Rating-Agentur Expert RA confirmed the reliability rating of Balcia Insurance SE at ‘BB+’ according to the international scale. The rating outlook changed from stable to negative.

Rating-Agentur Expert RA 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 stable to negative which means that in the mid-term perspective there is a high probability of downgrading the rating score.

INSURANCE SECTOR RISK ASSESSMENT:

The insurer’s operations are concentrated as follows: 53,9% in Poland, 23,9% in Lithuania, 14,9% in France, 5,2% in Germany, 1,5% in Italy and 0,6% in Latvia. The Insurance Sector Risk (ISR) of Poland is adequate, of France is low, of Lithuania is moderate, of Germany is very low, of Italy is low and of Latvia is adequate. Therefore the overall risk exposure to the insurance sector of Balcia Insurance SE is adequate.

MAJOR FACTORS THAT INFLUENCED THE RATING:

Positive factors:

- The macro profile of the company has remained favorable and stable as the insurer operates in countries with an adequate level of our weighted average Insurance Sector Risk (ISR) score. This shows manageable systemic risks as the economies of the main countries of operations have shown positive and solid figures. However, the non-life insurance market penetration and density indicators are considered acceptable;
- We continue to assess the overall risk management system as adequate to the needs of the insurer. There is a number of financial risk management procedures in place with clear quantitative tests such as sensitivity analyses and defined coverage ratios. However, we observe opportunity for improvement in managing underwriting risks as we have seen increases in loss ratios, as well as hikes in one-off insured events;
- The customer base remained practically unchanged in terms of concentration as the top-10 clients of Balcia accounted for around 22% of the total GWPs in 2019. All of these clients belong to the Compulsory Motor Third Party Liability Insurance (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 quality of reinsurers is still positive as 97% of the reinsurance partners have credit ratings higher than ‘A-’ in international scale, while a share of 1,9% is rated ‘BBB’. Moreover, the concentration of transferred GWPs remains high as Vienna Insurance Group AG Wiener Versicherung Gruppe (rated ‘A+’ by S&P) accounted for 75% of total transferred premiums by the end of 2019;
- The level of accounts payable and receivable to total assets continued to be quite stable over the year and remains moderate at 10,6% and 9,3% respectively in 2019 indicating relatively low indebtedness and reduced credit risk;
- The company's solvency capital requirement ratio increased in 2019 up to 124% as we observed a decrease in the calculated solvency capital requirement, which reflects lower overall risk incurred by the insurer. This development provides the company with additional room to take additional, but measured risks in its portfolio;

- The investment portfolio has remained practically unchanged in term of quality and liquidity. As of end-2019, about 89% of the portfolio was liquid while around 90% of the assets were rated at investment grade. Furthermore, the largest investment remains in Polish sovereign debt with a concentration of 47% of the overall portfolio (rated 'A-' by Fitch, 'A-' by S&P and 'A2' by Moody's).

Restricting factors:

- The largest paid claims (net of reinsurance) increased up to 14% of equity altogether (two guarantees in Spain) as a result of the claims doubling down during 2019, despite the claim being initiated in 2014. Moreover, there was no reinsurance involved in these two claims. However, the 10 highest risks currently incurred by the company are partially reinsured;
- The combined loss ratios for the two main types of insurance segments increased over the past year. On the one hand, the CMTPL went from 99,4% in 2018 up to 106,4% in 2019; while for the CASCO insurance segment the ratio hiked from 73% up to 77% in the same period. The combined loss ratio of CMTPL was made up of a loss ratio of 68,4% and an expense ratio of 38%, while the combined ratio in the CASCO was equal to a loss ratio of 52,9% and an expense ratio of 24%. The third largest segment, property insurance, saw a decline in the combined loss ratio from 139,6% in 2018 down to 136,4% in 2019 with a loss ratio of 98,2% and an expense ratio of 38,2%. Thus, the adverse technical result for property insurance and CMTPL is the high level of underwriting losses;
- In 2019, GWPs saw a decline of 17% as compared to a year before mainly reflecting the steep reduction in the CMTPL in Poland; however, premiums in Germany and France also observed a fall;
- Balcia's strategic approach is considered to remain acceptable. The strategy set out in 2018 was mostly fulfilled in 2019. In Poland, the company increased diversification by introducing new products other than CMTPL, in France the property insurance portfolio was shrunk, while other segments increased and, in Lithuania, the company continued to pursue penetration in the motor insurance market, which it successfully achieved. At the same time, the company expanded its portfolio. Nonetheless, the insurer continues to settle payments derived from increased claims in the property sector in France and has not been able to divest from this completely. Moreover, the reduction of GWPs in Poland as a result of the contraction in prices prevented the company from increasing their market share. Going forward, the company's strategy remains consistent with previous goals, namely, reducing unprofitable segments and expanding motor insurance products in France, increasing product diversification and CMTPL sales in Poland and continuing to grow its market share in Lithuania. In our view, the success of this strategy will largely depend on an adequate pricing model, successful risk assessment in order to reduce large claims, as well 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, 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;
- The geographical diversification of the insurance portfolio continued to improve in 2019 as the share in the top-3 countries became more evenly distributed. As of the end of last year, the distribution of GWPs was as follows: Poland (53,9%), Lithuania (23,9%), France (14,9%), Germany (5,2%), Italy (1,5%) and Latvia (0,6%);
- The company remains highly dependent on partners and brokers in order to sell its products as 96% of GWPs are generated through this channel. Balcia's main partner is RESO Europa Service in Poland with whom a long-standing relationship exists and the insurer has also developed sales partnerships in Germany and France. Moreover, the client acquisition costs to GWPs ratio declined in 2019 to stand at 20%. Also, Balcia's underwriting expenses to earned premiums decreased by 2p.p. down to 36% as of end-2019. These figures show efficiency in channels used to increase the customer base;

- Liquidity metrics continued in a downward trend in 2019 reflecting a reduction in the cash balance while liabilities continued to increase, especially the overall claims reserves. As of the end of 2019, the ratio of liquid assets to total liabilities stood at 74,6% and the ratio of cash to net reserves at 29%. However, the net reserves remained well covered by liquid assets by 1,15x;
- The return on investment increased slightly in 2019 up to 2,3% resulting from an increase in interest income. The investment approach from the company is conservative as shown by almost 90% of investments in instruments rated above 'BBB'.

Negative factors:

- Profitability was once again negative in 2019; however it improved as compared to a year before. This was mainly a result of the substantial increase in claims and decrease in premiums for the Polish segment, but it was cushioned by a higher share of reinsurance participation and a lower build-up of claim reserves. In 2019, ROA posted a figure of -3,6% while ROE stood at -0,8%;
- The company's market position regressed in 2019 and continues to be assessed as moderately weak. The operations of the company in terms of regions have remained mostly unchanged. Balcia continues to have presence in seven different European markets; four of them being in the top-5 of total GWPs in Europe. In terms of share of GWPs, Poland remains the main market followed by Lithuania and France. In Poland, Balcia accounted for around 0,48% of the market share, while in Lithuania it accounts for about 3,1%. In both countries, Balcia mainly specializes in CMTPL where it has a share of 1,1% in Poland and 6,4% in Lithuania, reflecting a strong market penetration in the Baltic country. The overall non-life insurance market in Poland continued to perform adequately as GWPs rose by 5,2% in 2019; however, the CMTPL segment saw a decline of 1,7%, which impacted the overall business performance of Balcia in that market. Moreover, the competition in the Polish motor insurance market remains strong and the market is still highly concentrated in the top insurers. In Lithuania, the overall non-life insurance sector hiked by 7,2%, while the CMTPL segment climbed by 3,8%. The share of premiums in France declined slightly and Balcia's market position in the French market remains negligible;
- Balcia's overall insurance portfolio distribution remain practically unchanged from a year ago and stays concentrated on the CMTPL segment as its share on total GWPs stood at 74,3%, which is very similar to the reading of 2018. In addition, the CASCO segment had a share of 11,2%, followed by property insurance which accounted for 8,6%;
- The technical result remained negative in 2019 as net paid claims increased by 22% led by a hike in the guarantees segment related to one insured event in Spain, followed by claims in the property insurance of the lingering risky portfolio in France. On the contrary, net earned premiums declined by 15,4% in the same period as a substantial decrease in CMTPL of 19% was observed mainly as a result of lower written contracts in Poland, while property insurance net earned premiums also fell by 33% reflecting the reduction of business in France. We anticipate these metrics to start performing better as the insurer continues to divest non-profitable segments and lingering claims from property insurance are phased out;
- Given the aforementioned facts, the combined loss ratio was quite high at 106,4% in 2019, with a net loss ratio of 73,6% (3,3p.p. higher than 2018), while the expense ratio was 32,8% (2,8p.p. lower than 2018). This clearly shows that expense management has been successful and, at the same time, technical losses have been mostly driven by rising incurred claims.

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 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
- Inability to phase-out of loss-generating insurance segments successfully;
- Continued deterioration of the main liquidity and solvency metrics.

JUSTIFICATION OF THE RATING:

The Agency confirmed the reliability rating of Balcia Insurance SE at 'BB+' and changed the outlook from stable to negative. The change in the outlook mainly reflects the consistent negative technical result as well as overall profitability which was not able to pick up as we anticipated in 2019. The underlying causes of the negative readings remained underwhelming throughout 2019, namely high incurred claims, elevated claim amount of one-off insurance events, as well as lower overall performance in the ability to increase GWPs. Moreover, the current situation as a result of the coronavirus crisis already caused several motor insurers across Europe to provide certain refunds as a result of a combination of lower vehicle usage and reduction in claims. These measures could potentially create pressure in the overall segment for other companies to follow the same line. Also, due to the crisis, we expect less new premiums to be written.

Despite this, we consider that the insurer still has strong fundamentals to overcome the situation. The macro profile remains solid, the company's actions remain consistent with the business plan and, from a strategic perspective, the insurer's guidance remains favorable. As a result of the negative outlook, we will closely follow-up on the developments of the company looking a reduction on the unprofitable segments combined with an improved pricing strategy, which would turn the direction of operational and overall profitability metrics

Moreover, our evaluation still considers favorable reinsurance and risk management practices. Liquidity metrics, despite remaining acceptable, showed a slight deterioration in 2019, but solvency requirements increased. The rating remains constrained as the weak market position deteriorated in most markets with the exception of Lithuania, where market share in the CMTPL segment has consistently increased. Despite remaining subdued, investment results improved.

The countries where Balcia mainly operates are considered to have low systematic risk according to our ISR score assessments. The insurance market in Poland is moderately well developed with an insurance penetration and density of USD 1,8 Non-life Premiums to GDP and USD 270 Non-life Premiums per capita respectively. Moreover, the country's economy is growing and developing faster than its peers. In the case of Lithuania, penetration and density posted similar, albeit slightly lower, figures than Poland standing at USD 1,3 Non-life Premiums to GDP and USD 246 Non-life Premiums per capita respectively; additionally, Lithuania has a solid economy but highly exposed to external factors. The remaining countries are considered to have a very favorable environment for insurances with strong financial systems and developed economies. In addition, we consider that all of the countries have above average institutional development as well as regulatory effectiveness. However, we do anticipate a deterioration in the overall economic conditions in all geographical regions as a result of the coronavirus pandemic.

The market position of Balcia remains weak and its market share has declined in most of the countries where it operates, except for Lithuania. In Lithuania the insurer accounts for about 6,4% of the CMPTL premiums, reflecting a rapid increase in penetration in this specific segment; the overall non-life market share in Lithuania was 2,2%. In Poland, the overall market share decreased to 0,5% in the non-life sector and to1% of the CMPTL segment. As pricing pressures in this insurance sector continued, the GWPs shrunk by 1,7% in Poland. On the other hand, in Lithuania, the same sector grew by 3,8%. However, in the rest of the five countries, the market share is negligible. Furthermore, as mentioned in our previous reviews, we still consider that it will remain a challenge to produce some positive yield in the CMTPL segment in Poland as we have already observed product pricing reductions in 2019 and competition and market concentration remains high.

The GWPs of the company decreased by 17% in 2019, while net incurred claims climbed by 11,4% mainly as a result of a substantial hike in claims from the property segment as well as the CMTPL segment in Poland and one-off guarantee insurance claims. This resulted in a combined ratio of 106,4% with a net loss ratio of 73,6% and the expense ratio standing at 32,8%. Even though the combined ratio remained very similar to that of 2018, the share of the loss ratio was higher meaning that the company incurred in higher underwriting losses. We anticipate an improvement in these metrics to be difficult, especially in Poland due to the high competition in the CMTPL segment combined with expected lower new premiums as a result of the coronavirus crisis. On the other hand, disposal of the property portfolio in France should reduce the number of claims going forward.

The reinsurance policy of the company remains positive. The insurer has exposure to 97% of reinsurers having financial strength rating from a recognized agency above the 'A-' level. Moreover, all of the highest risk exposures are reinsured.

The company's liquidity deteriorated slightly in 2019 but remains acceptable. In contrast, the solvency ratio hiked due to the reduced risk in the underlying portfolio of the company. Moreover, profitability figures remained at the negative territory as a result of higher incurred claims, as mentioned previously.

The business plan and strategy of the company remain congruent and consistent. Goals continue to be set out in clear, concise and realistic manners and developments in 2019, despite some drawbacks, have behaved according to plans stated beforehand. Despite this, we still consider a challenge to penetrate new markets in such competitive product segments combined with the expected negative effect from the coronavirus pandemic. Finally, the investment result continued to improve despite the conservative investment strategy. The combination of the low interest rate environment alongside the conservative investment approach by the insurer will continue to result in low investment returns. However, the quality and liquidity of the portfolio are outstanding.

The current risk management system of the company is considered as positive. The Agency acknowledges that the current stance of the risk management system is adequate to the size of the company and the needs of the markets and insurance segments as well as investment instruments used. The company's Own Risk and Solvency Assessment (ORSA) Report continues to reflect that the capital coverage will be sufficient in the mid-term perspective.

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, France and Lithuania with a smaller amount of operations in Italy, Germany and Latvia. The GWP of the company as of end-2019 amounted to EUR 87 m, its assets were equal to EUR 224 m and equity was EUR 48 m.

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RATING HISTORY:

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

Minute's summary:

The rating committee for Balcia Insurance SE was held on 13 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 (from February 2018)
- Methodology for Assigning Insurance Sector Risk Score – Full Version (from 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 and 2019
- Audited IFRS Annual reports for 2014, 2015, 2016, 2017, 2018 and 2019
- Balcia Insurance SE Own Risk And Solvency Assessment Report (Year 2019)
- 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 Sovereign 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.

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