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Research Update:

Unity Re Upgraded To 'BB/ruAA' On Improved Competitive Standing And Sound Operating Results; Outlook Stable

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Overview

- Russian reinsurer Unity Re managed to improve its competitive position in 2010, taking leading positions in the Russian reinsurance market.
- The company consistently achieved sound operating results in 2010 and the first quarter of 2011.
- We are raising our long-term counterparty credit and financial strength ratings on Unity Re to 'BB' from 'BB-' and the Russia national scale rating to 'ruAA' from 'ruAA-'.
- The stable outlook reflects our expectation that Unity Re will maintain its competitive position in Russia and insurance markets in other parts of the Commonwealth of Independent States.

Rating Action

On Aug. 8, 2011, Standard & Poor's Ratings Services raised its long-term counterparty credit and financial strength ratings on Russian reinsurer Unity Re to 'BB' from 'BB-'. The outlook is stable. At the same time, the Russia national scale rating was raised to 'ruAA' from 'ruAA-'.

Rationale

The upgrade reflects improvements in Unity Re's competitive position in Russia and other parts of the Commonwealth of Independent States (CIS) and the company's consistently sound operating results in 2010 and the first quarter of 2011.

The ratings on Unity Re reflect the relatively high industry risks of operating in the Russian Federation (foreign currency BBB/Stable/A-3; local currency BBB+/Stable/A-2; Russia national scale 'ruAAA'), combined with concentration of expertise within a small management team. These negative factors are offset by good operating results and marginal capitalization.

In our view, Unity Re has managed to improve its competitive standing in Russia and other CIS insurance markets, slightly increasing its share to 5%. With gross premium written of Russian ruble (RUB) 1,025 million (about \$34 million) in 2010, Unity Re has a leading position in the Russian reinsurance market.

The improvements in the company's competitive position are supported by a

locally recognizable and stable brand, significant technical expertise, and a high level of customer service. These factors have enabled Unity Re to build a well-established, wide, and loyal customer base among Russian insurers.

We consider Unity Re's operating performance to be good overall, but still volatile. In the first quarter of 2011, the net combined ratio was 71.9% (78.6% in 2010, 92.2% in 2009), owing to a relatively low net loss ratio of 48.2 % (52.6% in 2010, 68.7% in 2009). We believe that the operating performance is supported by the stability and low losses of the property business, which dominates Unity Re's portfolio. We expect that the company will continue to demonstrate adequate underwriting results and that its combined ratio will gradually become less volatile.

Starting from the second quarter of 2010, Unity Re entered into repurchase agreement (repo) transactions with large banks whereby the banks provide a revolving credit line against which the company's investments in corporate bonds of marginal credit quality are pledged. This, in our view, puts some pressure on the company's capital and liquidity. As of March 31, 2011 Unity Re had increased the level of such transactions to 37% of its total assets. In our view, this was a temporary excess of repo transactions over the company's internal guidelines. Currently, Unity Re follows stricter guidelines, keeping repo transactions at less than 35% of total assets. According to preliminary results as of June 30, 2011, the company's repo transactions stood at 23% of total assets.

Positively, Unity Re has increased its statutory capital to RUB500 million, meeting new regulatory requirements under which Russian insurers and reinsurers must have capital of RUB480 million. The requirements will come into effect in 2012. Total capital including retained earnings is RUB740 million. In our assessment, Unity Re's risk-based capital adequacy has weakened due to increased asset risk charges since it started repo transactions. However we believe that the capital is supported by adequate reserving and good reinsurance protection. We consider that the company's capitalization remains at a level supportive of the current rating. However we note that the company's capitalization could come under pressure and pose risks to its capital adequacy if its repo transactions exceed the set limits.

In our view, Unity Re has a loyal, stable, and experienced staff that has seen few changes over the years. However, we believe that the company will require additional resources to effectively manage the risks arising from further growth.

Outlook

The stable outlook reflects our expectation that Unity Re will maintain its competitive position in Russia and other CIS insurance markets. In addition, we expect the company to produce a sound operating performance with a less volatile combined ratio at less than 90%. We also expect Unity Re's capitalization to remain at least marginal, and the level of repo transactions

no higher than 35% of total assets.

We could consider a negative rating action if Unity Re fails to maintain its competitive advantages and this results in a significant decline in premiums and market share, or if its operating results deteriorate significantly. In addition, negative rating actions could follow if the company's results based on our risk-based capital model decline below marginal levels and the level of its repo transactions exceeds 35% of total assets.

An upward rating action is, in our view, remote at this stage unless Unity Re considerably improves its competitive standing while significantly increasing its book of business and showing very strong operating results, and increases its capitalization significantly without proportional growth of leverage.

Related Criteria And Research

- Interactive Ratings Methodology, April 22, 2009
- Group Methodology, April 22, 2009
- Holding Company Analysis, June 11, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded; Outlook Action

	To	From
Unity Re		
Counterparty Credit Rating	BB/Stable/--	BB-/Positive/--
Financial Strength Rating	BB/Stable/--	BB-/Positive/--
Russia National Scale Rating	ruAA	ruAA-

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