S&P Global
Ratings

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ARCHIVE | Criteria | Insurance | Request for Comment:

Request For Comment: Insurers Rating Methodology

December 3, 2018

(*Editor's Note: On July 1, 2019, S&P Global Ratings published the criteria "Insurers Rating Methodology."*)

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OVERVIEW AND SCOPE

1. These proposed criteria comprise S&P Global Ratings' global framework for rating insurance companies, as well as the methodology for assessing their stand-alone creditworthiness. These proposed criteria should be read in conjunction with the related guidance document (see "Proposed Guidance: Insurers Rating Methodology" in the Appendix).

2. The proposed criteria, if adopted, would apply to all global-scale foreign and local currency, long-term issuer credit, financial strength, and financial enhancement ratings on insurers in the business of life, health, property/casualty, mortgage, title, and bond insurance and reinsurance sectors (including start-up and run-off entities). The criteria would also apply to ratings on obligations other than hybrid instruments. The criteria would not apply to ratings on insurance brokers, nor would the criteria apply to any company with unsustainable financial commitments or that has obligations vulnerable to nonpayment; instead we would use 'CCC' rating criteria (see "General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," Oct. 1, 2012).

IMPACT ON OUTSTANDING RATINGS

3. The proposed criteria are largely focused on simplifying and consolidating currently outstanding criteria pertaining to rated insurance entities. Accordingly, we believe there will be only a modest impact on ratings within the scope of these criteria. Based on our testing and assuming that these entities maintain their current credit characteristics, less than 5% of ratings will be impacted. We estimate that the majority of these rating changes would be within one notch.

QUESTIONS

4. S&P Global Ratings is seeking responses to the following questions, in addition to any other general comments on the proposed criteria:

- What are your views on the methodology we have discussed in this article?
- Are there any other factors you believe we should consider in the proposed criteria?
- In your opinion, do the proposed criteria contain any significant redundancies or omissions?
- Is the structure of the methodology clear, and if not, why?

- Do you believe this framework places too much emphasis on any particular rating factor, and if so, do you believe this emphasis could be mitigated by the use of the modifiers?
- Do you believe we are appropriately capturing risk and agree with the manner in which we propose to assess this risk? If not, what alternative(s) would you propose?

RESPONSE DEADLINE

5. We encourage interested market participants to submit their written comments on the proposed criteria by Feb. 1, 2019, to http://www.standardandpoors.com/en_US/web/guest/ratings/rfc where participants must choose from the list of available Requests for Comment links to launch the upload process (you may need to log in or register first). We will review and take such comments into consideration before publishing our definitive criteria once the comment period is over. S&P Global Ratings, in concurrence with regulatory standards, will receive and post comments made during the comment period to www.standardandpoors.com/en_US/web/guest/ratings/ratings-criteria/-/articles/criteria/requests-for-comment/filter/all#rfc. Comments may also been sent to CriteriaComments@spglobal.com should participants encounter technical difficulties. All comments must be published, but those providing comments may choose to have their remarks published anonymously or they may identify themselves. Generally, we publish comments in their entirety, except when the full text, in our view, would be unsuitable for reasons of tone or substance.

Key Publication Dates

- Original publication date: Dec. 3, 2018
- Response deadline: Feb. 1, 2019
- Effective date: Immediately upon publication of final criteria.
- Impact on outstanding ratings: See the Impact On Outstanding Ratings Section.
- These criteria address the fundamentals set out in "Principles Of Credit Ratings," published on Feb. 16, 2011.

PROPOSED METHODOLOGY

6. The criteria describe the methodology for assessing the stand-alone credit profile (SACP) of insurers. The SACP, together with the support framework, determine the issuer credit rating (ICR) on the insurer. For most companies, the financial strength rating (FSR) and financial enhancement rating (FER), if any, are identical to the ICR.

Determining The Rating: Key Steps

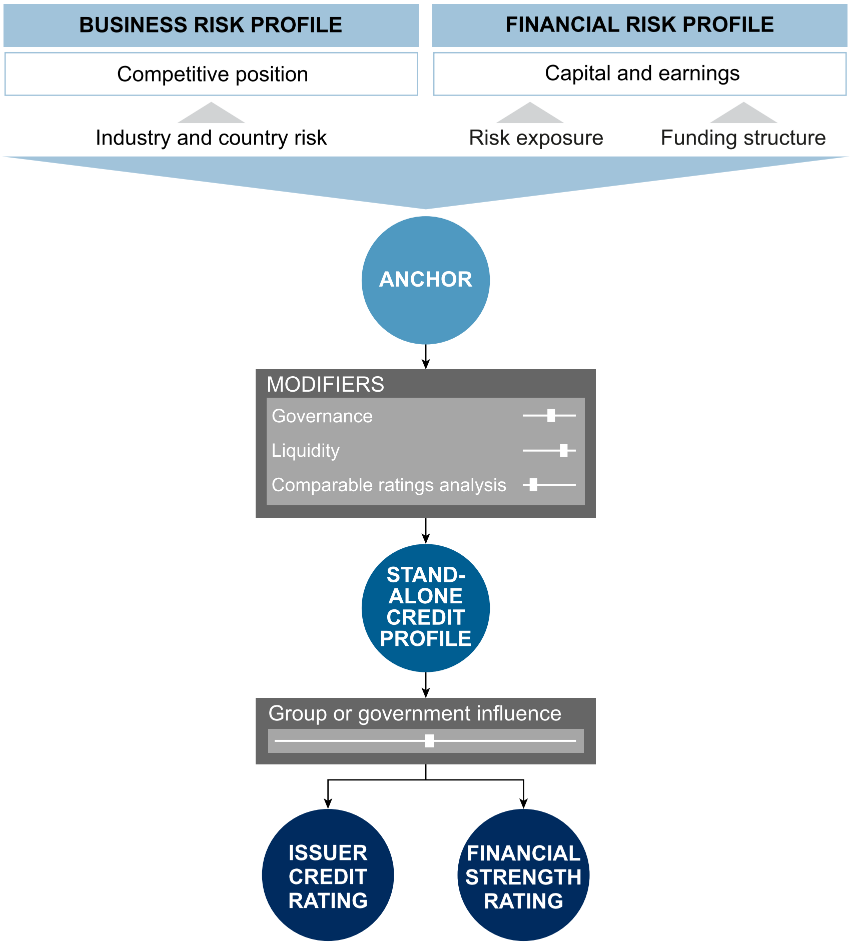
7. The methodology for analyzing the creditworthiness of insurers is forward-looking. Our analysis typically uses projections for the current and upcoming two years, as informed by the past five years, unless otherwise stated, and takes into consideration:

- Developments since the most recent financial statements; and
- Developments that have a reasonably high degree of certainty of occurring.

8. The assessment of the SACP is based on the following rating factors (see chart 1):

- Competitive position,
- Insurance Industry And Country Risk Assessment (IICRA),
- Capital and earnings,
- Risk exposure,
- Funding structure,
- Governance, and
- Liquidity.

Insurance Ratings Framework


BUSINESS RISK PROFILE
FINANCIAL RISK PROFILE
Competitive position
Capital and earnings
Industry and country risk
Risk exposure
Funding structure
ANCHOR
MODIFIERS
Governance
Liquidity
Comparable ratings analysis
STAND-ALONE CREDIT PROFILE
Group or government influence
ISSUER CREDIT RATING
FINANCIAL STRENGTH RATING

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9. We determine the long-term issuer credit rating of an insurer as follows:

- The business risk profile (BRP) is based on our analysis of an insurer's competitive position, modified by the IICRA.
- The financial risk profile (FRP) is based on our analysis of an insurer's capital and earnings, modified by risk exposure and funding structure.
- We derive the anchor from the combination of the business risk profile and the financial risk profile (see table 1).
- We then modify the anchor by our assessment of governance, liquidity (subject to any caps), and any adjustment due to our comparable ratings analysis to determine the SACP (see table 2).
- We derive the ICR by combining the SACP and the support framework, which determines the extent of uplift, if any, for group or government support, or the risk of extraordinary negative intervention or sovereign-related risks (see Related Criteria).
- The FSR, if any, equals the ICR unless the present default risk leads to a rating conclusion of 'CCC+' or lower, or unless policyholder obligations, but not other financial obligations, are supported by a more creditworthy counterparty.

Table 1

Anchor

	--Financial risk profile--							
Business risk profile								
	1.Excellent	**2.Very Strong**	**3.Strong**	**4.Satisfactory**	**5.Fair**	**6.Marginal**	**7.Weak**	**8.Vulnerable**
1.Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
2.Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
3.Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
4.Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
5.Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
6.Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
7.Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

10. Where table 1 indicates two possible outcomes, we determine the anchor as follows:

- For FRPs that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the BRP and FRP.
- For FRPs that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the FRP.

Table 2

Determining The SACP

	Anchor
	‘aa+’ to ‘b-’*
--	
Governance	
Neutral	0 notches
Moderately negative	-1 notch
Negative	-2 or more notches
--	
Liquidity	
Exceptional	0 notches
Adequate	0 notches
Less than adequate	Capped at ‘bb+’
Weak	Capped at ‘b-’
--	
Comparable ratings analysis¶	+1, 0, -1 notch

*The modifiers do not lower the anchor below ‘b-’. ¶The comparable ratings analysis cannot be used to raise the SACP above the caps imposed by less than adequate and weak liquidity.

11. We may apply an adjustment to determine the SACP of up to one notch in either direction based on our comparable ratings analysis to capture a more holistic view of creditworthiness. Our comparable ratings analysis incorporates additional credit factors, which the criteria do not separately identify, as well as existing credit factors not fully captured, which may be informed by peer analysis.

Assessing The Business Risk Profile

12. We assess the BRP on a scale from '1' (excellent) to '7' (vulnerable) (see table 1 for the full scale) based on our analysis of the insurer's competitive position, modified by the IICRA specific to the insurer (see table 3). For instance, a competitive position of '2', or very strong, combined with an IICRA of '4', or moderately high, would lead to a BRP assessment of '3' (strong) unless otherwise modified.

Table 3

Business Risk Profile*

	--Competitive position (from table 4)--					
IICRA (from table 5)						
	1.Excellent	**2.Very strong**	**3.Strong**	**4.Satisfactory**	**5. Fair**	**6. Weak**
1. Very low or 2. Low	0	0	0	0	0	0
3. Intermediate	+1	0	0	0	0	0
4. Moderately high	+2	+1	+1	+1	+1	+1
5. High	+4	+3	+2	+2	+1	+1

Table 3

Business Risk Profile* (cont.)

IICRA (from table 5)	--Competitive position (from table 4)--					
	1.Excellent	2.Very strong	3.Strong	4.Satisfactory	5. Fair	6. Weak
6. Very high	+5	+4	+4	+3	+2	+1

IICRA--Insurance Industry And Country Risk Assessment. *Adjustments may apply.

13. The impact of the IICRA modifier for a given insurer from applying table 3 (represented by +1 to +5 in the table) may be mitigated by one or more categories if we determine that the IICRA materially overstates the specific industry and country risk exposures of the insurer. The IICRA modifier for a given insurer is increased by one or more categories (for example from +1 to +2) if we determine that the IICRA materially understates the specific industry and country risk exposures of the insurer.

14. We typically limit an insurer's BRP as follows when its reinsurance utilization exceeds:

- 20%: '2' (very strong);
- 40%: '3' (strong); or
- 60%: '4' (satisfactory).

Competitive Position

15. We assess an insurer's competitive position on a scale from '1' (excellent) to '6' (weak) (see table 4) based on our analysis of the following factors:

- Competitive advantage,
- Business diversity, and
- Profitability.

Table 4

Competitive Position Assessment

Assessment	What it typically means
Excellent	An insurer's competitive strengths make it highly resilient to adverse operating conditions. It has no material competitive weaknesses and substantial business diversity.
Very strong	An insurer's competitive strengths make it resilient to adverse operating conditions. It has no or very few material competitive weaknesses and broad business diversity.
Strong	An insurer's competitive strengths outweigh its weaknesses and make it somewhat resilient to adverse operating conditions.
Satisfactory	An insurer's competitive strengths and weaknesses are balanced and make it somewhat vulnerable to adverse operating conditions.
Fair	An insurer's competitive weaknesses somewhat outweigh its strengths and make it vulnerable to adverse operating conditions.
Weak	An insurer's competitive weaknesses outweigh its strengths and make it highly vulnerable to adverse operating conditions.

Competitive advantage

16. We typically consider the following sources of competitive advantage when assessing the sustainability of an insurer's profitability:

- Market or niche position,
- Scale or efficiency of operations,
- Brand name recognition or reputation, and
- Strength of distribution.

17. The competitive position assessment is typically limited to "fair" if we determine an insurer lacks competitive advantage.

Business diversity

18. We assess business diversity to identify those insurers that are likely to benefit from greater business stability and resilience to stress. We do not typically consider businesses or lines of business that add significant risk or that are unprofitable as contributing to an insurer's diversity. The competitive position assessment is typically limited to "strong" if we determine an insurer lacks broad business diversity.

Profitability

19. We consider the level, sustainability, and volatility of an insurer's profitability, including contributions from non-insurance businesses. We also consider the insurer's approach to optimize risk-adjusted returns and methods for evaluating and prioritizing strategic options. We will typically limit the competitive position assessment to "strong" if we determine an insurer's profitability is consistently weak.

20. If an insurer is less focused on maximizing profits or its related profitability ratios owing to its business model or ownership structure (such as a mutual), but these factors generate a material and sustainable competitive advantage, we will typically not view profitability as a weakness or a constraining factor in competitive position.

Insurance Industry And Country Risk Assessment

21. The IICRA addresses the risks typically faced by insurers operating in specific industries and countries. We may also analyze industry and country risk on a global basis for specific sectors. We assess the IICRA on a scale from '1' (very low) to '6' (very high).

22. To determine the IICRA, we assess the country risk and thereafter modify this with our assessment of industry risk (see table 5). For instance, a country risk of '4' (moderately high) combined with an industry risk of low would result in an IICRA of '3' (intermediate), unless otherwise modified.

Table 5

Insurance Industry And Country Risk

	--Country risk--					
Industry risk						
	1. Very low	**2. Low**	**3. Intermediate**	**4. Moderately high**	**5. High**	**6. Very high**
Low	+1	0	0	-1	-1	-1
Moderately low	+1	+1	0	0	0	0
Moderately high	+2	+1	+1	0	0	0
High	+3	+2	+2	+1	0	0

A negative modifier improves country risk whereas a positive modifier worsens country risk.

23. In cases where we determine that the balance of industry and country risks from applying table 5 materially understates or overstates the risks for the insurance sector of operating in a given country, the IICRA will be one category higher or lower, respectively, than indicated in table 5.

24. For insurers operating in more than one country or sector, we assign a combined IICRA assessment. We may adjust up or down by one category the combined relevant IICRAs for a given insurer to capture: (1) the directional trend of the overall IICRA; or (2) where the combination does not fully represent the relative exposure to industry and country risks.

25. We assess country risk on a scale from strongest to weakest of "very low risk" to "very high risk." Our analysis of country risk addresses the major factors that affect the country where the company operates--including economic; institutional, and governance effectiveness; financial system; and payment culture and rule of law risks. We apply country risk criteria to determine our country risk assessment (see Related Criteria).

26. We assess industry risk as "low," "moderately low," "moderately high," or "high." The analysis of industry risk addresses the level, volatility, and sustainability of profitability in a given industry sector. The primary factor in our industry risk analysis is an assessment of prospective profitability, supplemented by a holistic analysis of factors that in combination are likely to either support or threaten industry profitability prospects, such as barriers to entry, market growth prospects, product risk, and the institutional framework (see table 6).

Table 6

Industry Risk Assessment

Descriptor	What it typically means
Low	Strong prospective profitability with low potential impact of competition and product risk, and supportive institutional framework
Moderately low	Satisfactory prospective profitability with low to modest potential impact of competition or product risk and supportive institutional framework
Moderately high	Weak prospective profitability; or satisfactory prospective profitability with potentially material impact of competition or product risk
High	Weak prospective profitability and either high potential impact of competition or product risk, or an unsupportive institutional framework

Assessing The Financial Risk Profile

27. We assess the FRP on a scale from '1' (excellent) to '8' (vulnerable) based on our analysis of the insurer's capital and earnings, modified by risk exposure and funding structure (see table 7).

Table 7

Determining The Financial Risk Profile

	Capital and earnings assessment
	'1' to '8'
Risk exposure	
Low	-1*
Moderately low	0
Moderately high	+1
High	+2
Very high	+3 or more
Funding structure	
Neutral	0
Moderately negative	+1
Negative	+2 or more

*Does not apply if capital and earnings is '8'. Modifiers are cumulative. The impact of modifiers is floored at '1' and capped at '8'.

Capital And Earnings

28. We assess an insurer's capital and earnings on a scale of '1' (excellent) to '8' (vulnerable). If we determine the insurer is at significant risk of regulatory intervention, then we assess capital and earnings as '8' (vulnerable).

Table 8

Capital And Earnings Assessment

Score	Assessment	Description
1	Excellent	Projected capital and earnings are able to withstand an extreme stress.
2	Very strong	Projected capital and earnings are able to withstand a severe stress.
3	Strong	Projected capital and earnings are able to withstand a substantial stress.
4	Satisfactory	Projected capital and earnings are able to withstand a moderate stress.
5	Fair	Projected capital and earnings are able to withstand a modest stress.
6	Marginal	Projected capital and earnings are able to withstand a mild stress.
7	Weak	Projected capital and earnings are not able to withstand a mild stress, but we determine there is no significant risk of breaching the minimum regulatory capital requirements.
8	Vulnerable	Significant risk of breaching the minimum regulatory capital requirements.

29. In the absence of significant regulatory intervention risk, we assess capital and earnings on a forward-looking basis at the end of the forecast period. The projection does not typically raise the

assessment by more than two categories. This is to reflect the inherent uncertainties in projecting a sustainable improvement in capital and earnings.

30. We may adjust the capital and earnings assessment from applying table 8, typically by one category stronger or up to two categories weaker, if we determine the capital and earnings assessment for a given insurer is materially understated or overstated, respectively. We do not modify the capital and earnings assessment if we have assessed it as '8' (vulnerable).

31. Since a smaller insurer is likely to be more susceptible to an exogenous shock impairing capitalization, we typically limit the capital and earnings assessment (after applying table 8 and any adjustment) to '3' (strong) if we expect capital to be below approximately $100 million or equivalent, and to '4' (satisfactory) if we expect capital to be below approximately $25 million or equivalent.

Risk Exposure

32. We assess risk exposure on a scale of low risk ('1') to very high risk ('5') (see table 9) based on an analysis of the following:

- Risk controls,
- Risks not captured in our capital and earnings analysis,
- Risk concentrations or risk diversification, and
- Complexity of products and risks.

Table 9

Risk Exposure Assessment

Score	Descriptor	What it typically means
1	Low	The insurer's prospective capital and earnings have low volatility risk with respect to all material risks, the insurer has no material risk concentrations, and all material risks are captured in the capital analysis.
2	Moderately low	The insurer's prospective capital and earnings have moderately low volatility risk, there are no material risks that are not incorporated in the capital analysis, and no material risk concentrations exist.
3	Moderately high	The insurer's prospective capital and earnings have moderately high volatility risk, certain risks are not incorporated in the capital analysis, or risk concentrations exist and these may be material.
4	High	The insurer's prospective capital and earnings has high volatility risk or certain risks are not incorporated in the capital analysis, and material risk concentrations exist.
5	Very high	The insurer's prospective capital and earnings have very high volatility risk or certain risks are not incorporated in the capital analysis and significant risk concentrations exist, or some risk characteristics exist that could cause severe capital stress.

33. The risk exposure assessment considers material risks that the capital and earnings analysis does not incorporate and specific risks that it captures but that could make an insurer's capital and earnings significantly more or less volatile. The assessment is prospective and considers an insurer's risk appetite utilization. We also assess the effectiveness of the insurer's risk controls in limiting losses and mitigating volatility to levels within its risk appetite.

Risk controls

34. Our assessment of an insurer's risk exposure considers the effectiveness of risk controls in:

- Limiting (or exacerbating) losses across all risk categories to levels materially below (or above) the assumptions in our capital and earnings assessment; and
- Mitigating exposures that would typically lead to at least high volatility.

Risks not captured in our capital and earnings analysis

35. The typical risks that the capital and earnings assessment does not capture are items such as an insurer's exposure to postemployment defined-benefit obligations (including pension and retiree health care benefits), foreign exchange risk, and contingent liabilities not otherwise captured. These risks are material when we determine they may affect our capital and earnings assessment. In our assessment, we determine the aggregate impact of all risks not captured in our capital and earnings analysis.

Risk concentrations or risk diversification

36. We analyze an insurer's risk exposures to identify concentrations or diversification of risks that may lead to greater or less volatility in the capital and earnings assessment. A company that has highly diverse risk exposures is likely to exhibit less volatility. Conversely, risk concentrations can lead to volatility in capital and earnings.

Complexity of products and risks

37. We assess the likelihood that complex products and risks could introduce additional sources of capital and earnings volatility. These risks can also arise, for example, as an insurer innovates in new product areas, enters new markets or risk segments, or competes by offering more generous product features.

Funding Structure

38. We consider the risks posed by use of financial leverage and a significant amount of intangibles on the balance sheet. A company with high leverage and a low fixed-charge coverage ratio is likely to have less capacity and flexibility to withstand a stress scenario.

39. We assess an insurer's funding structure as "neutral," "moderately negative," or "negative." We will assess an insurer's funding structure as moderately negative when we determine the use of leverage materially increases the insurer's risk. If we believe this risk is significantly higher, we would assess an insurer's funding structure as negative. Otherwise, the assessment is neutral.

Other Modifiers

Governance

40. The analysis of governance covers a number of risk factors relating to an enterprise's risk culture and how it is governed; its relationship with shareholders, creditors, and other stakeholders; and how its internal procedures, policies, and practices can create or mitigate risk.

41. Our assessment of an insurer's risk culture focuses on the insurer's approach to managing its risk appetite framework, risk governance, risk communications and reporting, and the embedding of risk metrics in its compensation structure. The analysis also evaluates the degree to which there is a broad understanding and participation in risk management throughout the organization.

42. We assess governance as "neutral," "moderately negative," or "negative" to address certain governance-related risks not otherwise captured. We assess governance as "moderately negative" when we identify some material shortcomings in an organization's governance structures and as "negative" when we consider governance structures pose a severe risk to an insurer; otherwise it is "neutral." A governance deficiency is severe when it has the potential to impair the ability of the enterprise to execute strategy or manage its risks.

Liquidity

43. The liquidity analysis addresses an insurer's ability to cover its liquidity needs on a stressed basis. The analysis is absolute, rather than relative to peers. When assessing liquidity for a group, our analysis is based on a consolidated view including the holding company. We therefore do not assign a liquidity assessment to nonoperating holding companies (NOHCs). To determine a short-term rating on an NOHC, we apply the standard mapping in "Methodology For Linking Long-Term And Short-Term Ratings" (see Related Criteria).

44. We assess an insurer's liquidity on a scale of '1' to '4', where '1' is the strongest (see table 10). The two strongest assessments (of '1' and '2') do not affect an insurer's SACP or long-term ICR.

Table 10

Liquidity Assessment

Score	Descriptor	What it typically means
1	Exceptional	The liquidity ratio is favorable and there are no material liquidity risks.
2	Adequate	The liquidity ratio is adequate and there are no material liquidity risks.
3	Less than adequate	The liquidity ratio is unfavorable or there are factors that raise concerns over liquidity.
4	Weak	There is a severe risk to the insurer's liquidity.

45. We may adjust the liquidity assessment from applying table 10, typically by one category, when we believe the risk is materially over- or understated.

46. Without external support, less than adequate ('3') liquidity limits the SACP to 'bb+' and the ICR to 'BB+'. And, without external support, weak ('4') liquidity limits the SACP to 'b-' and the ICR to 'B-'.

47. We will limit the liquidity assessment to weak ('4') where we determine there is an appreciable likelihood that, incorporating a significant, but not extreme, downside, liquidity risk factors render the insurer unable to entirely service all its financial and policyholder obligations in a timely manner over the next 12 months.

48. We will limit the liquidity assessment to adequate ('2') where we determine the insurer's maturities beyond 12 months may not be manageable.

49. We analyze liquidity based on the following liquidity assumptions and considerations:

- Assets and liabilities typically exclude segregated funds and separate (or unit-linked) accounts.
- An insurer experiences immediate and unforeseen stress from withdrawals, surrenders, and lapses on life insurance policies over the next 12 months.
- Refinancing is unavailable for 12 months. Short-term debt is thus the sum of all debt and hybrid maturities over the next 12 months.
- Available liquid assets exclude posted collateral, or collateral that is otherwise encumbered or pledged (other than those related to insurance policyholder obligations).
- An analysis of committed credit facilities available for general financing or for backing up debt obligations (up to the issued amount), with a maturity sufficient to cover liquidity needs.
- An analysis of an insurer's exposure to rating triggers, collateral posting, and covenant requirements, restricted to material instruments and facilities to third parties (not group affiliates) where they may be cancelled or repriced with no stated and reasonably conservative cap.

Liquidity ratio

50. We assess the liquidity ratio as favorable, adequate, or unfavorable (see "Proposed Guidance: Insurers Rating Methodology" in the Appendix). The liquidity ratio is calculated based on our forward-looking view over the next 12 months, and it assesses the extent an insurer can cover its short-term debt and stressed insurance liability outflows over a one-year period with backup facilities and by converting assets to cash on a stressed basis. We may also include our expectations of net cash flows to the extent they are material and have a reasonably high certainty of occurring.

Rating An Insurer Above The Sovereign Rating

51. The application of these criteria may result in an SACP on a domestic unsupported insurer that is above the sovereign rating in the jurisdiction where the company has operations. See "Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions" (see Related Criteria) for details of when an insurer would be assigned a rating above the sovereign rating.

Assigning Issue Ratings To Instruments Other Than Equity Hybrids

52. This section addresses how we assign ratings to long-term nonpolicyholder obligations that are not deferrable or mandatorily convertible.

53. If the issuer is a holding company, we rate its senior unsecured debt at the same level as the ICR. If the ICR is 'BBB-' or higher, we rate debt that we consider to be subordinated one notch below the ICR; if the ICR is 'BB+' or lower, we rate debt that we consider to be subordinated two notches below the ICR.

54. If the issuer is an operating company, we rate senior debt at a lower level than the ICR when policyholders are senior to financial creditors. If the ICR on a company is 'BBB-' or higher, we rate the company's subordinated and senior unsecured debts one notch below the ICR. If the ICR is 'BB+' or lower, we rate the company's subordinated and senior unsecured debts two notches

below the ICR. When policyholders are not senior to financial creditors, we rate senior debt at the same level as the ICR and we rate debt that we consider to be subordinated either one or two notches below the ICR as described above.

APPENDIX: PROPOSED GUIDANCE: INSURERS RATING METHODOLOGY

Overview And Scope

55. This guidance document provides additional information and guidance related to our request for comment "Request For Comment: Insurers: Rating Methodology." It is intended to be read in conjunction with those criteria and provides additional information and guidance related to the analytical application of our methodology and assumptions. Guidance documents are not criteria, as they do not establish a methodological framework for determining credit ratings. Guidance documents provide guidance on various matters, including articulating how we may apply specific aspects of criteria; describing variables or considerations related to criteria that may change over time; providing additional information on nonfundamental factors that our analysts may consider in the application of criteria; and providing additional guidance on the exercise of analytical judgment under our criteria.

56. Our analysts consider guidance documents as they apply criteria and exercise analytical judgment in the analysis and determination of credit ratings. However, in applying criteria and the exercise of analytic judgment to a specific issuer or issue, analysts may determine that it is suitable to follow an approach that differs from one described in the guidance document. Where appropriate, the rating rationale will highlight that a different approach was taken.

General

57. When applying sections of the criteria or guidance that reference dollar-based values, we may consider how foreign-exchange translations affect an insurer's financial statements and information, and normalize these movements to the extent we deem analytically relevant.

Determining The Rating: Key Steps

58. Where table 1 indicates two possible outcomes, examples of how we may choose the anchor follow:

- The combination of a strong business risk profile and strong financial risk profile could result in an anchor of 'a' if we deem both of the assessments are in the upper end of the strong category. Conversely, we could choose an anchor of 'a-' if we deem both of the assessments to be closer to the satisfactory level.
- The combination of a strong business risk profile and fair financial risk profile could result in an anchor of 'bbb+' if in aggregate the assessment of the financial risk profile was closer to a satisfactory level.

Business Risk Profile

Competitive position

59. **Competitive advantage.** We assess the following sources of competitive advantage when analyzing an insurer's overall competitive position:

- Market or niche position if leading to an effective barrier to entry for other competitors or pricing power;
- Scale or efficiency of operations, allowing for lower overall expense ratios and either a pricing advantage or higher profitability for the insurer;
- Brand name recognition or reputation where the insurer is differentiated from the perspective of its current or potential policyholders or, where applicable, its intermediaries; and
- Strength of distribution, leading to improved control over the insurer's cost structure and either greater ability to execute on strategic initiatives or improved stability of revenues.

60. We consider these factors holistically when determining an insurer's overall competitive position. Any one of these factors, if a significant strength or weakness, could have a material impact on our overall view of the insurer's competitive positon.

61. We typically view an insurer as lacking competitive advantage when it is limited in scale and does not operate in an identifiable niche. For example, we would typically view an insurer that does not operate in an identifiable niche and is unable to sustain premiums (typically for non-life insurers) or assets (typically for life insurers) consistently above approximately $50 million as lacking competitive advantage.

62. **Business diversity.** When assessing an insurer's diversity, we typically consider the number of material lines of business or business segments, both insurance and non-insurance; geographic footprint; and the potential correlation between the lines of business or segments.

63. For example, we are likely to consider an insurer with three or more business segments, each contributing more than 20% to earnings, operating in multiple geographic regions, with earnings patterns that are not highly correlated, to have business diversity.

64. **Profitability.** We typically assess profitability using one or more of the following metrics, depending on the sector(s) in which the insurer operates:

- Return on equity (all insurers);
- Return on assets (typically life insurers);
- Prebonus, pretax earnings divided by total assets (typically life insurers);
- Return on revenue (typically non-life insurers); and
- Combined ratio, net of ceded reinsurance (typically non-life insurers).

65. We may supplement these with other ratios where we deem them to be relevant for a particular sector.

66. Profitability, over time, is a likely consequence of a healthy competitive position. We would typically expect an insurer that has a stronger overall competitive position to exhibit consistently higher and more stable profitability metrics compared to its competitors. We typically determine

an insurer's competitors based on whether they compete within similar lines of business or similar markets.

67. When considering the level, sustainability, and volatility of an insurer's profitability, we may also consider the riskiness of the insurer's product offerings relative to peers with the same IICRA. For example, an insurer with low-risk products, leading to more stable profitability, may be viewed more favorably than a peer with a similar level of profitability who has higher-risk products that lead to more volatile profitability.

68. Our assessment of an insurer's profitability is informed by our view of the insurer's approach and methods for optimizing risk-adjusted returns and the underlying risk/reward rationale, and we may also consider the context of prevailing inflation and interest rates. Risk-adjusted return optimization is the process by which insurers are able to form a view on prospective profitability when taking into account the required risk capital.

69. We typically assess how an insurer optimizes its risk-adjusted returns and how it executes consistent and effective risk-return analysis in key areas, such as:

- The company's strategic planning,
- Product pricing and repricing,
- Strategic asset allocation,
- Reinsurance strategy and net retained risk profile,
- New risk-bearing initiatives (including mergers and acquisitions, and entry into new markets), and
- Capital and economic capital budgeting.

70. We view favorably a well-defined process for allocating capital among different products, lines of business, and risk factors we believe will lead to sustainable profitability. Our analysis focuses not only on the choice and outcome of the strategic decisions, but, more importantly, on the risk/reward rationale underlying the insurer's chosen strategy and consistency with its risk appetite, and the potential evolution of that strategy and competitive position.

Insurance Industry And Country Risk Assessment

71. For an insurer operating in more than one market, we combine the IICRAs, reflecting the exposure to the markets in which the insurer operates. Typically, we measure these exposures using gross premium written, insurance liabilities, or insured exposure in those markets. We combine the IICRAs from the insurer's main markets to cover at least 80% of its exposures, including all countries representing more than 5%, and up to 20 countries.

72. For a country or sector with no IICRA, we use the IICRA of the country-sector combination whose country and industry characteristics we consider most similar to those of the country or sector where the insurer operates.

73. **Global industries.** Insurers operating in the property and casualty (P/C) reinsurance, life reinsurance, trade credit insurance, and marine protection and indemnity (P&I) sectors are assigned the sector's global score for the relevant proportion of their business. We typically assess the country risk for these global sectors as intermediate risk.

74. However, if an insurer or reinsurer in these four sectors focuses on a single country or region, we apply IICRAs at a country level.

75. **Profitability.** We use relevant metrics that reflect the return prospects of the industry, consistent with the profitability metrics applied in our competitive position assessment.

76. We consider profitability within the context of our determination of whether there is excessive risk taking within the sector, and we may consider this in the context of prevailing inflation and interest rates. We may determine excessive risk taking is occurring where we perceive that any of the following characteristics exists:

- The industry has significantly relaxed its underwriting standards,
- New and unproven products have been introduced and are growing rapidly,
- Miss-selling risk is heightened,
- Commissions to intermediaries have significantly increased, or
- Premiums are insufficient to achieve long-term profitability.

77. **Product risk.** We assess sources of product risk stemming from business written, liabilities, and matching assets, if relevant. For example, exposure to significant "tail" risks across the industry. When material sectorwide risk exposures are comprehensively and effectively reinsured or otherwise mitigated, we recognize this in our consideration of product risk. High product risk is typically a negative factor in our industry risk analysis.

78. **Barriers to entry.** Barriers to entry that we typically assess are regulatory and operational. Low barriers to entry are typically a negative factor in our industry risk analysis.

79. **Market growth prospects.** Market growth prospects are an indicator of the levels of maturity and competition within the market and, consequently, the sustainability of profit levels. We base the assessment on the growth of (or contraction in) the market, generally based on premiums or assets. We view a market that we expect to contract in real terms as a negative factor.

80. **Institutional framework.** We base our assessment of the strength of the institutional framework on our views of the regulatory framework, its application, and on the standards of governance and transparency. If we determine that regulation is not effective or that there is a clear deficiency in the standards of either governance or transparency for the industry, it will be a negative factor for industry risk.

81. Our assessment is informed by the depth and frequency of monitoring of insurers and the regulator's track record of intervention to reduce or mitigate the effects of insurer failures. A regulatory framework that is comprehensive and effective for the authorization and ongoing supervision of insurers with incentives for good risk management is a supportive factor.

82. We assess governance standards by evaluating the balance of stakeholder interests among owners, managers, lenders, and policyholders. We consider that corporate governance that is transparent, prudent, and independent of undue external influences is supportive of lower risk for an insurance industry. Conversely, opaque or imprudent governance that does not materially constrain those external influences increases that risk. We assess transparency by evaluating the frequency and timeliness of reporting, the quality and standardization of financial reports, and the quality of accounting and disclosure standards.

Financial Risk Profile

Capital and earnings

83. **Capital and earnings assessment.** We typically apply our capital model criteria and the following table to determine our capital and earnings assessment (C&E assessment):

Table 11

Capital And Earning Assessment

Assessment	Description
Excellent	Prospective TAC is at or above the prospective RBC requirement at the 'AAA' confidence level.
Very strong	Prospective TAC is below the prospective RBC requirement at the 'AAA' confidence level but at or above the prospective RBC requirement at the 'AA' confidence level.
Strong	Prospective TAC is below the prospective RBC requirement at the 'AA' confidence level but at or above the prospective RBC requirement at the 'A' confidence level.
Satisfactory	Prospective TAC is below the prospective RBC requirement at the 'A' confidence level but at or above the prospective RBC requirement at the 'BBB' confidence level.
Fair	Prospective TAC is no more than 30% below the prospective RBC requirement at the 'BBB' confidence level.
Marginal	Prospective TAC is more than 30% below but no more than 60% below the prospective RBC requirement at the 'BBB' confidence level.
Weak	Prospective TAC is more than 60% below the prospective RBC requirement at the 'BBB' confidence level and there is no significant risk of breaching the minimum regulatory capital requirements.
Vulnerable	Significant risk of breaching the minimum regulatory capital requirements.

TAC--Total adjusted capital. RBC—Risk-based capital.

84. When determining whether to adjust the C&E assessment, we consider the net impact of all relevant factors and our determination of the magnitude of the understatement or overstatement of the capital and earnings assessment from applying table 1. We also consider the relative strength or weakness within the C&E assessment category.

85. We typically consider the following or other information in making our determination of whether capital and earnings is understated or overstated:

- If the assumptions in our capital and earnings analysis materially under- or overstate the insurer's risks;
- If the assumption of capital fungibility and risk diversity in our consolidated capital analysis overstates capital and earnings owing to legal, contractual, or regulatory restrictions;
- If the insurer has a propensity for acquisitions or uncertain shareholder distributions that we are unable to reliably quantify;
- Excessive growth in insured exposures if we assess that management does not have the capacity to manage increases in risk exposures;
- If the insurer is more vulnerable to losses than those assumed under the capital model--for example, where capital is consistently under approximately $1 billion or equivalent; or
- If the composition of capital relies primarily on weaker forms of capital to support the C&E

assessment. We typically consider value of in-force, discount on P/C reserves, and hybrid/debt instruments as weaker forms of capital.

86. For purposes of considering limits to the C&E assessment, we base our assessment of capital on total adjusted capital as defined in our capital model criteria.

Risk exposure

87. **Risk controls.** We typically consider an insurer's risk control program is effective when it:

- Identifies, measures, monitors, and manages the risk exposures;
- Has a track record of effectively managing risk exposures to remain within its defined risk tolerances and limits, even during stressful periods;
- Has an established risk-specific risk management structure that comprehensively identifies risk exposures from all sources;
- Employs risk monitoring and risk reporting in a timeframe appropriate for the risk profile;
- Has a formal and clearly communicated risk limit system that is linked to its risk appetite;
- Uses effective risk mitigation strategies to proactively contain exposures to be within risk limits; and
- Has clearly defined risk limit enforcement policies that address risk limit breaches in an effective and timely manner.

88. We view risk controls in the context of the efficacy of the controls in managing and mitigating risk exposures to a level that is consistent with the company's risk tolerances and limits.

89. We may give greater consideration to those risk controls that we determine are of greater importance based on the insurer's exposures. For example, we will give greater weight to market risk controls for an insurer with a large variable annuity business with living benefit guarantees or a large life with-profits business, than for a P/C insurer with only short-term liabilities and limited equities and real estate in its investment portfolio.

90. An example of how risk controls affects risk exposure is as follows: An insurer has exposures that we would otherwise consider high risk, but we determine that the insurer's risk controls are effective at limiting the potential volatility in capital and earnings to levels consistent with a moderately high assessment for risk exposure.

91. **Risks not captured in our capital and earnings analysis.** When assessing the impact of risks not captured in our capital and earnings assessment, and whether they may have a material impact, we will consider any mitigants to the risk. For example, an insurer may have an employee benefit plan, with liabilities that are material relative to capital. Where such a plan is underfunded, it may give rise to considerable volatility in capital and earnings. We may consider this risk to be limited where there is a track record of strong and sustainable overfunding.

92. **Risks concentrations or risk diversification.** Risk concentrations can potentially cause an insurer's capital and earnings to be more volatile. We typically assess concentrations net of risk mitigation (e.g., hedging, reinsurance, or collateral) where we determine the mitigants are effective. The source of concentrated risk exposures can include credit exposures relating to assets, reinsurance, hedge, or other counterparties; market risks relating to FX, interest rates, or equities; geographic mortality concentrations; and geographic P/C catastrophe event

concentrations. Examples include:

- A concentrated credit exposure to a small number of reinsurers or hedge counterparties or to investments in a small number of obligors or single sector or industry;
- A material exposure to high risk assets (see glossary) in the investment portfolio or through reinsurance or other counterparties;
- Material potential aggregations in casualty claims (sometimes referred to as casualty clash); and
- Material potential geographic aggregations in property risk.

93. **Complexity of products and risks.** Complex products and risks can potentially cause an insurer's capital and earnings to be more volatile. Examples include:

- For life insurers that issue variable annuities with guaranteed living benefits, unhedged market exposures that have significant potential to cause volatility;
- Material exposure to terrorism, cyber, or emerging risks;
- Material deficiencies in reinsurance protection relative to the risk profile;
- Large discrete portfolios of legacy liabilities with significant potential for volatility; and
- Material exposure to certain long-tail businesses such as workers' compensation and long-term care.

Funding structure

94. Our assessment of funding structure is informed by one or more of the metrics below and is dependent on analysis of a company's capital structure and individual characteristics:

95. **Financial leverage.** We will typically assess funding structure as moderately negative when we expect leverage to exceed 40%, and negative when we expect it to exceed 50%.

96. We may weaken our assessment of funding structure when we consider an insurer with leverage close to these thresholds that also has significant intangibles relative to its equity.

97. We may weaken our assessment of funding structure when we consider an insurer's financial leverage is close to these thresholds but understated due to material distortions in reported balances. Consider the following examples:

- Where there is an accounting mismatch between the valuation of assets and liabilities, we may determine reported equity is overstated by the inclusion of unrealized gains on bonds backing life insurance liabilities.
- Where we believe significant deficiencies exist in reported liabilities, we may determine reported equity is overstated, and therefore the financial leverage ratio is understated.

98. If we determine that reported equity is materially understated, we may consider it a potential mitigant to the risk from leverage identified in the funding structure assessment when financial leverage is close to these thresholds but overstated due to material distortions in reported balances. For example, we may determine reported equity is understated and therefore the financial leverage ratio is overstated where we believe significant redundancies exist in reported liabilities (e.g., the value of in-force life business).

99. **Fixed charge coverage.** We may weaken our assessment of funding structure by one or more categories when we expect coverage to remain less than 4x. If an insurer's fixed charge coverage ratio raises concerns about the sustainability of its financial leverage, even when greater than 4x, we may weaken our assessment of funding structure by one or more categories.

100. **Financial obligations to EBITDA.** We may weaken our assessment of funding structure by one or more categories when we expect the financial obligations to EBITDA ratio to remain greater than 4x. If this ratio raises concerns about the sustainability of financial leverage, even when less than 4x, we may weaken our assessment of funding structure by one or more categories.

101. We may also weaken our assessment of funding structure if we consider use of operational leverage to significantly increase the insurer's risk.

102. A company's ability and willingness to change its capital structure--such as the demonstrated ability to raise equity through public markets in times of stress--is a potential mitigant to the risk from leverage identified in the funding structure assessment.

Other Modifiers

Governance

103. We will typically assess governance as moderately negative if an insurer displays material shortcomings in any of the following areas:

- The board's independence from management to provide effective oversight of it;
- The board's control as the final decision-making authority with respect to key enterprise risks, compensation, or conflicts of interest;
- Presence of professional and independent board of directors that is engaged in risk oversight on behalf of all stakeholders, including noncontrolling interests;
- Suitability and transparency of accounting policy choices;
- Regulatory, tax, or legal infractions; or
- Consistent and effective communication to stakeholders, including controls around financial reporting.

104. If these pose a severe risk to the insurer, we would typically assess governance as negative.

105. **Risk management culture.** Our view of the insurer's risk management culture informs our assessment of governance. In particular, we focus on the following key areas:

- Risk governance. We typically consider the extent to which the risk management culture is embedded in the organization and characterized by a well-defined and independent enterprise risk management (ERM) governance structure that supports effective risk management at an enterprise level. We view negatively a lack of support by the Board of Directors and senior management for ERM, and insufficient active involvement in the ERM process.
- Risk appetite framework. We consider the process by which desired risks are identified, the risk appetite is developed, how overall risk tolerances are established, and how the ERM framework supports the effective selection, mitigation, management, and optimization of risk. We view unfavorably an insurer that maintains aggressive or poorly defined risk tolerances, or has a risk tolerance that is inconsistent with its risk appetite framework.

- Risk reporting and communication. We view unfavorably a failure to disclose, or limited internal communications of, risk exposures to the Board of Directors. We also view unfavorably internal risk reporting that is not frequently updated, not granular enough to reflect significant risk exposures, or not communicated consistently.
- Incentive compensation structures. We view negatively compensation structures that are inconsistent with the insurer's strategic long-term goals and objectives, or that are not based on an analysis of risk/return tradeoffs.

Assessing liquidity

106. We typically assess the liquidity ratio as favorable when it exceeds 2.2x, adequate when between 1x and 2.2x, and unfavorable when less than 1x.

107. We define the liquidity ratio as:

$$\frac{\text{Stressed liquid assets + backup facilities}}{\text{Stressed insurance liability outflows + short term debt}}$$

108. We typically include as liquid assets most publicly traded common stocks and bonds, money market instruments, deposits, and cash. We subject the values of liquid assets to the following haircuts for the liquidity analysis to determine stressed liquid assets:

- Listed equities: 50%
- Bonds rated 'BBB-' or higher: 10%
- Bonds rated 'BB'/'B' categories: 35%
- Bank deposits with a bank rated 'BBB-' or higher: 1%
- Bank deposits with a bank rated 'BB'/'B' categories: 5%
- Other asset classes including the following: Investment in affiliates; hedge fund investments; private placements with a mandatory minimum holding period of one year or greater; bonds rated in the 'CCC' category or lower; unrated bonds and loans, except if demonstrably of a creditworthiness equivalent to the above ratings; private equities; privately held loans and mortgages; property; posted collateral or collateral that is otherwise encumbered or pledged (other than those related to insurance policyholder obligations); and any other assets that don't fit any of the above categories, as well as assets held in certain ownership situations or assets that we believe would only be transferred at a significantly discounted price: 100% charge
- We may include (or adjust for) certain entity- or sector-specific assets when material, provided that the insurer can demonstrate that it is possible to convert them promptly into cash. The applicable charge would be one of the above, based on a review of its specific liquidity characteristics.

109. Backup facilities include only committed credit facilities for general financing or for backing up debt obligations (up to the issued amount)--in both cases with a maturity sufficient to cover liquidity needs (e.g., for liquidity requirements arising in the next 12 months, the credit facilities do not mature within 12 months) and only those provided by banks of a credit quality equivalent to

'BBB-' or higher. The analysis typically includes amounts drawn as a liquidity requirement and the entire size of the facility as a resource. Alternatively, the analysis can ignore the amounts drawn, but then consider as a liquidity resource only the facility's undrawn amount. If credit facilities are provided by banks of a credit quality equivalent to 'BB+' or lower, we may consider inclusion of the backup facility in situations where the bank providing the backup facility is rated more highly than the insurer.

110. To determine stressed insurance liability outflows, we typically consider (where applicable for the respective insurer) the following:

- Stressed insurance liability outflows are typically defined as: {(net non-life claim reserves + net non-life reserve charge)/non-life claims reserve duration} + net property catastrophe charge + net non-life premium charge + net trade credit exposure charge + 35% (life liabilities that are subject to withdrawal, surrender, or lapse risk);
- The non-life claims reserves duration reflects the insurer's mean term of claims reserves and is subject to a floor of one year;
- The net non-life reserve charge, net non-life premium charge, net property catastrophe charge, and net trade credit exposure charge are typically equal to the respective 'A' confidence level charges from the capital model; and
- Our expectations of any significant delays in reinsurance claim recoveries or reinsurance reinstatement premiums.

111. We typically include in debt maturities hybrid securities with simultaneous call and step-ups, since we assume for the purposes of the liquidity assessment that the issuer will call the instruments.

112. We typically consider whether an insurer's liquidity resources are sufficient to cover the following exposures, where material, under moderate stress:

- Rating triggers,
- Collateral posting requirements,
- Covenant requirements, and
- Confidence sensitive liabilities.

113. Examples of where we may weaken our liquidity assessment include:

- We believe a large proportion of a company's life liabilities are highly likely to be paid out (e.g., through surrenders or lapses) in the near term due to an event (e.g., M&A or negative reputational developments).
- (b) We determine there are regulatory or other provisions that may significantly restrict the flow of cash and liquid assets among legal entities within a rated group.

Sector-Specific Applications

114. The sector-specific applications provide additional details on applying the criteria to specific subsectors or situations (such as start-ups and run-offs).

Bond insurance

115. **Competitive position.** For bond insurance, operating return on equity is the primary metric that informs our view of the sector's and insurer's earnings. When operating return on equity is not available, we use the typical metrics for the P/C insurance sector.

116. **Capital and earnings.** We typically apply a separate capital model for bond insurers, as detailed in the Bond Insurance Capital Adequacy criteria (see Related Criteria), and the following table to assess capital and earnings:

Table 12

Capital And Earnings Assessment--Bond Insurers

Assessment	Description
Excellent	Capital adequacy ratio at or greater than 1.0x
Very strong	Capital adequacy ratio at or greater than 0.9x and less than 1.0x
Strong	Capital adequacy ratio at or greater than 0.8x and less than 0.9x
Satisfactory	Capital adequacy ratio at or greater than 0.6x and less than 0.8x
Fair	Capital adequacy ratio at or greater than 0.45x and less than 0.6x
Marginal	Capital adequacy ratio at or greater than 0.25x and less than 0.45x
Weak	Capital adequacy ratio less than 0.25x and there is no significant risk of breaching the minimum regulatory capital requirements
Vulnerable	Significant risk of breaching the minimum regulatory capital requirements

117. **Risk exposure.** For bond insurers, we also consider exposure to self-insured bonds, the largest obligor test, and growth in exposures.

118. We typically view self-insured bonds in the investment portfolio of greater than approximately 10% of total insured bonds as a risk concentration that could cause an insurer's capital and earnings to be more volatile.

119. The largest obligor test is calculated as the greater of the stressed losses resulting from a default scenario of:

- The two largest exposures rated 'AAA' or lower
- The three largest exposures rated lower than 'AAA'
- The four largest exposures rated lower than 'AA-'
- The six largest exposures rated lower than 'A-'
- The eight largest exposures rated lower than 'BBB-'
- The 10 largest exposures rated lower than 'BB-'
- The 12 largest exposures rated lower than 'B-'

120. This test excludes exposures already in default because the financial impact of these defaults is already incorporated in the rating on the insurer.

121. We calculate stressed losses by multiplying the par value of the obligation by 100% minus the recovery parameter. Recovery parameters by risk category for U.S. municipal and non-U.S. local

and regional governments (LRGs) are in table 13. For corporate and non-LRG public-sector issuers, the recovery parameter is 5%. Stressed loss potentials for structured finance exposures are determined on an individual transaction basis using the same credit-gap concept employed to determine capital charges.

Table 13

U.S. Municipal And Non-U.S. Local And Regional Government Recovery Parameters For Largest Obligors Test

Risk category	Recovery (%)
1 and 2	60
3 and 4	30

See the BI capital adequacy criteria article listed in the Related Criteria And Research section for details on the applicable category for a given issuer.

122. The greatest of the stressed loss totals, calculated as defined above, is expressed as a percent of the bond insurer's capital. Typically, if the result is 25% or greater, the outcome of the test would be viewed as a risk concentration that could cause an insurer's capital and earnings to be more volatile.

123. **Liquidity.** For bond insurers, stressed insurance liability outflows typically includes our view of loss and loss adjustment expenses reserves payable in the next 12 months, and may incorporate our prospective view of additional loss events.

Mortgage insurance

124. **Capital and earnings.** We typically apply a separate capital model for monoline primary mortgage insurers, as detailed in "Methodology: Mortgage Insurer Capital Adequacy," and the following table to assess capital and earnings:

Table 14

Capital And Earnings Assessment--Mortgage Insurers

Assessment	Description
Excellent	Prospective sources of capital are at or above prospective uses at the 'AAA' stress level.
Very strong	Prospective sources of capital are below the prospective uses at the 'AAA' stress level but at or above the prospective uses at the 'AA' stress level.
Strong	Prospective sources of capital are below the prospective uses at the 'AA' stress level but at or above the prospective uses at the 'A' stress level.
Satisfactory	Prospective sources of capital are below the prospective uses at the 'A' stress level but at or above the prospective uses at the 'BBB' stress level.
Fair	Prospective sources of capital are below the prospective uses at the 'BBB' stress level but at or above the prospective uses at the 'BB' stress level.
Marginal	Prospective sources of capital are below the prospective uses at the 'BB' stress level but at or above the prospective uses at the 'B' stress level.
Weak	Prospective TAC sources of capital are below the prospective uses at the 'B' stress level and there is no significant risk of breaching the minimum regulatory capital requirements.
Vulnerable	Significant risk of breaching the minimum regulatory capital requirements.

125. **Liquidity.** For mortgage insurers, the net non-life reserve charge and the net non-life premium charge are typically equal to the respective 'A' confidence level charges from the insurance capital model. In cases where net premiums written does not essentially reflect the off-balance-sheet mortgage risk exposure, we may typically use net premiums earned or incorporate a prospective view of additional losses.

Title insurance

126. **Capital and earnings.** We view claim reserves and statutory premium reserves as capital available to absorb losses that are therefore added to TAC. Most title-specific assets, such as title plants and agent balances, are written off. To calculate liability risks, we incorporate 7.5% as our base case for likely losses on the insured portfolio. The base case is based on our analysis of the relationship (from Schedule P of the statutory statements) of reserves to premiums for the industry. To stress the base case, we apply the multiples shown in table 15.

Table 15

Liability Risk Calculation

Rating-based stress	Multiple	Resulting gross charge (% of premiums)
AAA	5.0	37.50
AA	3.1	23.25
A	2.1	15.75
BBB	1.5	11.25
BB	1.2	9.00
Base	1.0	7.50

127. To determine interest rate risk, we apply the interest rate risk methodology described in our capital model criteria.

128. In view of the revenue volatility inherent in the title industry, the operating risk charge reflects a scenario in which revenue falls while expense reductions lag. In our experience, the largest year-to-year increases in statutory expense ratios are about 5%. We extrapolate charges for other stress levels as shown in table 16:

Table 16

Operating Risk Calculations

Rating-based stress	Multiple	C-4 (% of operating income)
AAA	(5.0/2.1) = 2.38	11.9
AA	(3.1/2.1) = 1.48	7.4
A	(2.1/2.1) = 1.00	5.0
BBB	(1.5/2.1) = 0.71	3.6

129. For title insurers, we typically incorporate the liability risk charge and insurance operating risk charge in lieu of premium and reserve risk charges (as defined above) equal to the respective 'A' confidence level in our consideration of stressed insurance liability outflows.

Start-up insurers

130. An insurer that lacks a track record of past performance is typically considered a start-up. We typically assess the competitive position assessment no higher than fair for a start-up insurer given its lack of a track record of sustainable profitability by which it could demonstrate its competitive advantage. We typically assess capital and earnings no higher than strong, and may weaken our capital and earnings assessment from applying table 8 by one category to reflect the inherent uncertainties in projecting capital and earnings for an insurer during its start-up phase. For a start-up, we do not assess risk exposure as low.

Insurers in run-off

131. We would typically consider an insurer (or group) that fully or substantially closes to new business to be in run-off. We typically assess the competitive position assessment as no higher than fair for a run-off insurer given the lack of competitive advantage. An insurer that is active in acquiring closed life blocks (sometimes referred to as a closed-fund consolidator) is not considered an insurer in run-off.

Glossary

132. We typically define the ratios as referenced in the Glossary, and may reflect analytical adjustments for nonrecurring items or to otherwise take into consideration issuer-specific reporting conventions.

133. **Bond insurers.** In these criteria, this includes bond insurers, financial guarantors, and companies with similar product offerings.

134. **Combined ratio.** The ratio of the sum of loss expense, loss adjustment expense, and operating expenses divided by premiums earned. All elements are net of ceded reinsurance. We may use net premiums written (NPW) in the denominator where net premiums earned is not available or where expenses are not deferred in the accounting system the insurer uses (e.g., U.S. statutory accounting).

135. **Covenant requirement.** Refers to the most-stringent level that, if breached, is defined as an event of default under the documentation. The level of ratio-based covenants is that calculated from the insurer's most recent financial statements.

136. **EBIT.** The sum of profit before tax and interest expense. We may apply analytical adjustments for items such as nonrecurring events; realized investment gains/losses; or impairments to goodwill.

137. **EBITDA.** Earnings before interest (other than interest on operational leverage), taxes, depreciation, and amortization. We may apply analytical adjustments for items such as nonrecurring events; realized investment gains/losses; impairments to goodwill; or other non-cash items. Where we believe depreciation and amortization is immaterial, we may use EBIT.

138. **Fixed-charge coverage.** EBITDA/fixed charges. Fixed-charge coverage represents an insurer's ability to service interest on financial obligations out of EBITDA. Fixed charges include total interest expense including interest expense reported as investment expense, estimated operating lease interest expense and preferred stock dividends (net of tax), minus any interest expense on operational leverage.

139. **Financial leverage.** Financial obligations/(reported equity + financial obligations). We deduct from reported equity any off-balance-sheet pension deficit, net of tax, and any financial obligations included in reported equity, such as preferred stock.

140. **Financial obligations.** Includes total debt as reported plus the net present value of operating leases treated as debt, pension deficit (net of tax), any hybrids reported as equity such as preferred stock, debt reported in other liabilities, long-term capital leases, and other financial obligations adjustments, minus any debt that we consider to be either nonrecourse or operational leverage.

141. **Financial obligations/EBITDA.** Determines the number of years of normalized earnings required to pay back debt and is another measure of the sustainability of the level of debt taken on by an insurer.

142. **High risk assets.** We typically include the following in our definition of high risk assets:

- Fixed-income investments or deposits in institutions that are rated 'BB+' or lower;
- Unrated bonds and loans, except if demonstrably of a credit quality equivalent to 'BBB-' or higher;
- Unaffiliated equity investments in common stocks and preferred stocks (unless rated investment grade);
- Investments in equity real estate assets (except for own use), investments in partnerships, joint ventures, and other alternative investments; and

143. For the purposes of this assessment, and where material, we may consider assessing the credit quality of unrated assets using alternative measures, such as a credit estimate.

144. **Insurance or insurers.** In these criteria, unless otherwise stated, these terms include reinsurance and reinsurers.

145. **Life insurance.** We define insurance sectors broadly as life and non-life, as well as primary and reinsurance segments within those sectors. We typically consider life insurance to encompass individual life protection, individual long-term health protection, group life and health protection, group pension, unit-linked or separate account savings (including U.S. variable annuities), non-unitized savings (including with-profit and U.S. fixed annuities), and annuities (or pensions) in payment.

146. **Non-life insurance.** We define insurance sectors broadly as life and non-life, as well as primary and reinsurance segments within those sectors. We typically consider non-life insurance to encompass auto or motor (liability and property); personal property; commercial property; ships, aircraft, and cargo (liability and property); workers' compensation or employers' liability; other liability; personal accident and short-term health; and credit, surety, financial lines, or pecuniary.

147. **Operational leverage.** Includes debt that we determine is not for general corporate purposes.

148. **Operating return on equity (operating ROE, for bond insurers).** The ratio of operating income (net income excluding aftertax realized gains or losses on investments; aftertax unrealized gains or losses on credit derivatives, with the exception of credit impairments on those derivatives; and fair-value adjustments related to the company's credit risk) divided by equity. Equity excludes the accumulation of other comprehensive income and aftertax unrealized gains or losses on credit derivatives, with the exception of credit impairments on those derivatives, and fair-value

adjustments related to the company's own credit risk.

149. **Reinsurance utilization ratio.** For life insurers, the ratio is ceded reserves over gross reserves. For property and casualty insurers, the ratio is ceded premiums written over gross premiums written. We typically exclude captives and other forms of nonrisk transfer reinsurance (e.g., financial, block divestitures, and acquisitions executed as reinsurance).

150. **Return on assets (ROA).** EBIT divided by the average of opening and closing total assets (less reinsurance assets) for the year.

151. **Return on equity (ROE).** Reported net income divided by the average of opening and closing reported equity for the year. Reported net income is before remuneration of preferred and minority shareholders. Reported equity includes minority interests and preferred stock.

152. **Return on revenue (ROR).** EBIT divided by total revenue. Total revenue is the sum of net premiums earned (or NWP if NPE is not available), net investment income, and other income. We remove the effects of realized and unrealized gains or losses from investments and derivatives to provide a more complete picture of an insurer's revenue-generating abilities.

153. **Risk appetite utilization.** An insurer's current exposure relative to its risk appetite.

154. **Prebonus, pretax earnings divided by total assets.** Prebonus pretax earnings are the sum of EBITDA and policyholder dividends. Total assets is the average of opening and closing total assets (less reinsurance assets) for the year.

155. **Single sector or industry.** Sectors may be aggregated as follows:

- Nondomestic government obligations: Aggregated by jurisdiction.
- Non-U.S. obligations of local and regional governments: Aggregated on a national basis.
- U.S. municipal bonds: Tax-backed and appropriation-backed government obligations, municipal water sewer obligations, and public university obligations are aggregated by state, and each state is viewed as a sector. In addition, the following types of municipal bonds are viewed as individual sectors on a national basis: private education, health care, housing revenue, transportation, public power and other utilities, and other not-for-profit obligations.
- Structured finance: By country, each of the following is defined as a sector: residential mortgage-backed securities; commercial receivables; autos; credit cards; student loans; commercial real estate, including commercial real estate collateralized debt obligations (CDOs); CDOs of asset-backed securities; all else, including corporate CDOs.
- Corporate securities: Sectors as defined under S&P Global Ratings' Global Industry Classification Standard (GICS).

RELATED CRITERIA AND RESEARCH

Criteria To Be Superseded

- Methodology: Treatment Of U.S. Life Insurance Reserves And Reserve Financing Transactions, March 12, 2015
- Key Credit Factors For The Mortgage Insurance Industry, March 2, 2015

- Methodology For The Classification And Treatment of Insurance Companies' Operational Leverage, Oct. 31, 2014
- Key Credit Factors For Title Insurers, Sept. 22, 2014
- Methodology And Assumptions: Industry And Country Risk Assessment For Bond Insurers, Sept. 16, 2014
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Bond Insurance Rating Methodology And Assumptions, Aug. 25, 2011
- Liquidity Model For U.S. And Canadian Life Insurers, April 22, 2004

Criteria To Be Partly Superseded

- Group Rating Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Related Criteria

- Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology: Mortgage Insurer Capital Adequacy, March 2, 2015
- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- A New Level Of Enterprise Risk Management Analysis: Methodology For Assessing Insurers' Economic Capital Models, Jan. 24, 2011
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Credit Stability Criteria, May 3, 2010

Related Research

- Request For Comment: Methodology And Assumptions For Analyzing Bond Insurance Capital Adequacy, Dec. 3, 2018
- S&P Global Ratings Definitions, Oct. 31, 2018

The proposed criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Once proposed criteria become final, their use is determined by issuer- or issue-specific attributes as well as our assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.

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