

May 13, 2005

Criteria | Insurance | General:
**Rating Insurance Companies: Key
Influential Heads Of Analysis For
Russian Insurers**

Primary Credit Analyst:

Tatiana Grineva, London (44) 20-7176-7061; tatiana_grineva@standardandpoors.com

Secondary Credit Analyst:

David Laxton, London (44) 20-7176-7079; david_laxton@standardandpoors.com

Table Of Contents

Industry Risk
Investment Risk
Management
Note
Group E-Mail Address

Criteria | Insurance | General:

Rating Insurance Companies: Key Influential Heads Of Analysis For Russian Insurers

The criteria used by Standard & Poor's Ratings Services when assessing an insurance company's financial strength are the same, regardless of where in the world that company is situated. These criteria, which are grouped together under eight heads of analysis, inevitably take account of the political, economic, industry, business, and financial risks (see "Insurance Ratings Criteria: Property/Casualty Edition", published on RatingsDirect).

Standard & Poor's also considers how national and local factors could affect an insurer's operations. The Russian market has some particular characteristics that affect the ratings on its insurance companies. Considering the specific details of these factors shows how the ratings are adversely affected by issues other than the potential cap of the sovereign rating (foreign currency BBB-/Stable/A-3, local currency BBB/Stable/A-3). Those issues that have a key influence on the ratings on Russian insurers are industry risk, investment risk, and management. A detailed understanding of these particular considerations shows the weaknesses in the Russian insurance market when looked at from a ratings perspective.

Industry Risk

Standard & Poor's assessment of industry risk takes into account a number of factors, including the following country-specific issues.

Regulatory environment

The regulatory environment is an essential element of an insurance company's ability to demonstrate a successful set of strategic goals to build on: if a company is to achieve financial strength, it has to be operating within a system that is managed for the long term and has a stable and consistent approach to regulatory decisions.

In Russia, regulatory decisions are weak, unpredictable, and may not have a clear rationale. Furthermore, there is a lack of consistency throughout the decision-making process. Key examples of the immature state of regulation in Russia include:

- An unexpected announcement by insurance regulators in January 2004, the day before the law became effective, that reinsurance business must be written out of a separate legal entity. This paralyzed the reinsurance market for a few days, translating into lost business and the unnecessary hurdle of creating new subsidiaries. This law has since been quietly shelved.
- The increased solvency margin requirements, which are expected to be implemented by 2007, are still lower than for neighboring insurance markets. (Minimum charter capital should be Russian ruble {RUR} 30 million {\$1.08 million} for non-life companies, RUR60 million for life companies, and RUR120 million for reinsurers.)
- In 2003, the State Duma attempted (unsuccessfully) to revoke the law on mandatory third-party motor insurance after companies had invested heavily in building an infrastructure and sales teams to provide this new line of business.

These are only a few examples among many demonstrating the weak and unpredictable regulatory environment. Some of the progress in wide institutional reform achieved in Russia in 2002-2003 was placed in jeopardy in 2004

by greater authoritarianism, and further problems may occur in the future. The Russian insurance market is still dominated by the tax-optimization schemes that account for about 95% of life insurance business. Some property insurance is also used as a means to avoid paying tax. These schemes are not always transparent, and insurance companies are not as open about their involvement as desired. While these practices are legal, they are also unorthodox and prone to rapid change if the government decides to take action against what it sees as a major loss in revenue. As a result, a company could lose its insurance licenses overnight, which causes difficulties in analyzing companies as going concerns.

Accounting environment

Accounting systems are weak and still underdeveloped. The transition to accrual from cash accounting only took place in 2003, and while Russian Accounting Standards have continued to develop in the direction of International Financial Reporting Standards (IFRS), they still fall significantly short of the full IFRS requirements. This process of ongoing change means that a comparison of year-on-year financials is extremely difficult and time-consuming.

During the transition period toward IFRS, presentations of financials will be constantly changing, and information will continue to be unclear and confused. There will be a range of different reporting systems in place, and there is still a lack of general understanding in the market about IFRS.

In addition, the use of tax-optimization schemes also contributes significantly to a lack of transparency in financial reporting. With such a high level of schemes, there is almost no way of discerning the true figures for the market. These factors prevent any peer review, market development, or forecast analysis, thereby hindering the development of a healthy insurance industry in Russia.

Legal environment

Industry risk is heightened by the weak judicial system. Without a judicial system that is reliable and consistent there is no contract certainty, which also means that there is uncertainty about property and ownership rights. The Yukos affair in December 2004 (when the Russian authorities ordered OAO NK Yukos, one of the largest private Russian oil companies, to sell its main subsidiary to pay for large claims on back taxes related to the tax-optimization practices), although to a certain extent unique, does exemplify the institutional weaknesses that apply to all entities operating in Russia, including the insurance sector. Russia lacks independent courts and a developed corporate governance system that could shield a company from state pressure on shareholders, prevent selective application of the law, and provide protection of ownership rights. The Yukos incident has caused particular concern about sovereign intervention as a risk to private companies.

The combination of these factors leads to a very high industry risk, which represents one of the major downsides for rating Russian companies.

Investment Risk

Investment risk is another key influential in determining the ratings on Russian insurers. The slow pace at which the financial infrastructure in Russia--with which companies can support their business plans and balance sheets--is being strengthened hampers Russian insurers. Investment portfolios suffer from poor credit quality (the average rating on Russian issuers is 'B') and lack of diversity. If insurers either invest in or place the majority of their assets with weak counterparties, their ratings are necessarily constrained by the quality of investments available.

Improving bank creditworthiness is held back by bad practices and leaves the sector as one of the riskiest in the

world, with an average rating for financial institutions of 'B-'. An improved economic environment is counterbalanced by institutional weakness and an immature credit culture that could lead to high loan losses in an economic downturn. The sector is, however, showing signs of a readiness for major change, and a single large foreign bank investment or a significant domestic merger could trigger major restructuring of the sector and accelerate the positive credit trends in the banking industry that are already in place.

In some cases, insurers invest in banks within the same ownership group. While this is an understandable strategy, it leads to a concentration of risk. Some banking business partners require deposits as a precondition for providing insurance business to insurance companies. Although this assists the commercial relationship, it is not necessarily in the best interest of the financial stability and security of the insurer.

Insurers have a limited choice of good-quality equity and fixed-income investments. They have tended to go for the higher risk/higher return option of investing domestically, and this limited pool of investment risk is a problem.

Standard & Poor's Ratings On Russian Financial Institutions

Entity	Counterparty credit rating	National scale rating
AIG Russia Insurance Co. ZAO	NR	ruAAA
Alfa Bank	B-/Positive/C	ruA+
Aljba Alliance	CCC/Stable/C	NR
B.I.N. BANK	CCC+/Stable/C	ruBB
Bank of Khanty-Mansiysk (JSC)	B-/Positive/C	ruBBB
Bank Soyuz	CCC/Stable/C	ruB+
Commercial Bank Petrocommerce (OJSC)	B/Stable/C	ruA
DeltaCredit Bank	B-/Positive/C	ruBBB+
European Trust Bank	CCC/Stable/C	ruB
Gazprombank	B+/Developing/B	ruA+
Home Credit and Finance Bank LLC	B-/Stable/C	NR
Ingosstrakh Insurance Co.	BB/Stable/--	ruAA
Interfin Trade Financial Co. (CJSC)	CCC-/Stable/C	ruCCC+
International Bank of Saint-Petersburg	CCC/Stable/C	ruB+
International Industrial Bank	B-/Positive/C	NR
International Moscow Bank	BB-/Stable/B	NR
JSC IMPEXBANK	B-/Stable/C	NR
MDM Bank	B/Stable/C	NR
Moscow Reinsurance Co.	B/Stable/--	ruA-
Neftepolis Insurance Co. LLC	B-/Developing/--	ruBBB-
Promek-Bank	NR	ruB+/Watch Pos
Promsvyazbank JSCB	B-/Positive/C	NR
Renaissance Capital Holdings Ltd.	B/Stable/C	NR
Rosbank OJSC	B-/Stable/C	ruBBB-
Russian Bank for Development	BB+/Stable/B	NR
Russian Standard Bank ZAO	B/Stable/C	ruBBB+
Surgutneftegasbank	B-/Stable/C	NR
TransCreditBank	B-/Stable/C	NR
Ural - Siberian Bank (OJSC)	B-/Positive/C	NR

Standard & Poor's Ratings On Russian Financial Institutions (cont.)		
Ural Bank for Reconstruction and Development	CCC/Stable/C	NR
Vneshtorgbank (OJSC)	BB+/Positive/B	NR
Web-invest Bank	CCC/Positive/C	NR

All ratings at May 13, 2005. NR--Not rated.

Management

Russian insurers are destined to remain under the shadow of industry and countrywide factors for some time to come, as the slow task of reform dominates the regulatory and legal landscape. However, a rating is an opinion that is always offered in the context of an uncertain world. For Russian companies, the challenge is to show that they are responding to these uncertainties with a clear and focused strategy. Given their inability to alter the banking system or the government structure, managements' ability to limit exposure to risk is a vital component of financial strength. Managements need to demonstrate both that they recognize the level of risk to which they are exposed and that they have the capacity to manage such risks.

Note

"Insurance Ratings Criteria: Property/Casualty Edition" is in PDF format and can be found on RatingsDirect, Standard & Poor's Web-based credit analysis system. Click on "Criteria" and scroll down to "Insurance".

Group E-Mail Address

InsuranceInteractive_Europe@standardandpoors.com

Copyright © 2009, Standard & Poors, a division of The McGraw-Hill Companies, Inc. (S&P). S&P and/or its third party licensors have exclusive proprietary rights in the data or information provided herein. This data/information may only be used internally for business purposes and shall not be used for any unlawful or unauthorized purposes. Dissemination, distribution or reproduction of this data/information in any form is strictly prohibited except with the prior written permission of S&P. Because of the possibility of human or mechanical error by S&P, its affiliates or its third party licensors, S&P, its affiliates and its third party licensors do not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. S&P GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates and its third party licensors be liable for any direct, indirect, special or consequential damages in connection with subscribers or others use of the data/information contained herein. Access to the data or information contained herein is subject to termination in the event any agreement with a third-party of information or software is terminated.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1)212.438.7280 or by e-mail to: research_request@standardandpoors.com.