CREDIT RATING AGENCY

**95, Evlogi Georgiev Blvd.
1142 Sofia
phone (+359 2) 9876363
www.bcra-bg.com**

„IC Lev Ins” AD

Ventseslav Petrov, Lead Financial Analyst
v.petrov@bcra-bg.com
Radoslav Marinov, Financial Analyst
r.marinov@bcra-bg.com
Kalina Dimitrova, Economic Analyst
k.dimitrova@bcra-bg.com
Radostina Stamenova, Economic Analyst
stamenova@bcra-bg.com

CLAIMS PAYING ABILITY RATING **	Monitoring	Update
Date of Rating Committee:	18.12.2018	18.04.2019
Date of Publication:	19.12.2018	19.04.2019
Long-term Rating:	BB+	BB+
Outlook:	Positive	Positive
Long-term National-scale Rating:	A- (BG)	A- (BG)
Outlook:	Positive	Positive

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

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 equal with other ratings, recognized by the European Securities and Markets Authority (ESMA), without any territorial or other restrictions.

BCRA affirms the assigned ratings of “IC Lev Ins” AD as follows:

- ***Long-term claims paying ability rating: BB+, Outlook: „positive”;***
- ***Long-term National-scale Rating: A- (BG), Outlook: „positive”.***

The officially adopted methodology of BCRA for assignment of the ability of insurance companies 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 Supervision Commission, the National Statistical Institute, BCRA’s database, consultants and other public sources

The political situation in Bulgaria remains relatively 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,

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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. As a result, the unemployment rate dropped in all age groups to 5.6% on average for the first two quarters of the year (6.6% in the same period of 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[1] 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% in 2015 r.);
- **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 to be influenced by the solvency requirements of insurers, reinsurers and groups of insurers and reinsurers as well as reporting requirements, valuation of assets and liabilities and the formation 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", in force as of 01.01.2018.

There were no changes in the **share capital** (BGN 43,300 thousand) and the **shareholder structure** of IC Lev Ins AD (Lev Ins) in the period of the update.

The composition of the Supervisory Board is not changed in the period under review.

[1] 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.

On 22 January 2019, a decision of the Supervisory Board was taken for the appointment of Mr. Pavel Ognyanov Panayotov as a member of the Management Board (MB). The inclusion of a new member is related to the expansion of the company's activities and the necessary adjustments in the functions of the members.

Following the exceptionally high growth of Lev Ins's Gross Premium Income (GPI) in 2016, (20.0% YoY with growth of only 1.2% in the adjusted sector) in 2017, the company continued to report growth but at considerable decelerated pace (4.7%), unlike the previous year, it lagged behind the average of other insurers in the sector (8.4%). For the five-year period, from 2012 to 2017, the cumulative growth of the gross premium income amounted to 29.0%, and that of the adjusted sector - to 31.1%. These changes led to a slight decline in the company's market share and at the end of 2017, according to the ratio, the company lost first place to IJSC “Bulstrad Vienna Insurance Group” AD. In 2018, however, Lev Ins regained its leadership position and for the first three quarters of the year, the company became a leader in terms of general premium income and was in first place with a market share of 13.5%. Gross premium income registered a high-record growth in the ninth months of 2018, with total premium exceeding the one registered in 2017. Compared to the same period of 2017, the increase was by 31.0% on an annual basis, while the adjusted sector, which was also growing steadily for the period under review, registered almost twice as lower growth of 16.3%.

Lev Ins does not carry out active reinsurance, which is why the entire amount of premium income is generated through direct insurance activity.

There are no significant changes in the portfolio structure of Lev Ins in the period under review. A leader continues to be the “Motor Third Party Liability” insurance, followed by "Auto Casco". In the first nine months of 2018, the “Motor Third Party Liability” insurance retained its dominant position, its share further rising at the expense of a reported shrinkage of "Auto Casco".

Despite the fact that the company implemented actions to diversify the insurance portfolio, its structure continues being dominated by motor insurance, with a share significantly higher than the average level of the leading reference group[2]. In a comparative aspect, the rated entity continues to account for a significantly higher share of “Motor Third Party Liability” insurance than the average of its direct competitors, respectively a lower share of the average for the other car insurance (“Auto Casco”).

In 2017, the company broke the two-year downward trend, registering a significant increase in *Gross Claims ratio* by 25.4 p.p. up to 78.4% on an annual basis. A major factor is the growth of 15.2% of Gross Claims ratio net of reinsurance. At the end of 2018, there was a reduction in Gross Claims ratio of nearly 10 p.p. - to 68.7% compared to the year-end of 2017 and an increase of about 4 p.p. compared to the same period of the previous year.

Net claims ratio, dropped in 2017 by 6.1 p.p. to 39.5%, while their level at the end of the first nine months of 2018 (48.3%) was very close to that of the same period of the previous year (48.0%).

The reinsurance activity's importance found expression in the preservation of the downward trend in self-retention level down to 69.4% at the end of 2017 and 61.8% at the end of September 2018.

For the period of the update, the rated company kept the trend started in 2015 to report lower *net claims rates* than the average level of the competitive group. At the end of 2017, the difference was above 10 p.p. a value of Lev Ins - 39.5%, compared to 53.4% on average for the group. By the end of September 2018, the increased value of the company's claims was slightly higher (0.6 p.p.) than the average but was triggered by the lowest possible value for the period of one of the companies in the reference group.

At the end of 2017, the *combined cost ratio* reached a record-low value of 73.3%, a drop of 18.4 p.p. on an early basis. Due to the abovementioned changes, the rated company generated profit from insurance activity for the third year in a row, while in 2017, the profit was tripled compared to the one from the preceding year.

For the first nine months of 2018, the reported value of the combined cost ratio was 95.1% (compared to 85.9% a year earlier).

During the period of the update, no significant changes were made to the applied reinsurance policy.

In the period 2013-2017, Lev Ins maintained a significantly lower share of investment in assets compared to the aggregated sector. The tendency remained similar by the end of September 2018.

[2] Includes: ZAD "Armeec" AD, ZAD "Bulstrad VIG", "DZI – General Insurance" EAD, ZAD "Allianz Bulgaria" and ZD "Bul Ins" AD.

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In 2017, the company's investment portfolio shrunk for the fourth consecutive year, by an annual decline of 4.7%. For the past five completed years (2012 as a base), the size of the investment portfolio reduced by 35.4%, and mainly resulted in a decline in deposits base. The effect was mainly compensated by the growth of investments in land and buildings.

In 2017, the concentration observed in the investment portfolio was further strengthened, with a dominating share of investment properties.

In the first nine months of 2018, the investment portfolio grew by 6.1% compared to the end of 2017. It was a result of the increase of the share of deposits in banks.

Since 2015, the company has not been holding government securities, thus the share of its high liquid assets (government securities and bank deposits) in the following periods overlapped with the share of deposits in banks. In a comparative aspect, the company reports a significantly lower share of highly liquid assets compared to the average level of the adjusted sector.

In 2017, the net income from investment activity declined by 52.3% on an annual basis, amounting to BGN 584 thousand (BGN 1,224 thousand a year earlier). For the first nine months of 2018, the company reported a negative investment income (BGN -401 thousand), whereas for the same period of the previous year its value was positive (BGN 91 thousand).

Since 2014, the realised investment return has a decelerating positive value, thus, it was lower than the average levels of the other companies in the sector at the end of each year.

In 2017, Lev Ins reported positive financial result, a profit of BGN 361 thousand (BGN 436 thousand for 2016), registered an annual decline of 17.2%.

In 2017, for the second consecutive year, the company reported lower values of the return on equity ratio, with a rate at the end of the year being 0.5% (0.6% in 2016). In 2017, its value was significantly lower compared to the average of the other companies in the sector of 6.7% (12.5% in 2016).

The coverage levels of the Solvency Capital Requirement, achieved by the rated entity at the end of 2017 and at September 2018, are relatively lower compared to the average of the insurance companies in the sector and as well as to the individual companies in the reference group. Similar is the position of the company in terms of coverage levels of the Minimum Capital Requirement.

The reported liquidity indicators are still considerably lower to the average of the adjusted sector and leading insurers in a comparative aspect.

IC "Lev Ins" AD maintained a higher level of operating leverage (ratio of net earned income to equity) at the end of 2017 and end of September 2018, as compared to the average for other leading insurance companies, as well to the average for the adjusted sector.

At the end of 2017, the rated entity maintained lower levels of *insurance leverage* (the ratio technical provisions to equity) compared to the average for the reference group. During the first nine months of 2018, the value of the indicator increased and for the first time since 2014, exceeded the average level of the comparative group.

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In the period of update, the company continues to report growth in gross premium income, maintaining relatively stable financial position. In 2017 and the first nine months of 2018, the company managed to achieve a positive financial result at low rates of return. In early 2018, ***IC "Lev Ins" AD*** *has attracted subordinated debt amounting to nearly BGN 5 million, and the steps taken by the shareholders aim at increase the capital of a minimum 10% at the end of 2019.*

An additional ***negative impact*** *on the company's rating might cause a reduction in gross premium income, a rise in the gross premium income, an increase in claims, significant negative revaluations of the investment portfolio, retention of low levels of liquid assets, liquidity ratios and those for coverage of capital requirements.*

A remarkable improvement in the diversification of the insurance portfolio, the liquidity ratios, the coverage of the Solvency Capital Requirement and the Minimum Capital Requirement of IC “Lev Ins” AD could have a ***positive impact on the company’s rating.***

Main Financial Indicators:

Indicator / Year:	*09.2018*	*09.2017*	*2017*	*2016*	*2015*	*2014*	*2013*
Gross Premium Income (BGN thousand):	**207 900**	**158 758**	**204 680**	**195 482**	**162 876**	**170 132**	**182 063**
Change in annual basis	*1.6%*	*9.3%*	*4.7%*	*20.0%*	*-4.26%*	*-6.6%*	*14.8%*
Net Earned Income (BGN thousand):	**119 796**	**108 043**	**141 764**	**152 694**	**184 449**	**171 812**	**162 435**
Change in annual basis	*-15.5%*	*1.0%*	*-7.2%*	*-17.2%*	*7.4%*	*5.8%*	*1.9%*
Net Profit (BGN thousand)	**1 178**	**629**	**361**	**436**	**10 667**	**68**	**13 704**
Result from Insurance Activity	**5 831**	15 188	**37 783**	12 578	9 602	-11 673	-1 081
Gross Claims Ratio	68.7%	64.2%	78.4%	53.0%	70.3%	80.3%	59.8%
Net Claims Ratio	48.3%	48.0%	39.5%	45.6%	42.8%	66.8%	58.1%
Cost Ratio	36.6%	24.9%	17.8%	23.8%	32.6%	19.5%	20.9%
Acquisition Ratio	10.3%	13.1%	16.1%	22.3%	19.3%	20.5%	21.7%
Combined Ratio	95.1%	85.9%	73.3%	91.8%	94.8%	106.8%	100.7%
Operating Leverage	170%	155%	204%	221%	268%	295%	280%
Insurance leverage	203%	200%	194%	195%	185%	314%	317%
Immediate Liquidity Ratio	3.4%	3.5%	4.9%	3.0%	3.8%	2.2%	2.4%
Return on Equity	1.3%	1.4%	0.5%	0.6%	17.8%	0.1%	28.9%

Rating History:
The ratings in the table are assigned under the previously used Methodology for a rating of the ability of insurance companies to pay claims, respectively with the applied rating scale, are not directly comparable with the ratings assigned after the entry into force of the current methodology (as of July 2016).

Claims-paying ability rating	Initial Rating 6.2006	Non-solicited update 11.2007	Non-solicited update 11.2008	Update 7.2009	Update 20.07.2010	Monitoring 07.12.2010
Long-term Rating:	BB+	iBBB-(ns)	iBBB(ns)	iA-	iA-	iA-
Outlook:		*positive*	*positive*	*stable*	*stable*	*negative*
Claims paying ability rating	**Monitoring 25.05.2011**	**Update 25.10.2011**	**Update 29.11.2012**	**Update 04.11.2013**	**Update 13.12.2014**	**Update 10.12.2015**
Long-term Rating:	iBBB+	iBBB+	iBBB+	iBBB+	iBBB+	iBBB
Outlook:	*negative*	*In development*	*positive*	*stable*	*stable*	*negative*
Claims-paying ability rating	**Monitoring 05.07.2016**	**Update 06.01.2017**				
Long-term Rating:	iBBB (under review)	iBBB (w)*				
Outlook:	-					

(w) – withdrawn rating – following a procedure, due to a failure to update the rating in a timely manner

CLAIMS-PAYING ABILITY RATING *	Initial Rating	Update	Monitoring
Date of Rating Committee:	09.02.2017	22.03.2018	20.06.2018
Long-term Rating:	BB+	BB+	BB+ (under review) **
Outlook:	positive	positive	-
Long-term National-scale Rating:	A- (BG)	A- (BG)	A- (BG) (under review) **
Outlook:	positive	positive	-

*** The rating is placed “under review” pursuant to the requirements of Directive 1060/2009 due to a procedure for implementation of changes in the Methodology for claims-paying ability rating, until the end of the procedure and followed by a review of the ratings assigned according to the amended and entered in force Methodology.*