Credit FAQ:

An Overview Of Standard & Poor's New Insurance Criteria

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This week, Standard & Poor's Ratings Services published new criteria governing its approach to rating insurers globally. Some of the most common questions we expect from the industry are answered here.

Frequently Asked Questions

Why is Standard & Poor's publishing new insurance criteria?

This series represents the insurance part of our commitment to the market, undertaken in 2008, to enhance the transparency, rigor, and specificity of our criteria across sectors and asset classes. Our objective is to provide the market with greater insight about how we rate insurers and to enhance the global comparability of our ratings through a clear, coherent, and globally consistent criteria framework.

For example, we have introduced a matrix that shows in a very transparent manner how we derive the anchor based on the combination of the business and financial risk profiles. In addition, we are much more specific as to how the macroeconomic and industry environment affects the creditworthiness of an insurer, having introduced the assessment of industry and country risk as an explicit rating factor.

What criteria have been published?

- Our new framework to rate global insurers (except bond insurers). This is based on eight specific rating factors;
- Our new Group Rating Methodology to rate subsidiaries and holding companies, consolidating our approaches for financial institutions and insurance groups;
- Our new consolidated enterprise risk management (ERM) criteria;
- Our updated short-term/long-term ratings linkage criteria, with the insurance sector converging with the corporate and sovereign sectors.

What other related articles have been published?

- A list of issuers with ratings under criteria observation due to our new insurers rating methodology. Under Regulation (EC) No 1060/2009, rating agencies are required immediately to place credit ratings potentially affected by such changes "under observation."
- Insurance Industry And Country Risk Assessments. We have assigned Insurance Industry and Country Risk Assessments to 97 insurance sectors covering 52 countries and four global sectors.
- Credit FAQ about what informative evidence we use in our updated enterprise risk management analysis.

What will the rating impact be?

We currently expect a majority of our ratings to remain unchanged. Any ratings changes are likely to be within one notch of the current ratings. Preliminary results suggest that positive rating actions will slightly outweigh negative rating actions. We expect very few rating changes by more than one notch. During our testing, we have not identified any sectors or regions in which the distribution of ratings is likely to change significantly.

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What are the key changes in these criteria?

The changes are more evolution than revolution. In the sectors covered by the new criteria framework, ratings performance (defaults and transitions) has in our view been very satisfactory during the past decade. We would highlight three key changes:

- The introduction of a business risk/financial risk matrix framework to anchor our insurer ratings;
- The formalization of our insurance industry country risk assessment (IICRA); and
- Specification of the combined impact of ERM and management and governance on our insurer ratings.

How have the criteria changed since the request for comment last year?

We solicited feedback from the market during the comment period, and considered that feedback carefully. We believe we have responded to market perceptions that analytical judgment was under-represented and that too many features could cap ratings. In part to address these concerns, but also because of our own criteria-development thought process, we adjusted various scoring elements in the framework to be less formulaic and more judgmental. For example:

- The matrix that generates the anchor now includes more possible outcomes and specifies how judgment is to be applied when the matrix has two.
- We now expect the fixed-charge coverage rating cap to apply only in specifically highly leveraged situations.
- We replaced guidance perceived to be rigid with examples of how elements should be assessed, such as in the geographic diversification subfactor of competitive position and in the risk-position factor.

Our discussions with the industry and the market and the many comments we received were helpful in adjusting our communication about our new ratings framework. More details are available in appendix D of "Insurers: Rating Methodology," published May 7, 2013, on RatingsDirect.

How has the performance of insurance ratings in the past informed the criteria?

The main sources that we used to review the history of insurance-company defaults are our default studies. Creditworthiness in this heavily regulated sector appears to be sustainable during periods of economic stress. Default rates have increased during periods of stress, such as economic downturns or following major catastrophes, but have remained relatively low and are among the lowest of any sector.

The global financial crisis did not trigger a wave of life insurance and property/casualty (P/C) defaults. In fact, no significant insurer that we rated at the time has defaulted due to the financial crisis. Insurers defaulted in the bond insurance and mortgage insurance sectors, but these are outside the scope of the criteria.

The criteria globally address the issues that caused these failures, specifically through:

- New liquidity metrics;
- Capital metrics that focus more on asset-liability risks;
- IICRA metrics that take into account industry-wide pricing adequacy; and
- A larger role for ERM for insurers with complex risks.

See the appendix in the main criteria document for more details.

How does Standard & Poor's arrive at the rating?

Two factors--the new IICRA assessment and the company-specific competitive position--determine the insurer's business-risk profile. The financial risk profile has three components--capital and earnings, risk position, and financial flexibility. We take the anchor and the combined impact of ERM and management and governance into account to generate the indicative stand-alone credit profile or group credit profile.

We then add two more factors: the insurer's liquidity and the sovereign rating, which most of the time would be neutral, and in rare cases cap ratings. We assess each of these eight factors in an explicitly forward-looking approach. For example, capital and earnings, which anchors the financial profile, is now clearly assessed by projecting capital and earnings two to three years out.

We expect to publish our assessments of these factors regularly for each insurance group we rate globally.

How does the insurance industry country risk assessment (IICRA) work?

Our previous criteria included industry- and country-related risks. These are not risks that we are considering for the first time. But they are complex and varied around the globe.

We have now added a transparent, robust, and specific framework for analyzing these risks systematically. We analyze four specifically identified features of country risk and five similarly specified aspects of industry risk--together nine "subfactors." We aggregate them in a specified way to generate IICRA assessments. For example, we will publish one each for Canada's life insurance sector, the U.S. health insurance sector, and Russia's P/C sector. We expect to publish these assessments regularly for the countries and insurance sectors where we rate companies.

Regarding country risks specifically, the framework intends to ensure consistency with our views in other asset classes. For example the economic, political, and financial-system factors underlying country risk analysis draw on our sovereign and banking criteria (see "Insurers: Rating Methodology," published May 7, 2013, for more detail).

When will new ratings be announced?

From late May through the end of July, we intend to release the ratings, followed by individual research updates, on all interactively rated (re)insurance companies based on the revised methodologies. We aim to communicate all rating actions (affirmations, upgrades, downgrades, CreditWatch placements) by the end of July.

From July onward, we plan to review our unsolicited ratings, which we will complete within six months of the effective date of our new insurance criteria.

When will individual IICRA reports be published?

On May 7, 2013, we assigned IICRAs to 97 insurance sectors covering 52 countries and four global sectors. We expect to publish reports on all sectors before the end of this year. In the interim, the rating rationales we release on each insurer will also explain these industry and country risks and how they relate to our ratings.

How will the revised ratings be released?

We have segmented insurance companies into groups and will publish ratings on insurers in these groups at the same time via a single "group media release." Each group media release will include a ratings list showing the insurers included in that group, the new ratings under the revised criteria, and the former rating. The list will include holding companies and rated subsidiaries that are core and highly strategic and may also include strategically important, moderately strategic, or nonstrategic subsidiaries (as our criteria define these terms). For example, the first group media release will include the largest global reinsurers and global multiline insurers and a small number of large regionally focused insurers. Subsequent group media releases will be more regionally focused. We will communicate to the insurers which group they are in and when we expect to publish.

Following each group media release, we will publish individual research updates on each insurance group, including a list of ratings on affiliated entities, as well as the ratings by debt type--senior, subordinated, junior subordinated, and equity hybrid instruments including preferred stock. We may publish a separate research update on subsidiaries that we consider strategically important, moderately strategic, or nonstrategic as our ratings on these are based more on their individual credit characteristics than on support from the group to which they belong.

Where is more information available?

All commentaries, videos, and the research updates will be available at: www.standardandpoors.com/insurancecriteria and on RatingsDirect. There will also be information at www.ratings.standardandpoors.com/insurance/Global_criteria

Related Criteria And Research

- Special Report: U.S. Insurers Eye Emerging Demographic, Economic, And Climatic Trends In 2013, June 4, 2013
- Credit FAQ: What Informative Evidence Does Standard & Poor's Use In Its Updated Enterprise Risk Management Analysis?, May 8, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Group Rating Methodology, May 7, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- List Of Issuers With Ratings Under Criteria Observation Due To S&P's New Insurers Rating Methodology, May 7, 2013
- Standard & Poor's Assigns Insurance Industry And Country Risk Assessments, May 7, 2013