

Research Update:

Russian Insurer Sogaz Insurance Upgraded To 'BBB' On Sound Operating Performance; Off Watch; Outlook Stable

June 19, 2019

Overview

- Sogaz Insurance's (Sogaz's) sound operating performance will support the group's creditworthiness over the medium term, in particular regarding its strategic goals and capital management.
- Sogaz has strengthened its investment portfolio's credit quality by focusing on investment-grade instruments, in particular sovereign and government related bonds and fixed income instruments of highly systemically important banks.
- We are therefore raising our ratings on Sogaz to 'BBB' from 'BBB-' and removing them from CreditWatch with developing implications.
- The stable outlook on SOGAZ reflects our view that the group will continue to advance its strategy to sustain its business position and strengthen its capital and earnings position within the next two years.

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Rating Action

On June 19, 2019, S&P Global Ratings raised its long-term issuer credit and financial strength ratings on Russia-based insurance company Sogaz Insurance (Sogaz) to 'BBB' from 'BBB-' and removed them from CreditWatch with developing implications. The outlook is stable.

Rationale

The upgrade reflects our view that SOGAZ's overall financial strength has stabilized in the last seven months following its acquisition of a 100%-stake in Russia-based VTB Insurance on Nov. 9, 2018. We think that the combined entity has strengthened its market position in terms of earnings and competitive standing, which benefits SOGAZ's group credit profile. Estimated premium for 2019 stands at more than Russian ruble (RUB) 300 billion (above \$4.5 billion), indicating that the

consolidated group will have a share of more than 25% of the Russian property/casualty insurance market in 2019. Based on our calculations, SOGAZ's capital adequacy worsened in 2018 due to the VTB Insurance acquisition because of high amount of deferred acquisition costs and intangibles on the balance sheet. However we expect capital adequacy will become more robust following sufficient capital generation, making the group resilient to any high insurance premium growth, unexpected large losses, or the expected stress from its large portfolio of domestic assets that would accompany any sovereign foreign currency default.

We expect management's focus on the quality of the underwriting processes (already in place) will support Sogaz's underwriting performance. The historical performance of both Sogaz and VTB Insurance has been positive, with net combined ratios (loss and expense) significantly below 100%, which we expect will continue. Merger terms could affect the expense ratio of consolidated entity, but we believe that loss ratio, as well as bottom-line results, will remain solid.

In our view, the company's investment strategy is evolving, with its portfolio's average credit quality moving toward the 'BBB' category. Sogaz' investments have historically been skewed toward government-related banks and banks with high systemic importance. We expect this will remain the case in 2019.

We apply our criteria for rating companies above their related sovereign to SOGAZ. Under our criteria, we assess the potential impact of a hypothetical Russian sovereign default on SOGAZ's consolidated balance sheet, based on a stress scenario. After applying our foreign currency sovereign stress scenario, we consider that SOGAZ would likely retain positive regulatory capital and maintain a liquidity ratio in excess of 100%. According to our criteria, this indicates that SOGAZ is unlikely to default on its insurance liabilities under the scenario and passes our sovereign foreign currency stress test. Therefore, the ratings on SOGAZ can be higher than our 'BBB-' long-term foreign currency rating on Russia, but are limited by the 'BBB' long-term local currency rating on Russia.

Outlook

The stable outlook on SOGAZ reflects our view that the group will continue to advance its strategy to sustain its business position and strengthen its capital and earnings position within the next two years. We expect the insurer will maintain its strong competitive position in the Russian insurance market and keep its conservative investment policy.

Upside scenario

A positive rating action is unlikely at this stage, taking into account that the rating is capped at the level of the local currency sovereign rating. If we raise the local currency rating on Russia, it will not immediately lead to a similar rating action, because it will require SOGAZ to improve its standalone characteristics, in particular related to its capital position.

Downside scenario

We could lower the ratings in the next two years if, for instance:

- The group increases its exposure to lower-quality instruments, or the capital position weakens, thereby undermining the group's ability to sustainably pass our hypothetical foreign currency sovereign stress test;
- Capital weakened for a prolonged period below the 'BBB' level according to our capital model,

squeezed either by weaker-than-expected operating performance or investment losses, considerably higher dividend payouts, or expenditures for any further acquisitions; or

- We lower our local currency sovereign credit rating on Russia.

Ratings Score Snapshot

	To	From
Financial Strength Rating	BBB/Stable	BBB-/C.W. Dev
Anchor	bbb+	bbb-
Business Risk Profile	Satisfactory	Satisfactory
IICRA*	High Risk	High Risk
Competitive Position	Strong	Strong
Financial Risk Profile	Upper Adequate	Less than Adequate
Capital & Earnings	Moderately Strong	Extremely Strong
Risk Position	Moderate Risk	Moderate Risk
Financial Flexibility	Adequate	Adequate
Modifiers	0	0
ERM and Management	0	0
Enterprise Risk Management	Adequate	Adequate
Management & Governance	Fair	Fair
Holistic Analysis	0	0
Liquidity	Exceptional	Strong
Support	0	0
Group Support	0	0
Government Support	0	0

*Insurance Industry And Country Risk Assessment. NB: Support does not consider Ratings Above Sovereign criteria.

Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Insurance | General: Insurers: Rating Methodology, May 7, 2013
- Criteria | Insurance | General: Enterprise Risk Management, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Sogaz Insurance		
Issuer Credit Rating	BBB/Stable/--	BBB-/Watch Dev/--
Financial Strength Rating	BBB/Stable/--	BBB-/Watch Dev/--

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