BCRA
CREDIT RATING AGENCY

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CLAIMS PAYING ABILITY RATING*	Update	Update	Monitoring	Review	Update
Date of Rating Committee:	16.12.2016	24.01.2018	20.06.2018	18.12.2018	07.02.2019
Date of Publication:	19.12.2016	26.01.2018	21.06.2018	19.12.2018	08.02.2019
Long-term Rating:	BB+	BB+	BB+ (under review)	BB+	BB+
Outlook:	Stable	Stable	-	Stable	Stable
National-scale Long-term Rating:	A- (BG)	A- (BG)	A- (BG) (under review)**	A- (BG)	A- (BG)
Outlook:	Stable	Stable	-	Stable	Stable

***** *За да се запознаете с пълната рейтингова история, вижте таблицата в края на документа.*
***** *The rating is placed „under review" due to a procedure on changes in the BCRA's methodology for assigning a rating of the ability of insurance companies to pay claims (https://www.bcra-bg.com/files/cpaic_methodology_2018_bg.pdf), concerns all currently valid insurers' ratings and is not related to the activity of the rated entity.***

"BCRA – Credit Rating Agency" (BCRA) is the third qualified rating agency in the EU, registered under Regulation (EC) No. 1060/2009 of the European Parliament and of the Council. The credit ratings, assigned by BCRA, are recognized throughout the EU and are equal to the other ratings, recognized by European Securities and Markets Authority (ESMA), without any territorial or other limitations.

BCRA affirms the assigned ratings to the „IJC Armeec" AD:

- **Long-term claims paying ability rating: BB+;**
- **National-Scale Long-term Rating: A- (BG);**
- **Maintains the "stable" outlook**

The officially adopted methodology of BCRA for assigning a rating of the ability of insurance company to pay claims is used: https://www.bcra-bg.com/files/cpaic_methodology_2018_bg.pdf

The report has been prepared and the rating - assigned, based on information made available by the rated insurance company, the Financial Supervisory Committee, the National Statistical Institute, BCRA's database, consultants and other sources of public information.

The political situation in Bulgaria remains stable. The Government of the Republic of Bulgaria is committed to speeding up the process of joining the euro area by officially submitting a letter of intent. In August 2018, the Council of Ministers approved an Action Plan including measures for realizing Bulgaria's intentions to join the Exchange Rate Mechanism II and the Banking Union by July 2019. A number of legislative changes related to financial sector supervision, insolvency framework, anti-money laundering framework and modernisation of the management of state-owned enterprises are envisaged. The measures will be implemented by national and international institutions in coordination. Progress in all these areas, when achieved, should pave the way for the country to join both the ERM II and the Banking Union.

In the first half of 2018, the Bulgarian economy expanded by 3.4%[1] in real terms (3.6% in 2017). Domestic demand (consumption and investment) contributed positively to GDP dynamics. Household consumption increased by 7.9% on an annual basis, boosted by the favourable labour market developments and credit acceleration. Investments' trend is also in an upward direction. Gross fixed capital formation accelerated considerably,

[1] Unadjusted Data.

reaching an annual growth of 8.5% (compared to 3.3% in the same period of 2017. On the other hand, net exports had a negative contribution to the GDP growth in the first half of 2018.

At the end of August 2018, the country's **gross external debt** amounted to EUR 33 805 million (61.1% of projected GDP). In nominal terms, the debt increased by EUR 408 million compared to the end of 2017. The relative share of the public sector's external debt fell to 18.2%, while that of the private sector rose to 81.8% of the total external debt.

As of the end of August 2018, the **BNB's international reserves** amounted to EUR 23 960 million (43.3% of projected GDP) and provided 160.7% coverage of the monetary base, a solid buffer used by the central bank to ensure the stability of the currency board.

The inflow of **foreign direct investment** to the country is decreasing. According to preliminary data, foreign direct investments in Bulgaria for the first eight months of 2018, reported according to the principle of the initial direction of the investment, amounted to EUR 231 million or 0.4% of projected GDP, which represents a nominal decrease of 71.6% compared to the same period of the previous year.

The **labour market** marks a favourable development. In the first half of 2018, the growth of the economy continued to mobilize the labour supply as the number of unemployed decreased in all of the age groups[2]. As a result, the unemployment rate dropped to 5.6% on average for the first two quarters of the year (6.6% in the same period of 2017). Employment growth was also confirmed except for younger age groups (between 15 and 34), whose number is mainly decreasing as a result of other effects like the demographic crisis and the external migration of working-age population. Labour incomes in the economy retain their upward trend. In the first half of 2018, the **average gross wage** in Bulgaria reached BGN 1 101 per month (~EUR 563 per month), nominally increasing by 7.6% compared to the same period in 2017. Annual minimum wage hikes in the country continued to be a major factor for wage growth in some economic activities. Gross base remuneration was raised by 11% to BGN 510 per month from the beginning of 2018. From the beginning of 2019, the gross base remuneration is raised to BGN 560 per month, which also has an analogous impact on labour costs.

The price level in Bulgaria continues to raise. Over the first eight months of 2018, inflation followed an upward trend. In September 2018, the annual inflation rate (measured by the HICP) reached 3.6%, while the average rate for the last 12 months accelerated to 2.3%. The price level was impacted jointly by internal and external factors. The rise was mainly driven by services inflation accelerating in line with the strengthened domestic demand. Additional pro-inflationary pressure was generated by hikes in some of the administered goods and services' prices. The external factor of significant contribution was the increase of international prices of oil and other major commodities, exerting both direct effects, as well as indirect effects on other HICP components.

Public finance indicators are improving, backed by the robust economic activity in recent years. In the period January - August 2018, total budget revenues under the Consolidated Fiscal Programme (CFP) increased by 11.6% compared to the same period of the previous year, with the tax revenues being the main driver. Tax revenues (including social security contributions) grew by 10.0% on an annual basis summing up to 82.3% of total CFP revenues for the period. The budget balance as of August 2018 posted a surplus in the amount of BGN 2 388 million or 2.2% of projected GDP, compared to a surplus of BGN 2 151 million or 2.1% of GDP in the same period of 2017. The CFP for 2018 set a budget deficit target at 1.0% of GDP but based on the budget execution so far we expect 2018 to be the third consecutive year with a deficit projected by law but an actual budget surplus achieved.

The **budget framework for 2019** envisages a deficit under the CFP amounting to 0.5% of GDP, and the updated mid-term forecast reaffirms the balanced budget objectives in 2020 and 2021. The government plans 10% increase in the funds for wages and contributions in the budget sector as from 2019, while the wage hike in the education sector would be 20% in line with the existing government commitment. The minimum wage in the country is scheduled to reach BGN 560 per month. Pensions are set to increase by 5.7% from July 1, 2019, and their maximum amount would reach BGN 1 200. Other measures with an impact on the insurance policy include an increase in the maximum insurable income to BGN 3 000 and an increase of the minimum insurable income for the self-insured persons to BGN 560.

[2] *According to the Labour Force Survey for population aged 15 years and over.*

The **government debt** follows a positive downward trend both in nominal terms and as a share of GDP. At the end of August 2018, government debt amounted to BGN 22 320 million (20.6% of projected GDP). The debt decreased nominally by BGN 1 215 million compared to the end of 2017 due to regular repayments and absence of new obligations during the year. As a result, the relative share of domestic debt dropped to 25.3% while the share of external debt rose to 74.7% of total government debt. As of the end of Q2 2018, the consolidated debt of "General Government" sector amounted to BGN 24 815 million or 23.8% of GDP. The country has a significantly lower level of government debt than the Maastricht convergence criterion of 60% and is among the three EU countries with the lowest government debt level, being outpaced only by Estonia and Luxembourg.

Bulgarian government securities achieve relatively low **yield** for the region. The yield on the long-term benchmark issue (with a maturity of 10Y and 6M), based on actual concluded deals on the secondary market, fell beneath 1% for the first time in January 2018 and reached 0.81% in August, which is the lowest monthly value of the long-term interest rate for convergence assessment purposes reported so far..

The **banking system** remains stable characterized by a gradual increase in assets base, as well as raise in deposit base from savings from households and non-financial corporations and lending.

By the end of September 2018, gross credit portfolio of the banking system annually increased by 7.6% - a record high value for the past five years. The quality of bank portfolios continues to improve, which is evidenced by the decreasing ratio of the gross non-performing exposures to the gross value of loans, which, however, remains relatively high (8.5%). There have been some structural changes concerning ownership in some banks, a further outflow of the Greek capital and the ongoing consolidation in the system. The European Central Bank plans to execute asset quality review and stress tests of Bulgarian banks in 2019 in order to ensure a smooth transition to the Banking Union[3].

The non-life Insurance market in Bulgaria

The following features characterize the Bulgarian non-life insurance market:

- **Growth tendency** in income from written gross premium;
- **High growth potential** with relatively low levels of insurance density and insurance penetration;
- **High market concentration** – in 2017, the seventh biggest insurers registered a gross premium income of 71.9% share in the sector (72.3% as of the end of 2016 and 70.7% as of 2015);
- **A high share of car insurance** in the aggregated insurance portfolio – at about 70%, to a great extent supported by the compulsory character of the "Motor Third Party Liability" insurance.

In the period under review, a major influence in the **regulatory framework** continues to have the solvency requirements of insurers, reinsurers and groups of insurers and reinsurers as well as reporting requirements, valuation of assets and liabilities and the technical provisions according to the **Directive "Solvency II"** (Directive 2009/138 of the EP and the EU). An additional impact on the reports also has the implementation of **IFRS 9** "Financial Instruments" as from 01.01.2018.

The general major factors impeding the development of the non-life insurance companies are the slow growth of the Bulgarian economy and the relatively low economic activity and the uncertainty about future household incomes. The sector retains its high growth potential due to the relatively low levels of insurance density and market penetration.

The published results on February 3, 2019, from the Assets Review and Stress Tests of the insurance companies, testified that the insurance sector is stable, sustainable and well-functioning, whereas for the problem areas corrective actions are taken.

In the period of the update, there are no changes in the shareholders capital and its amount is BGN 33 019 thousand. With regard to the shareholder structure, we note the continuing downward trend in the share of the main shareholder, namely CCB GROUP EAD, which by the end of 2017 reached 80.99%, compared to 84.47% by the middle of 2017.

There have been no changes in the composition of the Management and the Supervisory Board. Corporate Governance in 2017 is aimed at meeting the regulatory requirements under the Solvency II Directive, adapting and developing all policies related to its implementation. The strategy for the

[3] In published by ECB press release, dated November 12, 2018, six banks will be subject to evaluation: UniCredit Bulbank AD; DSK Bank EAD; United Bulgarian Bank AD; First Investment Bank; Central Cooperative Bank AD and Investbank AD.

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next three-year period preserves and continues the main priorities introduced in 2017.

Since after 2016, the Gross Premium Income (GPI) of Armeec registered a decline of 12.2%, while the adjusted sector registered growth of 5.5%. At the end of 2017, growth is reported of 6.8%, although in absolute value its size is not reached to the one from the previous two years (2014 and 2015). The company retains third share in the sector, but it retreats back compared to 2014 and 2015 when ranked first according to this indicator.

The main insurance “Autocasco” reported growth of 1 % in the total GPI, following a decline of 3.0% a year earlier. Another insurance, namely “Motor Third Party Liability” after the robust decline of 28.1% a year earlier, reported growth of 13.6% and the market share registered increase of 0.5 p.p. to a share of 7.3% (68.% in 2016 and 10.0% in 2015).

In the first nine months of 2018, GPI of Armeec marks the growth of 9% on an annual basis, albeit lags behind the average of the adjusted sector (19.2%). As a result, again (like in 2017) there is a loss of market share that reached 10.15% (at 10.99% a year earlier). There was an increase (9.4%) of GPI of the main insurance "AutoCasco", but the market share of the insurance company declined, albeit slightly.

The Company is focusing on raising GPI (and its share) in property insurance at the expense of car insurance but so far, no significant changes in the structure of the portfolio are observed. This strategic goal is also accompanied by striving to improve the technical result in business lines. Compared to the average levels for direct competitors, 2017 year, continues to be characterized by a significantly higher share of the AutoCasco insurance, but the gap is declining over the period considered.

The claims ratio analysis according to business lines indicates for a significant shrinkage of net claims for the leading insurance “AutoCasco”, thus demonstrating the successful efforts and the measures taken for improving the process of claims management, started in 2016. The net claims ratio of the other key insurance, namely “Motor Third Party Liability” declines as well, although considered as high. Compared to the average of direct competitors, the company is favourably positioned in terms of the indicator.

In 2017, the favourable downward trend of the net acquisition ratio discontinued over the last five years. However, "Armeec ZAD" continues to hold a better position compared to the other leading insurers. In the first nine months of the year, however, the indicator rises on an annual basis and its level is higher than the average for the reference group.

In a comparative aspect, the company is characterised by higher levels of cost ratio. In terms of dynamics, in 2017, the ratio significantly grows on an annual basis. In the first nine months of 2018, some improvement is noted on a yearly basis, but the value achieved is still well above the average compared to direct competitors.

As for the combined cost factor, in 2017, it is below 100 % (97.2 %), which is an indicator for insurance profit, with an average rate of 92.5% for the sector. However, in the first nine months of the year, the value of the indicator is 102.9%, which, besides indicating for an insurance loss, places the company in an unfavourable position in a comparative aspect.

The reinsurance policy of IC Armeec AD for 2019-2020 is planned to develop large-scale protection of the insurance portfolio, written by the company in accordance with the Solvency II Directive.

The Company is characterized by a permanently decreasing level of self-retention, from 91.54% in 2014 to 62.32% in 2017. During the first nine months of 2018, the trend is retained, and the decline over the same period in 2017 amounted to 2.36 p.p., reaching a level of 60.40%.

In 2017, the size of the investment portfolio of "ZAD Armeec" declined by 27.4% on an annual basis after a registered growth of 23.3% in the previous year. These dynamics are mainly due to two factors: on the one hand, the decrease in the shares and shares in investment funds (decline of 35.7%), on the other hand, the decrease in deposits with banks (72.3%). Despite the decrease in the shares and shares in IF, they dominate in the structure of the investment portfolio by 46.4%. Next, with a share of 28.8% are investments in government securities. Deposits in banks form only 4.7%, which is 7.6 p.p. less than the previous year.

During the first nine months of 2018, the size of the investment portfolio of "ZAD Armeec" increased by 8.8% compared to the corresponding period of the previous year, followed by a decrease of 17.0% as of the end of September 2017. Over the period the said increase is due to the growth of government securities (12.8%), forming 23.7% of the investment portfolio. The bank deposits as of the end of September 2018 are of a small volume and are located in the related Central Cooperative Bank AD.

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Unlike the previous two years (2015 and 2016) in 2017, the return on the investment portfolio of the company increased significantly on an annual basis (from 2.52% to 4.32%). As a structure, investment income is dominated by the net result of the revaluation of investment assets.

In 2017, "Armeec" AD generated a net profit of BGN 7,440 thousand, which represents a decrease of 12.1% on an annual basis. For the first nine months of 2018, the decline is even more obvious with the reported net profit of BGN 130 thousand compared to BGN 3 653 thousand as of the end of September 2017. Negative dynamics is observed in the result of insurance activity – a decline of 26.2% down to BGN 3 142 thousand. As for the first nine months of 2018, the analysis indicates that for both the mentioned period and the corresponding period of the previous year, the indicator has negative values (a loss). Moreover, in the first nine months of 2018, the loss was much higher than in the same period of 2017 in absolute value. In 2018, the company did not distribute dividends and the total realized profit was allocated to increase the reserves.

The ratio net earned income to equity (operating leverage) retains its downward trend as from 2015, reaching 146% in 2017 (351% in 2014). Similar is the dynamics of the insurance leverage (the ratio technical provisions to equity), whereas it declines as from 2015 (438% in 2014 to 232% in 2017).

The return on equity follows a downward trend in last two years, reaching 10.3% in 2017 (13.1% a year earlier) and 5.1% in the first nine months of 2018 (8.8% for the corresponding period of 2017).

As of September 2018, "Armeec" registered a decrease of both the excess of assets over liabilities and of the total eligible funds for the execution of the SCR[4] and the total eligible funds for the implementation of the MCR[5].

The company is characterised by remarkably lower liquidity both compared to the rest of leading insurers and the adjusted sector.

[4] Solvency Capital Requirement
[5] Minimum Capital Requirement

Main Financial Indicators:

Indicator / Year:	*09.2018*	*09.2017*	*2017*	*2016*	*2015*
Gross Premium Income (хил.лв.):	**156 225**	**143 334**	**194 797**	**182 366**	**207 717**
Change on a yearly basis (%)	*9.0%*	*-26.4%*	*6.8%*	*-12.2%*	*5.5%*
Net Earned Income (хил.лв.):	**91 677**	**87 762**	**112 932**	**147 456**	**172 614**
Change on a yearly basis (%)	*4.5%*	*-22.3%*	*-23.4%*	*-14.6%*	*-1.8%*
Self-Retention Level	**60.4%**	**62.8%**	**62.3%**	**67.5%**	**78.3%**
Net Financial Result (хил.лв.)	**130**	**3 653**	**7 440**	**8 464**	**9 569**
Result from Insurance Activity	**-2 623**	**-134**	**3 142**	**4 257**	**10 689**
Gross Claims Ratio	58.7%	63.4%	51.8%	63.6%	62.9%
Net Claims Ratio	48.2%	48.3%	43.2%	55.9%	45.2%
Cost Ratio	31.1%	35.5%	36.9%	25.8%	26.9%
Acquisition Ratio	23.5%	16.4%	17.2%	15.3%	21.8%
Combined Ratio	102.9%	100.2%	97.2%	97.1%	93.8%
Net Earned Income / Equity (Operating Leverage)	118%	119%	146%	212%	291%
Technical reserves / Equity (Insurance Leverage)	241%	242%	232%	263%	312%
Debt excluding Insurance reserves / Equity (Financial Leverage)	25.8%	27.1%	25.9%	28.8%	0.0%
Total Equity	**77 583**	**73 858**	**77 241**	**69 517**	**59 321**
Return on Equity	5.1%	8.8%	10.3%	13.1%	17.9%
Investment Portfolio Total Value	**183 737**	**168 855**	**153 262**	**211 196**	**171 238**
Change on a yearly basis (%)	*8.8%*	*10.2%*	*-27.4%*	*23.3%*	*-0.7%*
Share of High Liquidity Assets in Investment Portfolio	24.3%	26.2%	33.5%	32.4%	33.4%
Investment Portfolio Income on TTM	4.1%	2.6%	4.3%	2.5%	-1.1%
SCR Coverage	119%	0%	145%	0%	0%
MCR Coverage	384%	0%	450%	0%	0%
Liquidity ratio of technical reserves	26.0%	27.0%	30.8%	39.7%	33.6%
Liquidity ratio of the reserve for upcoming payments	44.8%	44.2%	53.4%	63.0%	66.2%

***Rating History:**

The ratings displayed in the chart are assigned under the previous Methodology for a rating of the ability of insurance companies to pay claims, respectively with the applied rating scale and are not directly comparable with the ratings assigned after the entry into force of the current methodology on 04.07.2016.

CLAIMS PAYING ABILITY RATING	**Initial Rating 6.2006**	**Update 11.2007**	**Update 12.2008**	**Update 10.2009**	**Update 30.08.2010**	**Update 10.08.2011**
Long-term Rating:	BB+	iBBB-	iBBB-	iBBB	iBBB	iBBB
Outlook:	*Stable*	*Stable*	*Stable*	*Stable*	*Stable*	*Stable*
	Update 10.08.2012	**Update 14.10.2013**	**Update 07.11.2014**	**Update 06.11.2015**	**Update 05.07.2016**	
Long-term Rating:	iBBB	iBBB	iBBB	iBBB-	iBBB- (under review)	
Outlook:	*Stable*	*Stable*	*Stable*	*Stable*		