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„DZI – General Insurance" EAD

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Claims paying ability rating *	**Monitoring**	**Update**
Date of Rating Committee:	**18.12.2018**	**08.03.2019**
Date of Publication:	**19.12.2018**	**12.03.2019**
Long-term Rating:	BBB	BBB+
Outlook:	Positive**	Stable
Long-term National-scale Rating:	AA+ (BG)	AA+ (BG)
Outlook:	Positive**	Stable

*** *To become familiar with the full rating history, please, see the chart at the bottom of the document*

**** *The outlook is changed due to a review of the rating placed "under review", given the changes entered into force on June 21, 2018 in the used by BCRA "Methodology for ability of the insurance company to pay claims".*

BCRA – CREDIT RATING AGENCY (BCRA) *is the third qualified rating agency in the EU, registered under Regulation (EC) 1060/2009 of the European Parliament and of the Council. The credit ratings, assigned by BCRA, are recognized throughout the EU and are entirely equal with other ratings, recognized by the European Securities and Markets Authority (ESMA), without any territorial or other restrictions.*

BCRA upgrades the long-term claims paying ability rating of "DZI – General Insurance" EAD from BBB to BBB+, affirms the long-term national-scale rating AA+ (BG) and changes the outlook from „positive" to „stable".

In assigning the final rating of DZI - General Insurance EAD, the positive impact of the belonging to one of the of the biggest financial groups – KBC Group – has been considered, which is why the final rating exceeds the ceiling of the sovereign rating of the Republic Bulgaria (nBBB, Outlook "Stable").

The officially adopted methodology of BCRA for assignment of the ability of insurance companies to pay claims is used.[1]

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

[1] https://www.bcra-bg.com/files/cpaic_methodology_2018_en.pdf

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.

In the first half of 2018, the **Bulgarian economy** expanded by 3.4% in real terms (3.6% in 2017). Domestic demand (consumption and investment) contributed positively to GDP dynamics. 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. Reserve adequacy indicators retain their high levels.

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** data continue to show favourable development, reports record-breaking high indicators for economic activity and employment of the 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.

The price level in Bulgaria continues to rise. 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%.

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. 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.

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. 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[2] in 2019 in order to ensure a smooth transition to the Banking Union.

Non-Life Insurance Market in Bulgaria

Characteristics of the Bulgarian Non-life insurance market in the updating period:

- Retaining the growth trend in **written premium income**;
- **High-growth potential** taking into account the relatively low levels of insurance density and penetration;
- **High level of market concentration** – in 2017 the seven biggest companies reported a share of 71.9% of gross premium income in the sector (72.3% at the end of 2016, 70.7% за 2015 г.);
- **The high share of the vehicle insurance** in the aggregated portfolio structure - about 70%, backed up by the compulsory character of the insurance “Motor Third Party Liability”.

During the review period, the **regulatory framework** continues being influenced by the

[2] 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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solvency requirements of insurers, reinsurers and groups of insurers and reinsurers as well as reporting requirements, valuation of assets and liabilities and the creation of technical provisions in line with the **"Solvency II"** (Directive 2009/138 of the EP and the EC). An additional impact on the accounts also arises from the application of **IFRS 9** "Financial Instruments", applied as of 01.01.2018.

Major general factors hampering the development of general non-life insurance companies continue to be the slow growth of the Bulgarian economy and relatively low economic activity, as well as the uncertainty about future household incomes. The sector retains high growth potential, given the relatively low levels of insurance density and penetration.

The results of the conducted review of the assets and stress tests of the insurance companies in the country, published on 03.02.2017, give grounds for the regulator's conclusion that the insurance sector in the country is stable, sustainable and well-functioning, and on the identified problem areas corrective actions are taken.

In the period of update the **share capital** of DZI – General Insurance is not changed and amounts at BGN 66 586 779, divided into 9 512 397 shares with a nominal value of BGN 7. **The sole shareholder** of the capital is "DZI - Life Insurance", and the sole ultimate owner is KBC Group NV.

The Supervisory Board is unchanged, while in 2018, there are changes in the Management Board (MB) and at the present moment, the members are:

- Mr Kosta Cholakov – Chairman and Chief Executive Director;
- Mrs Bistra Vassileva – member and Executive Director of “General and Corporate Insurance”;
- Mr Evgeni Benbasat – member and Executive Director of “Bank and Life Insurance;
- Mr Boris Hristov Palichev – member and Executive Director of “Finance” and “Risk”.

There have been some changes in the organizational structure, some of which are caused by a change in the number of members of the MB (from 3 in 2017 to 4 in 2018).

In 2017, DZI's **gross premium income** (GPI) rose for the fourth consecutive year, with a reported annual growth of 11.5% (7.1% in 2016). In the nine months of 2018, the upward trend in GPI is maintained with the registered rise of 21.2% on an annual basis. The increase is due to the major types of insurance products provided by the company. In a comparative aspect, the growth rates outpace the ones of the adjusted sector, which also registers an increase in GPI (by 7.6% for 2017 and 17.1% as of 09.2018). The outpaced growth rates of the rated company result in an increase in its **market share** – up to 10.8% as at the end of 2017 and 10.89% at the end of September 2018.

Despite the reported increase in the period of the update, the **active reinsurance** has an inconsiderable share in total premium income (0.11% at the end of 2017 and 0.18% at the end of September 2018). The share is lower than the average of the adjusted sector in a comparative aspect (2.70% at the end of 2017, 1.82% at the end of September 2018).

In structural terms, there have been no significant changes in the insurance portfolio, with the leading insurance policy "Autocasco", followed by the insurance for the motor vehicles and fire and natural disasters. In a comparative aspect, the company continues to report higher shares for auto insurance and property insurance, and a lower share of motor vehicle insurance compared to the average for the competitive group (formed by the other leading companies). In general, the portfolio concentration of the company remains close to the average for the rest of the leading companies.

In 2017, both the **gross** and **the net claims** registered growth compared to the end of 2016, while in the nine months of 2018 the opposite trend is observed – the gross and net claims decreased by 25.8 p.p. and 3.3 p.p. on an annual basis. In a comparative aspect, the level of net claims retains a bit higher although close to the average for the rest of the leading companies.

In the period of the update, the company maintains a high and relatively unchanged **self-retention level**, which is the highest, compared to the competitors in the reference group and considerably above the average levels. The reinsurance policy complies with the majority shareholder requirements, and the main

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reinsurers are known for their high reputation and high credit ratings. The changes in the reinsurance programmes for the period 2018-2019 are mainly connected with an increase in the coverages.

In the period of the update, the rated company retains a policy of preserving high liquidity and secured **investment portfolio**, guaranteeing high return on it. In 2017, the size of the investment portfolio grew by 4.8% on an annual basis, a tendency for average growth of around 5% annually for the last three years. The change is backed up by the stable growth in the share of Government securities (mainly Bulgarian), which are gradually growing as a share in the investment portfolio structure, reaching 75.7% at the end of 2017 and the even higher share of 87.2% at the end of September 2018.

The reported **net financial result** for 2017 is a profit at the amount of BGN 6 375 thousand, which on an annual basis signifies for a decrease of 25.7%. By a decision was taken by the sole owner (Minutes as from June 11, 2018, the whole profit amount is paid as a dividend).

The profit for the nine-months of 2018 amounts at BGN 15 069 thousand and compared to the same period of the previous year there is a decrease of 8.3%.

The analysed period is characterized by stable levels on the observed prudential indicators, whereas the reported values of **solvency capital requirement** (SCR) are 161% in 2107 and 178% as of the end of September 2018, while the value of the **minimum capital requirement** (MCR) is maintained at rates of 415% and 395%, respectively.

The reached coverage levels of SCR and MCR are considerably better than the average of the competitors.

In 2017, the **liquidity ratio of technical reserves** registered slight decline compared to 2016, but despite the fact, the ratio continued being significantly above the average of the adjusted sector and the rest of the leading companies. The liquidity ratio of the **reserve for upcoming payments** continues to increase in 2017, preserving its 5-year steady upward trend in contrast to the average for both the adjusted sector and the reference group of leading insurers that witnessed a three-year descending trend.

Over the last completed years, the **operating leverage** (the ratio net earned income to equity) followed a downward trend for most of the insurers and for the leading ones (in the reference group). In the nine months of 2018, there were no changes in the indicator levels. The company reports values close to the average of the reference group (slightly lower at the end of 2017 and slightly higher at the end of September 2018).

The rated insurer continues to maintain higher levels of **insurance leverage** (ratio technical reserves to equity) compared to the average of the reference group, whereas the difference is 32 p.p. in 2017 and as of September 2018 is 48 p.p.

The company does not report any other debt out of insurance reserves.

Main Financial Indicators:

Indicator / Year:	*09.2018*	*09.2017*	*2017*	*2016*	*2015*	*2014*	*2013*
Gross Premium Income (thousand BGN):	**167 694**	**138 408**	**188 646**	**164 618**	**158 067**	**142 926**	**141 561**
Net Earned Income (thousand BGN):	**144 673**	**137 370**	**163 400**	**147 452**	**141 904**	**129 509**	**133 128**
Net Financial Result (thousand BGN)	**15 069**	**16 426**	**6 375**	**8 585**	**8 823**	**6 243**	**7 343**
Gross Claims Ratio	44.6%	70.4%	71.8%	63.0%	49.8%	62.0%	49.3%
Net Claims Ratio	48.9%	51.9%	55.3%	54.0%	50.3%	52.7%	52.5%
Net Earned Income / Equity (Operating Leverage)	139%	138%	168%	164%	187%	179%	182%
Technical Reserves / Equity (Insurance Leverage)	233%	207%	229%	233%	267%	267%	251%
Debt excluding insurance reserves / Equity (Financial leverage)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

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Total Equity	**103 824**	**99 833**	**97 386**	**90 132**	**75 873**	**72 370**	**73 123**
Return on Equity	5.0%	15.5%	6.6%	10.4%	12.1%	8.7%	9.4%
Total Value of Investment Portfolio	**235 225**	**266 591**	**265 074**	**252 951**	**237 415**	**225 609**	**221 079**
Share of High Liquidity Assets in Investment Portfolio	90.6%	91.6%	94.3%	93.9%	93.5%	80.1%	71.6%
Investment Portfolio Yield TTM	2.4%	2.8%	2.5%	3.2%	3.9%	4.1%	4.4%
SCR Coverage	178%	n/a	161%	n/a	n/a	n/a	n/a
MCR Coverage	395%	n/a	415%	n/a	n/a	n/a	n/a
Liquidity Ration of Technical Reserves	106.8%	123.3%	116.7%	117.5%	112.9%	97.4%	89.0%
Liquidity Ratio of Reserves for Upcoming Payments	183.1%	179.9%	188.6%	176.6%	172.7%	145.1%	131.2%

Rating History:
The ratings in the charts are assigned according to the previous versions of “Methodology for insurance company to pay claims”.

Claims paying ability rating	**Review**	**Update**	**Update**	**Review**	**Review**
Date of Rating Committee:	**06.01.2017**	**21.02.2017**	**21.02.2018**	**15.05.2018**	**20.06.2018**
Date of Publication:	**12.01.2017**	**22.02.2017**	**22.02.2018**	**18.05.2018**	**21.06.2018**
Long-term Rating:	BBB-	BBB-	BBB-	BBB	BBB (under review)***
Outlook:	negative	stable	stable	stable	
Long-term National-scale Rating:	AA+ (BG)	AA+(BG)	AA+(BG)	AA+(BG)	AA+ (BG) (under review)***
Outlook:	stable	stable	stable	stable	

Claims paying ability rating	**Initial Rating 25.05.2015**	**Update 19.05.2016**	**Review 05.07.2016**
Long-term Rating:	**iA**	**iA+**	**iA+ (under review)*** **
Outlook:	**stable**	**stable**	

****** *The rating actions „under review“ are due to the changes in the methodology for claims-paying ability rating and concerns all valid insurers' ratings at the time and is not related to the activity of the rated entity.*