Research Update:

Portugal-Based Insurer Abarca - Companhia de Seguros, S.A. Rated 'BBB-'; Outlook Stable

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Overview

- We believe Abarca Companhia de Seguros, S.A. (Abarca) has developed a sustainable and profitable business model supported by the long-term nature of its surety bonds and its recognized expertise in renewable energy projects.
- At the same time, Abarca continues to benefit from wide access to reinsurance coverage and intends to expand prudently in the next two years, maintaining conservative underwriting practices and managing provisioning carefully.
- We assigned our 'BBB-' long-term financial strength rating to Abarca.
- The stable outlook reflects our expectation that Abarca will maintain its robust capital adequacy while strengthening its competitive position, namely through the continued improvement of profitability measures.

Rating Action

On Jan. 26, 2022, S&P Global Ratings assigned its 'BBB-' long-term financial strength rating to Portugal-based P&C insurer Abarca Companhia de Seguros, S.A. (Abarca). The outlook is stable.

Rationale

The rating reflects Abarca's success in creating a sustainable and profitable business model since its creation in 2016. Abarca's core specialty is to guarantee the completion of energy infrastructure projects, notably renewables, but it also provides surety on other types of projects and services, including housing projects. The long-term nature of surety bonds (four-to-five-year maturity) increases the predictability of premium generation in the coming three years. In addition, the huge need for growth in Europe for renewables and other energy infrastructure projects to fulfill the 2050 decarbonization goals puts Abarca in a good position for continued profitable expansion in 2022-2023.

We positively note Abarca's lengthening track record, since the comany has been operating in the surety insurance market in Spain and Portugal for more than five years and has been profitable since 2019. Abarca has demonstrated that it can expand profitably by following strict underwriting guidelines, while provisioning prudently and maintaining wide access to reinsurance coverage.

We believe that Abarca is largely comparable to peers with fair business risk profile assessments. Nevertheless, our business risk profile remains constrained by the company's small absolute size (€18 million in premiums at year-end 2020), concentration in one single line of business, and high reliance on reinsurance for capital adequacy.

We expect Abarca will expand at a prudent pace in the next two years. Abarca posted improved operating results, with a net combined ratio of 87% in both 2019 and 2020. The company's €1.1 million 2019 net income benefitted from a release of risk provisions from offsetting regular accounting to an equalization reserved on surety products. Following this, net income declined to €430,000 in 2020. Nevertheless, we see net income exceeding 2019 levels in the next three years. We also believe the combined ratio (loss and expense) will continue to improve in 2021-2023.

We expect Abarca's capital adequacy (according to our methodology) will keep on gravitating above the 'AA' confidence level in 2021-2023. The Solvency II capital ratio stood at 188% at year-end 2020 (down from 252% in 2019) largely due to the increase in the balance sheet and a large jump in counterparty risk from the large amount of reinsurance recoverable. We expect the Solvency II ratio at year-end 2021 to be in line with 2020.

We believe that Abarca's panel of reinsurers is highly creditworthy and will continue to provide a large amount of reinsurance coverage in the coming years. Abarca cedes 80% of its business to the panel on a proportional basis and also has facultative cover to limit its retention at a maximum of €3 million. In addition, Abarca's fronting business (source of a large claim in 2020, which is under litigation) is reinsured at above 95%. These covers protect Abarca from the risk of unexpected high losses, as witnessed in 2020. The small absolute size of capital limits our overall view of the company's financial risk profile, making it more exposed to unexpected losses or external shocks. We anticipate that the dividend policy will continue to prioritize capital build-up. Abarca's asset portfolio is mostly in cash, limiting investment risk.

Outlook

The stable outlook reflects our view that, over the next 12-24 months, Abarca will maintain its capital adequacy at solid levels while expanding profitably, notably thanks to continuing wide access to reinsurance funding. We also expect Abarca will maintain a net combined ratio below 100% in the next 12-24 months.

Downside scenario

We could lower the rating on Abarca if we believe the company is unable to at least maintain the premium level reached in 2020 and expected in 2021, if access conditions for reinsurance deteriorate, or if technical profitability or capital adequacy materially weaken for a prolonged period.

Upside scenario

Although unlikely at this stage, we could raise the rating on Abarca if the company significantly increases the size of its capital base while maintaining solid levels of profitability and capital.

Environmental, Social, And Governance

ESG credit indicators: E-1, S-2, G-2

Environmental factors are a positive influence on our credit rating analysis of Abarca. Abarca's focus on underwriting performance bonds related to renewable energy projects means it is well placed to benefit from Europe's goal to achieve carbon neutrality by 2050 and the resulting need for renewable infrastructure projects. Our assessment of Abarca's competitive position as fair includes the benefits of ongoing climate transition. Although we also believe the insurer is exposed to some key-person risk, given its small headcount, we view the decision-making process as highly collegial.

Ratings Score Snapshot

Business Risk Profile	**Fair**
Competitive position	Fair
IICRA	Intermediate risk
Financial Risk Profile	**Satisfactory**
Capital and earnings	Satisfactory
Risk exposure	Moderately low
Funding structure	Neutral
Anchor*	bbb-
Modifiers	**0**
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Financial Strength Rating	**BBB-/Stable/--**

IICRA—Insurance Industry And Country Risk Assessment. *This is influenced by our view of Abarca's monoline business model and high reliance on reinsurance.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- Criteria | Insurance | Specialty: Trade Credit Insurance Capital Requirements Under S&P Global Ratings' Capital Adequacy Model, Dec. 6, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer

Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Related Research

- ESG Credit Indicator Report Card: EMEA Insurance, Nov. 29, 2021

Ratings List

New Rating	
Abarca - Companhia de Seguros, S.A	
Financial Strength Rating	
Local Currency	BBB-/Stable/--