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Insurance Company "ARSENAL" LLC

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Credit rating components	
Business profile	
External environment factor	Above average (1.4)
Market position	Weak (4.5)
Operating performance	Average (3.4)
Business profile assessment	Average (3.1)
Financial profile	
Capital adequacy	Below average (4.6)
Asset quality	Average (3.0)
Liquidity	Strong (1.0)
Debt-to-equity ratio	Within normal limits (19.4%)
Financial profile assessment	Below average (4.6)
Management quality	
Management structure	Neutral influence
Strategic vision and management	Neutral influence
Corporate governance	Neutral influence
Actuarial function	Neutral influence
Risk management	Negative influence
Management quality assessment	Low
SCA	b+
Adjustments	
Individual	+1
Support	
Group	-
State	-
Credit rating	BB-(RU)
Outlook	Stable

Key rating assessment factors

Average business profile of [Insurance Company "ARSENAL" LLC](#) (hereinafter, ARSENAL or the Company) is determined by its limited market positions and average operating indicators. The business profile assessment does not take into account the compulsory state personal insurance (CSPI) contract concluded between the Company and the RF Ministry of Internal Affairs in 3Q2016, as the Company refused to extend the contract to 2017; ACRA considers the contract as an exceptional case. According to data for 9M2017, the ARSENAL's market share was less than 1%. Taking into account high shares of the largest customers and narrow geographic coverage of the insurance portfolio, the diversification of the ARSENAL's customer base is estimated at 'below-average'. The Agency is of the opinion that the quality of the ARSENAL's product line is weak, which follows from the assessment of the completeness and relevance of the insurance products offered by the Company. ACRA assesses the sales channels diversification as average.

The average assessment of operating indicators is based on the forecast for the ARSENAL's business. The combined loss ratio (excluding the CSPI contract) was 0.57 at the end-2016. It is expected that the ratio will be in the range from 0.99 to 0.81 in the future. Since 2016, there has been a decrease in the volume of the Company's signed insurance premium (excluding the CSPI contract). ACRA expects that in 2017–2018, the growth rate of the Company's insurance premium will be lower than the market average.

Below-average financial profile. As calculated according to the ACRA methodology as of September 30, 2017, the available capital to risk capital ratio was 0.55, which, combined with the average assessment of the absolute capital and the limited assessment of access to capital sources, resulted in the capital adequacy assessment 'below average'. In determining the available capital ratio, adjustments were made to include changes in the valuation of assets and liabilities made by ACRA.

The assets quality is limited by a 'moderate' risk assessment in terms of regulatory standards. ACRA notes that, in the periods from February 15, 2017 to April 04, 2017 and from April 28, 2017 to August 09, 2017, certain violations took place concerning the ratio of the total assets in which own funds (capital) were invested to the total own funds (capital) of the Company, and from March 16, 2017 to March 31, 2017 and from June 30, 2017 to July 28, 2017, certain violations took place concerning the ratio of the total assets in which insurance reserves were invested to the total insurance reserves of the Company. ARSENAL invests mainly in low-risk assets and maintains a high enough ratio of capital to assets (0.58). At the same time, the Company is characterized by an increased concentration of assets: as of September 30, 2017, the top 10 investments accounted for 74% of assets.

Strong liquidity position is determined by the current and long-term liquidity ratios of 1.39 and 1.62, respectively.

Management quality assessment is a result of the negative assessment of the 'risk management' sub-factor and neutral assessment of other management quality components, which, according to the ACRA methodology, limits the Company's standalone creditworthiness assessment (SCA) at 'b+'. Negative assessment of the 'risk management' sub-factor stems from the risk management system established in the Company, in particular, business decisions to conclude the CSPI contract in isolation from the risks of regulatory compliance of the Company's assets.

In view of the Company's competitive advantage in liability insurance of undergoing customs procedures, ACRA applied an individual positive adjustment of one notch up to the SCA.

Key assumptions

- The Company will successfully implement its business plans in the nearest 12–18 months
- The combined loss ratio will be below 0.99
- The Company will retain key positions in civil liability insurance undergoing customs procedures.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- A better risk management system.

A negative rating action may be prompted by:

- The operating ratio growing above 0.99;
- A loss of key positions in civil liability insurance of undergoing customs procedures.

Brief information about the Company

Over the past few years, ARSENAL has been a leading insurance company in terms of liability insurance of undergoing customs procedures (about 50% of the Company's insurance premiums). In 3Q2016, the Company concluded a compulsory state personal insurance contract with the Ministry of Internal Affairs of the Russian Federation (insurance premium of RUB 7.5 billion), following which the Company's insurance premiums increased by more than four times in 2016 compared to 2015. As of September 30, 2017, the Company operated in 26 regions of the Russian Federation.

Rating components**Business profile: average (3.1)**

Average business profile is based on the Company's limited market position and average expected operating performance in the short and medium term.

The business profile assessment does not take into account the compulsory state personal insurance (CSPI) contract concluded between the Company and the RF Ministry of Internal Affairs in 3Q2016, as the Company refused to extend the contract to 2017; ACRA considers the contract as an exceptional case.

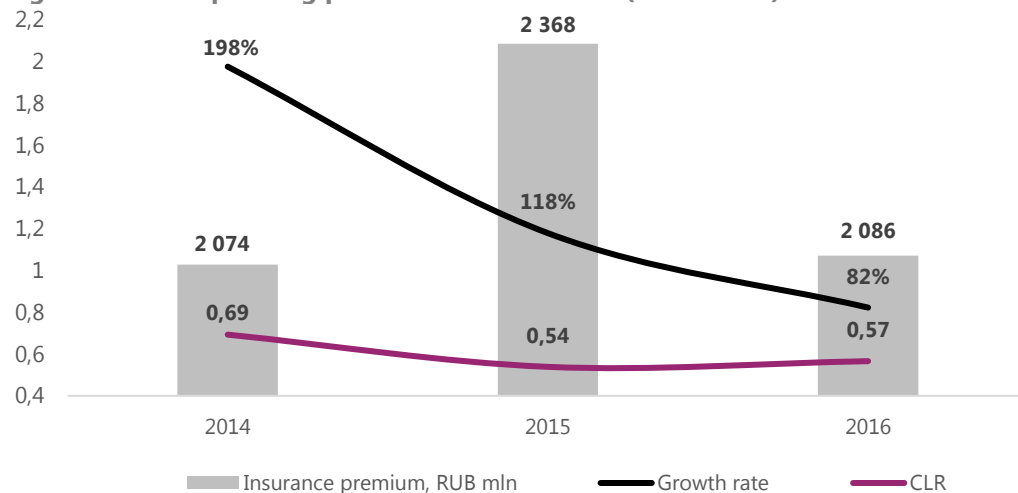
In 1H2017, the ARSENAL's market share was less than 1%. The Company holds its strongest positions in the narrow segment in civil liability insurance of cargo carriers (declarants) for causing damage during customs procedure of customs transit. Such type of insurance means that, on occurrence of an insured event, the Company shall pay insurance coverage to the benefit of Russian customs authorities, capped by the amount of customs charges payable by an insured declarant (except default interest). Moreover, in respect of the insured declarants, the Company acts as a surety before Russian customs authorities. According to ACRA methodology, such segment belongs to the upper level ('other types of insurance'). The insurance portfolio of the Company is ill-diversified. The Company does not operate in such segments like life insurance, car hull insurance and mandatory car insurance. Voluntary health insurance and corporate property insurance segments comprise about 10% of the portfolio. Other types of insurance take about 90%. Taking into account high shares of the largest clients and narrow geographic coverage of the insurance portfolio, the diversification of the Company's client base is assessed as 'below average'. The modified Herfindahl-Hirschman index used by ACRA to assess client base diversification is 1,236. Top 10 clients comprise about 40% of the Company's insurance portfolio.

In terms of product range, the Company is focused on its basic segment, namely, liability insurance during customs procedure of customs transit. In January 2012, the Company introduced a system of digital sureties covering the customs transit from the Russian border to the customs body of destination. The system is paperless and ensures a stable system of securities during customs transit. Other products offered by the Company are of a minor demand in the insurance market. Therefore, ACRA assesses the quality of the Company's product range as 'weak'.

The sales channels diversification is average. The modified Herfindahl-Hirschman index used by ACRA to assess the diversification of sales channels is 1,063. About 30% of insurance premiums are collected through a network of individual agents. Direct sales account for about 29%.

In view of the above, ACRA assesses the Company's market positions as 'weak' (4.5 points).

In 2016, the operational efficiency of the Company determined without taking into account the CSPI contract with the Ministry of Internal Affairs was high, while the combined loss ratio was 0.57. It is expected that, in the forecast period from 2017 to 2019, the CLR will be within 0.81–0.99. Over the past two years, the volume of insurance premiums of the Company has been decreasing, therefore, the growth rates of insurance premiums are below than that of the insurance market. ACRA also expects that, in the forecast period, the Company's insurance premiums will grow below the market average. The CLR dynamics, which is the key efficiency indicator in the non-life segment, is shown in Figure 1.

Figure 1. Main operating performance indicators (2014–2016)

Source: ARSENAL, ACRA estimates

Financial profile: below average (4.6)

The **'below average' financial profile assessment** stems from the capital adequacy assessment (4.6).

The 'below average' capital adequacy assessment is a result of the following sub-factors:

- Leverage ratio (19.4% as of September, 2017) is within standard limits ;
- Absolute capital amount (RUB 2,248 mln as of September, 2017) is average;
- Capital-to-risk asset ratio (0.55 as of September, 2017) is below average;
- Access to capital sources is limited.

As calculated in accordance with the ACRA methodology, the capital-to-risk asset ratio is equal to 0.55 (as of September, 2017), which, combined with the 'average' absolute capital assessment and 'limited' assess to capital sources assessment, yields the Company's capital adequacy assessment as 'below average' (4.6).

In the capital-to-risk asset ratio calculations, the available capital was estimated at RUB 0.72 billion, i.e. equity minus intangible assets, deferred acquisition expenses, minimum charter capital, and adjustments, including changes in the estimated assets and liabilities, applied by ACRA.

To calculate the capital at risk, ACRA applied stress-testing models developed in accordance with the relevant methodology. The results are presented in the table below.

Table 1. Stress-testing results (according to ACRA methodology)

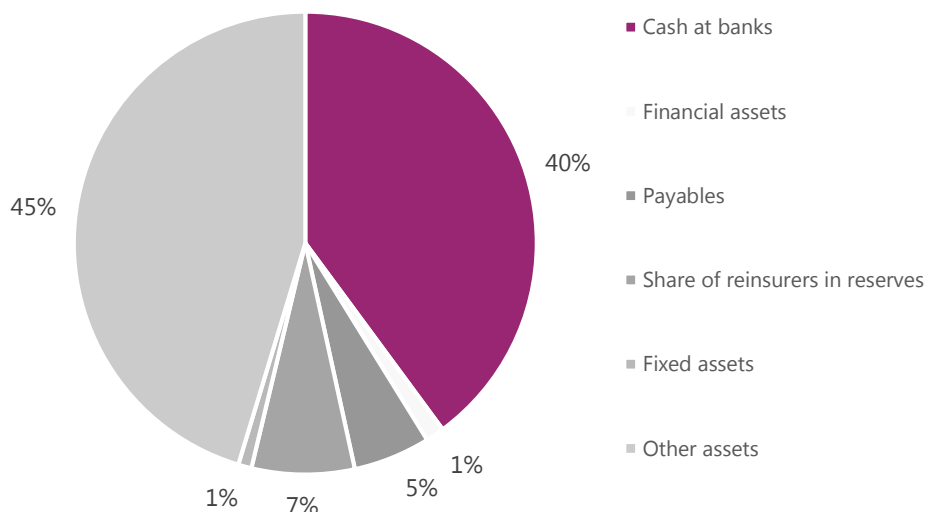
Scenario	Estimated loss, RUB mln
1. Growing insurance portfolio unprofitability	463
2. Growing loss provision	834
3. Disaster	800
4. Life insurance loss	0
5. Default of the largest reinsurer	223
6. Bankruptcy of the largest obligor	101
7. Combination of market risks	244

The most unfavorable combination includes scenarios 2 and 3, which gives the estimated loss of RUB 1.6 billion. Taking into account the 20% tax effect, the capital at risk is estimated at RUB 1.3 billion.

The Company's access to capital sources is limited.

The estimated weighted average asset risk index is 2.3. Taking into account the equity to assets ratio (0.58), the Company's asset structure is assessed at 1.0 ('strong') in accordance with the ACRA methodology.

Figure 2. Asset profile as at September 30, 2017



Source: ARSENAL, ACRA estimates

Other assets mainly include investment property, current income tax assets, investments in associates.

As of September 30, 2017, the concentration of assets exceeded the safe levels defined in the ACRA methodology: the share of the top 10 assets exceeded 74% of the total assets (ACRA criterion is up to 40%), the share of the largest asset exceeded 16% of the total assets (ACRA criterion is up to 15%). Therefore, the asset quality was assessed at 2.0 ('above average').

The total asset quality (3.0) is limited by a 'moderate' risk assessment in terms of regulatory assets. ACRA points out the following ratios were violated by the Company: the ratio of the total assets in which the Company invested its equity to the total amount of its equity (from February 15, 2017 to April 04, 2017 and from April 28, 2017 to August 09, 2017,) and the ratio of the total assets, in which the Company invested its insurance reserves to the total amount of insurance reserves of the Company (from March 16, 2017 to March 31, 2017 and from June 30, 2017 to July 28, 2017).

Strong liquidity position stems from the estimated liquidity ratios: 1.39 and 1.62, respectively.

Management quality: low

The management quality at the Company is a result of the negative assessment of the 'risk management' sub-factor and the neutral assessments of other components, which, according to the ACRA methodology, limits the Company's SCA at 'b+'. The assessment of the 'risk management' sub-factor is negative due to the existing risk management system in the Company, reflected in the business decision to conclude the CSPI contract in isolation from the compliance risks assessment.

Additional adjustments

The resulting rating takes into account the stable competitive advantages of the Company as the main insurer in civil liability insurance of cargo carriers (declarants) for causing damage during customs procedure of customs transit. On occurrence of an insured event, the Company shall pay insurance coverage to the benefit of Russian customs authorities, capped by the amount of customs charges payable by an insured declarant (except default interest). Moreover, in respect of the insured declarants, the Company acts as a surety before Russian customs authorities. In view of the above, the Agency adds one rating notch up to the Company's SCA.

Support**Group**

The Company is not part of an identifiable group as defined in [Methodology for Analyzing Member Company Relationships within Corporate Groups](#) resulting in no additional support to its SCA.

State

The Company is not a state-related organization resulting in no additional support to its SCA.

Issue ratings

No outstanding issues have been rated.

Rating history

December 04, 2017 — BB-(RU), outlook Stable.

Regulatory disclosure

The credit rating has been assigned under the national scale for the Russian Federation and is based on the Methodology for Credit Ratings Assignment to Insurance Companies Under the National Scale for the Russian Federation, and the [Key Concepts Used by Analytical Credit Rating Agency within the Scope of Its Rating Activities](#).

The credit rating has been assigned to Insurance Company "ARSENAL" LLC for the first time. The credit rating and its outlook are expected to be revised within one year following the rating action date (December 04, 2017).

The credit rating is assigned based on the data provided by Insurance Company "ARSENAL" LLC, information from publicly available sources, as well as ACRA's own databases. The rating analysis was performed using the RAS and IFRS financial statements of Insurance Company "ARSENAL" LLC. The credit rating is solicited, and Insurance Company "ARSENAL" LLC participated in its assignment.

No material discrepancies between the provided information and the data officially disclosed by Insurance Company "ARSENAL" LLC in its financial statements have been discovered.

ACRA provided additional services to Insurance Company "ARSENAL" LLC.

No conflicts of interest were discovered in the course of credit rating assignment.

Appendix

Table 1. Consolidated balance sheet items, RUB mln

	2014	2015	2016
Assets	2,492	2,923	6,174
Cash and equivalents	1,004	984	3,765
Deposits and other funds with credit organizations	10	642	327
Available-for-sale financial assets	137	-	-
Insurance receivables	200	263	190
Reinsurers' share in reserves	115	111	38
Investment property	230	243	619
Fixed assets	20	36	43
Deferred acquisition costs	12	31	42
Deferred tax assets	-	0	-
Other assets	764	613	1,152
Liabilities	1,045	903	3,649
Borrowings and other accounts payable	205	81	234
Insurance payables	-	-	-
Insurance reserves	583	510	3,078
Deferred acquisition income	-	-	-
Other liabilities	257	312	337
Own funds	1,447	2,020	2,525
Charter capital	576	578	1,011
Paid-in surplus	-	-	-
Fixed assets revaluation fund	-	-	-
Other funds	-	-	-
Retained earnings	871	1,442	1,513

Source: ARSENAL

Table 2. Consolidated profit and loss statement items, RUB mln

	2014	2015	2016
Life insurance revenues	-	-	-
Net earned premium	-	-	-
Net insurance settlement payments	-	-	-
Net change in reserves and liabilities	-	-	-
Operating expenses	-	-	-
Other revenues and expenses	-	-	-
Non-life insurance revenues	1,399	1,797	1,818
Net earned premium	1,898	2,062	2,034
Net claims incurred	-191	-25	54
Operating expenses	-308	-241	-270
Other revenues and expenses	-	-	-
Investment returns and expenses	103	195	61
General and administrative expenses	-816	-845	-934
Other operating income and expenses	-27	-340	-62
Income (loss) before taxes	659	807	883
Income (loss) after taxes	493	571	703
Other comprehensive income	-	-	-
Total gross income	493	571	703

Source: ARSENAL

Table 3. Key ratios

	2014	2015	2016
Non-life operating performance			
Non-life loss ratio	0.10	0.01	-0.03
Non-life expense ratio	0.59	0.53	0.59
Combined loss ratio	0.69	0.54	0.57
Insurance premium growth rate		114%	88%
Life operating performance			
Return on assets			
Insurance premium growth rate			
Financial profile			
Capital to risk ratio			
Share of the largest client (group) in total assets			
Share of 10 largest clients in total assets			
Related parties' share in own funds			
Current liquidity ratio			
Long-term liquidity ratio			

Source: ACRA estimates

(C) 2018

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