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RAEX-Europe confirmed the reliability rating of Balcia Insurance SE at 'BB+' (Sufficient level of reliability) according to the international scale. The rating outlook is stable, which means that in the mid-term perspective there is a high probability of maintaining the rating score.

JUSTIFICATION OF THE RATING:

The Agency has confirmed the rating of Balcia Insurance SE at **'BB+'** and has also confirmed the **outlook** as **stable**. This mainly reflects the overall stability of the company in regard to profitability, both above and below the line. On the one hand, we observed an adequate technical result as compared to 2020, as expenses were optimized. Even though the net profit was substantially lower, this was mainly a result of the one-off effect in 2020 from the sale of the 10% stake in BTA Baltic Insurance Company. Also, despite declining, investment and financial income remained positive. Moreover, we also observed a combined ratio of 97,8 in 2021, a slight improvement from the year before showing that the company weathered well the effects of the pandemic. Geographic diversification remains in place despite the decline in GWPs in some jurisdictions and the liquidation of the French branch at the end of 2021. Finally, the general macro profile remains solid, and the company's activities fall in line with its designed strategy and business plan.

The **macro profile** of the insurer remains positive and solid as the company operates in countries with an adequate level of our weighted average Insurance Sector Risk (ISR) score, which translates into low systematic risk exposure for the company. Even though Balcia still operates in the same countries, the amount of GWPs per country changed quite substantially in 2021. As of the end of 2021, the regional share of the insurance portfolio measured by the amount of GWPs was as follows: Poland (40,0%), Lithuania (29,7%), France (26,9%), Italy (3,4%), Latvia (0,04%), Spain (0,006%) and Germany (0,0%). Even though the French branch was liquidated at the end of 2021, Balcia continues to operate in the country in the motor vehicle segment on the freedom of service (FOS) basis.

The Polish and Lithuanian insurance markets had penetration and density figures of 2,6% and USD 409 and 2,0% and USD 390, respectively reflecting a stage of development on these markets. The same can be said of Latvia, which posted figure of 2,7% for penetration and USD 478 for density. On the other hand, Germany, France and Italy are considered to have very mature insurance sectors, as well as a stable economy and a solid financial system, strong regulatory frameworks and robust institutions; while Latvia is still a developing market, which presents interesting opportunities for Balcia.

Balcia's **risk management** practices remain favorable and continue to fulfil the specific needs of the insurer. There continues to be a number of financial risk management procedures in place with clear quantitative tests such as sensitivity analyses and defined coverage ratios. We still observe an area of opportunity in risk management as the combined ratio for CMTPL continues to be above 100%.

The stability of the **customer base** remained in place in 2021. The concentration of the top-10 clients of the company declined and accounted for 17,6% of the total client base in terms of GWPs as of the end of 2021, while in 2020 the figure was slightly at 21,7%. In addition, the share of each client in the top-10 did not show any signs of concentration as the largest customer, ME TRANSPORTAS UAB, accounted for only 2,2% of GWPs in 2021, while only one new client entered this group. The length of partnership with each of these entities is at least five years, which reduces the risk of the seeking services from a direct competitor and solidifies the customer base position of the company. All of these customers belong to the 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 **reinsurance policy** of Balcia improved slightly but remains practically unchanged. The quality of reinsurers improved from a year before as 92,4% of the reinsurance partners have credit ratings higher than 'A-' in the international scale, while a share of 7,6% is rated 'BBB'. However, the concentration of transferred GWPs showed a slight increase as the reinsurer with the highest share of total outbound transferred premiums was Swiss RE Europe S.A. with a share of 30% by the end of 2021. In addition, all of the highest risk exposures are reinsured. The largest paid claim (net of reinsurance) for the past five years remains at around 13% of equity altogether, which corresponds to the settlement of two guarantees in Spain and there was no reinsurance involved in these two claims. However, the 10 highest risks currently incurred by the company are partially reinsured well enough that the highest potential retention to equity for a single event is low at 1,98%.

The ratio of **accounts payable** to total assets decreased down to 4,4% in 2021 from 13% of in 2020. This was mainly a result of the normalization of the payables account after an amount of EUR 19 m due to shareholders for interim dividends was paid out. The amount due to insurance creditors remained practically unchanged so did the reinsurance creditors account. The ratio of **accounts receivable** to total assets remained unchanged at 9,3%. Both these figures continue to reflect relatively low indebtedness and reduced credit risk.

Blacia's **solvency capital** requirement ratio continued to hike in 2021 and posted a reading of 180%, while the minimum capital requirement ratio stood at 419%. The improvement was mainly due to an increase in eligible equity of EUR 7,7 m for solvency calculation purposes. The very healthy solvency position of the company gives Balcia the opportunity to expand more aggressively in 2022. The company's Solvency and Financial Condition report 2021 continues to reflect that the capital coverage will be sufficient in the mid-term perspective.

The **investment portfolio** remains liquid and with adequate quality. The quality of the investment portfolio declined slightly due to an increase in issued loans and non-rated investments. We observed the share of investment grade assets go from 88% in 2020 down to 80% in 2021. However, many of the non-rated items are ETFs with good reputation, thus, mitigating the credit risk of the portfolio. The largest spike was observed in loans issued, investments in non-government bonds and shares. On the other hand, we saw an important decline in the share of cash on current accounts. In regard to liquidity, the portfolio remained solid as, according to our calculation, around 88% of assets are highly liquid. Similar to last year, the largest investment remains in Polish sovereign debt with a concentration of 39% of the overall portfolio (rated 'A-' by Fitch, 'A-' by S&P and 'A2' by Moody's). In terms of profitability, the return on investment of the company, was low but solid at around 1,5%. The investment approach from the company is conservative as shown by 80% of investments in instruments rated above 'BBB', as well as a high share of non-rated assets allocation into ETFs.

The **financial result** of the company was favorable in 2021, both the technical result and the net profit were positive. The operation profit stood at EUR 1,19 m in 2021, as compared to EUR 86 k in 2020, a substantial increase. This was mainly due to the optimization of acquisition costs, while the rest of element declined practically at a similar pace. Both, net earned premium and net incurred claims declined by about 13% y-o-y as compared to 2020. Even though we saw a decline in volume as a result of lingering effect of the pandemic as well as a restructuring of insurance activities in different location, profit was still optimized.

As previously mentioned, the **technical result** saw some positive advances, as a result, the combined loss ratio improved to 97,8% in 2021, according to our internal calculation. This metric was composed of a loss ratio of 65,6% and an expense ratio of 32,2%, both figure reflecting an adequate management of underwriting risk, optimization of claims handling and reduction in acquisition costs. Observing the results by segment, we can see that the CMTPL went from 108,9% down to 104,5%, while the CASCO segment saw a substantially increase from 67% to 86% in 2021. The net loss ratio for CMTPL insurance was 69,8% and the expense ratio stood at 34,6%, while the same indicators for CASCO hiked up to 58,2% and 28% respectively. We anticipate the technical result indicators to improve going forward as the company has revamped the strategy towards more profitable business lines and a complete administration of the insurance life cycle in Poland.

The net profit of Balcia was favorable in 2021. Despite being substantially lower than in 2020 due to the one-off effect from the gain from the sale of the 10% stake in BTA Baltic Insurance Company, the bottom line was encouraging. By the end of the year, net profit was EUR 2,6 m with ROA at 1,6% and ROE at 6,1%.

The share of the insurer's **insurance portfolio** is still fairly unchanged. As of the end of 2021, the portfolio remained strongly dominated by Compulsory Motor Third Party Liability Insurance (CMTPL) with a share of 76,6%, followed by CASCO insurance accounting for 16,4% of the portfolio, while the property insurance segment is at a distant third place with a share of 2,5% of total GWPs. In regards to regions, the share of the insurance portfolio was as follows: Poland (40,0%), Lithuania (29,7%), France (26,9%), Italy (3,4%), Latvia (0,04%), Spain (0,006%) and Germany (0,0%). Even though the French branch was liquidated at the end of 2021, Balcia continues to operate in the country in the motor vehicle segment on the freedom of service (FOS) basis.

The **strategy** of Balcia, remains consistent and well executed. The plan set out in 2020, which included the introduction and development of a more digital approach, which includes an e-commerce project to deliver products directly to the client, has been successfully put into motion. However, the insurer failed to increase its GWP portfolio significantly in Latvia and Lithuania, as it had planned last year. In Poland, there were big changes as a new operational strategy was implemented and the team was strengthened by recruiting new experts. This, alongside lingering effects form the pandemic, caused GWPs to decline throughout the year. By the end of 4Q 2021, we saw a renew increase in premiums, however, it is in 2022 where we will actually observe the actual result of the newly implemented strategy. In 2021, we also observed an optimization of expenses and claims handling. In Lithuania, we observed a similar story as GWPs declined due to a new strategy being executed. The branch divested from unprofitable segment and increase the level of private insurance. This translated into a higher profit despite lower levels of GWPs. Balcia continues to pull away from the unprofitable property insurance segment in France and it closed its branch by the end of 2021 and the operations are now controlled directly from Riga. However, the insurer continues to operate in the fleet segment of motor insurance. So far, this direction has been proved to be successful as GWPs increased by 23% in 2021 and net profit was EUR 1,6 m.

Going forward, we anticipate the company to continue to build on the abovementioned blocks in each of the countries where it operates.

In general, the insurer will continue to divest from unprofitable product segments and regions, increase the level of digitalization and flexible product offering, as well as on building on strong relationships with new partners. Moreover, we also expect Balcia to increase its insurance portfolio in Latvia. The success of the strategy continues to depend on a favorable risk assessment in order to price products successfully and avoid 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, it 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.

Balcia's **dependency on intermediaries**, such as local partners and brokers, remains high as 97% of premiums are generated through these channels. An increase in dependency from previous year, which increases the importance of reliable partnerships with brokers. This strategy has helped Balcia to optimize its operations. The insurer has long-standing relationships in the countries where it operates. Nevertheless, the company's client acquisition costs to GWPs ratio continued to decline and stood at 16% in 2021, while underwriting expenses to earned premiums also declined slightly down to 34% as of the same date demonstrating an effective use of distribution channels.

Liquidity metrics remained mixed in 2021. The ratio of liquid assets to total liabilities stood at 89,5% and the ratio of cash to net reserves at 29,4%. Moreover, the net reserves remained well covered by liquid assets by 1,14x.

The company's **market position** is still moderately weak but with a solid stance in its niche markets. Balcia has presence in seven different European markets; four of which belong to the top-5 of total GWPs in Europe. Due to market conditions and restructuring in some branches, the share of GWPs changed in 2021; however, the overall focus and strategy of the company remains in place. Poland, Lithuania and France continue to be the top locations, while Germany, Italy, Latvia and Spain remain with marginal shares.

In terms of non-life insurance sector share of GWPs as of 2021 was slightly reduced in the two main countries where the insurer operates. In Poland, Balcia accounted for around 0,20% of the market share, while in Lithuania it had a share of 2,0%. In both countries, Balcia mainly specializes in CMTPL where, by the end of 2021, it had a share of around 0,5% in Poland and about 6,4% in Lithuania. In 2021, as anticipated in our previous report, we observed a renewed increase in premiums in most markets, as the effect from the pandemic started to fade away. In Poland, the level of non-life insurance GWPs increased by 10,3% in 2021 y-o-y, while in Lithuania the hike was of 8,5% y-o-y as of the same period. Moreover, the price pressure in the CMTPL insurance in Poland remains in place and we still consider that it will remain a challenge to produce some positive yield. Balcia's market position in the rest of the countries is negligible.

The stable outlook is supported by our view that the main rating drivers will remain unchanged in the mid-term perspective.

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;
- Continued deterioration of the main liquidity and solvency metrics.

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, Lithuania and France with a smaller scale of operations in Italy, Germany, Spain and Latvia. The GWPs of the company as of end-2021 amounted to EUR 50,9 m, its assets were equal to EUR 185 m and equity was EUR 53 m.

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RATING HISTORY:

Date	Review reason	Rating Score	Outlook
15.05.2021	Scheduled review	BB+	Stable
15.05.2020	Scheduled review	BB+	Negative
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 18 May 2022. 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 (as of August 2020)
- Methodology for Assigning Insurance Sector Risk Score – Full Version (as of 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 2017, 2018, 2019, 2020 and 2021
- Audited IFRS Annual reports for 2016, 2017, 2018, 2019, 2020 and 2021
- Solvency and Financial Condition report 2021
- 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 Insurance 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

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

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.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.