types of insurance for Balcia. In terms of regions, the portfolio rebalanced slightly but remained very similar to 2019.

The **strategy** of Balcia, in our view, has been evolving favorably. The goals set out in 2019 in terms of the direction of the products and customer segmentation were partially fulfilled in 2020 and we expect the company to continue to on this trend going forward. In 2020, the company implemented online self-service solutions and products that do not include long term commitments in Lithuania. This provides more flexibility for the insured and, at the same time, improves the attractiveness of the offering. Moreover, the company also adopted a new online identity, which will help to make their offering more attractive to the general population. In Poland, despite the decline in GWPs, the company revamped the operation strategy by starting to be involved in the full product lifecycle. Moreover, Balcia also overhauled the underwriting risk structure and will aim to become more expense-efficient, which, in our view will help to increase the technical result in the country. As expected in our previous revision, Balcia continues to pull away from the unprofitable property insurance segment in France. Instead, the company is refocusing its efforts in the fleet segment of motor insurance. Going forward, we anticipate the company to continue to build on the abovementioned blocks in each of the countries where it operates. In general, the insurer will continue to divest from unprofitable product segments and regions, increase the level of digitalization and flexible product offering, as well as on building on strong relationships with new partners. Moreover, we also expect Balcia to increase its insurance portfolio in Latvia. The successful implementation of the strategy continues to depend on a favorable risk assessment in order to price products successfully and avoid large claims, as well

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as a favorable claim handling process. In addition, we view as a positive step the IT development in the company as, in the current situation, it is increasingly important to have a solid IT infrastructure in order to handle operations, as well as to develop channels to attract clients and process customers' requests. One great example of this is the revamp of the Lithuanian website and online product offering.

Balcia's **dependency on intermediaries**, such as local partners and brokers, remains high as 88% of premiums are generated through these channels. However, this strategy has aided to optimize the insurer's operations. Moreover, the company has long standing relationships in the country where it operates. Nevertheless, Balcia's client acquisition costs to GWPs ratio declined further in 2020 down to 17,6%, while underwriting expenses to earned premiums stood stable at 36% as of the same date reflecting a still effective use of distribution channels.

Liquidity metrics recovered in 2020 mainly as a result of an increase in the cash balance due the income generated from the sale of BTA Baltic Insurance Company. As of the end of 2020, the ratio of liquid assets to total liabilities stood at 85,7% and the ratio of cash to net reserves at 43,7%. Moreover, the net reserves remained well covered by liquid assets by 1,27x.

The company's **market position** remained practically unchanged and is still moderately weak but with a solid stance in its niche markets. The insurer continues to have presence in seven different European markets; four of them being in the top-5 of total GWPs in Europe. The share distribution of GWPs changed in 2020 as the focus on Lithuania increased. As of the end of the year, Poland remained the main market for the company, followed by Lithuania and France, while Germany, Italy, Latvia and Spain followed with marginal shares. In terms of non-life insurance sector share of GWPs as of 2020, in Poland, Balcia accounted for around 0,31% of the market share, while in Lithuania it had a share of 2,7%. In both countries, Balcia mainly specializes in CMTPL where it has a share of around 1% in Poland and about 7% in Lithuania, reflecting a strong market consolidation in the Baltic country. Due to the pandemic, we saw an overall decline in premiums in most markets. In Poland, the level of non-life insurance GWPs declined by 5,1% in 2020 y-o-y, while in Lithuania the fall was of 1,7% y-o-y as of the same period. As the world economy recovers from the pandemic, we anticipate GWPs to increase towards the end of the year. Moreover, the price pressure in the CMTPL insurance in Poland remains in place and we still consider that it will remain a challenge to produce some positive yield. Balcia's market position in the rest of the countries is negligible.

The stable outlook is supported by our view that the main rating drivers will remain unchanged in the mid-term perspective.

Internal stress factors:

- Not identified

Internal support factors:

- Not identified

ESG Disclosure

Inherent factors:

- Compliance with regulation, Owners' reputation, Shareholding structure, Changes in the shareholding structure for the year, Strategy of the company, Level of transparency, The auditor for IFRS reports, Human resources and management, Quality of reporting, Risk management structure, Insurance risk management, Credit risk management, Market risk

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management, Liquidity risk management, Operational risk management, Geographical diversification of the insurance portfolio.

Drivers of change factors:

- None.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Consistently positive technical and investment profitability metrics;
- Improvement in underwriting risk management;
- Continued increase in geographic and product diversification alongside a stable consolidation of the market position in one or several of the markets where the company operates.;

The following developments could lead to a downgrade:

- Consistently high incurred claims and operating expenses which would maintain a negative technical result;
- Continued deterioration of the main liquidity and solvency metrics.

COMPANY PROFILE:

Balcia Insurance SE is an insurance company based in Latvia which is currently focused on non-life insurance products, mainly CMTPL, CASCO and Property Insurance. The main operations, measured by GWP, are in Poland, Lithuania and France with a smaller scale of operations in Italy, Germany and Latvia. The GWP of the company as of end-2020 amounted to EUR 61,7 m, its assets were equal to EUR 218 m and equity was EUR 50 m.

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RATING HISTORY:

Date	Review reason	Rating Score	Outlook
15.05.2020	Scheduled review	BB+	Negative
15.05.2019	Scheduled review	BB+	Stable
15.05.2018	Scheduled review	BB+	Stable
15.05.2017	Initial assignment	BB	Stable

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Minute's summary:

The rating committee for Balcia Insurance SE was held on 12 May 2020. The quorum for the rating committee was present. After the responsible expert presented the factors which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Insurance methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the rating class voting.

The rating was disclosed to the rated entity prior to the publication and was not changed during the process of coordination.

The following methodologies were used for the rating assessment:

- [Methodology for Assigning Reliability Ratings to Insurance Companies – Full Version \(as of August 2020\)](#)
- [Methodology for Assigning Insurance Sector Risk Score – Full Version \(as of February 2018\)](#)

Descriptions and definitions of all rating categories can be found under the [Rating scale](#) section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

The definition of default can be found on the Agency's website in the section for [Internal policies](#).

This rating is solicited. The rated entity participated in the rating assignment process.

No other third party participated in the preparation of the rating.

Main sources of information:

- Questionnaire from Balcia Insurance SE based on the form provided by the Agency
- IFRS Quarterly reports for 2016, 2017, 2018, 2019 and 2020
- Audited IFRS Annual reports for 2014, 2015, 2016, 2017, 2018, 2019 and 2020
- Balcia Insurance SE Own Risk and Solvency Assessment Report (Year 2019)
- Solvency and Financial Condition report 2020
- Answer for additional request based on the form provided by the Agency
- Information from media and other public sources.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Insurance entities. The disclosure document can be found on the Agency's website in the section: [ESG factors in RAEX-Europe's Credit Ratings](#)

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information as well as non-public information (obtained from the rated entity and/or other third parties) which was considered to be reliable, complete and non-biased. The responsible expert performed rating assessment of the insurance company with information considered as the most reliable and up to date in accordance to the overall position of the insurance company and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. The experts involved in the rating assessment and revision of the rated entity showed no conflict of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies from RAEX group.

Risk warning

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Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.

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