RFC Process Summary:

Insurers Rating Methodology

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ANALYTICAL CONTACTS

Simon Ashworth
London
(44) 20-7176-7243
simon.ashworth@spglobal.com

Taos D Fudji
Milan
(39) 02-72111-276
taos.fudji@spglobal.com

Ali Karakuyu
London
(44) 20-7176-7301
ali.karakuyu@spglobal.com

Hardeep S Manku
Toronto
(1) 416-507-2547
hardeep.manku@spglobal.com

Peggy H Poon, CFA
New York
(1) 212-438-8617
peggy.poon@spglobal.com

Eunice Tan
Hong Kong
(852) 2533-3553
eunice.tan@spglobal.com

See complete contact list at end of article.

On Dec. 3, 2018, S&P Global Ratings published a request for comment (RFC) on its proposed revisions to the methodology it uses to rate insurance entities. Following feedback from the market, we finalized and published our criteria, titled "Insurers Rating Methodology," on July 1, 2019.

We'd like to thank investors, issuers, and other market participants who provided feedback. This article provides an overview of the changes between the RFC and the final criteria, and the rationale behind those changes.

Summary Of Changes

Our RFC included several questions on which we asked feedback:

- 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?

Respondents addressed these and other issues, and expressed a general appreciation for the greater clarity and transparency of the criteria, as well as our efforts to consolidate several criteria articles. In certain cases, respondents provided feedback, including requests to issue further RFCs, on other in-use criteria. Those comments did not address these criteria; accordingly, we made no changes based on that feedback.

Scope

We received feedback requesting certain insurance sectors be excluded from the insurers rating methodology (IRM). While many respondents stated that aligning the methodology to rate bond insurers with other insurance sectors through the application of the IRM would lead to increased transparency and consistency, we also received responses stating that bond insurers should be excluded from the IRM and should be subject to a separate and more specific methodology. Similarly, we received feedback requesting health insurers should have a separate framework, and that the IRM does not provide sufficient differentiation for health insurers.

By including bond insurers (and maintaining health insurers) within the scope of the IRM, we believe we have improved the analytical rigor of the criteria, improved consistency and comparability across the various insurance sectors, enhanced global application of the criteria, and removed some more mechanistic aspects of the previous criteria and replaced them with a structure that focuses more on the key risk factors relevant for assessing the creditworthiness of insurers. We have not eliminated the consideration of analytically relevant factors from our analysis. Rather, we believe the IRM, in combination with the guidance document that provides more details of the sector-specific application of the criteria, allows sufficient analytical flexibility to assess the idiosyncrasies that may be relevant to a particular insurance sector and is an appropriate framework for the evaluation of all insurance sectors. Accordingly, we determined it was appropriate to retain health insurers in the scope of the criteria and expand the scope to include bond insurers.

Comparable ratings analysis

A number of respondents questioned the need for comparable ratings analysis (CRA) rating factor given other elements within the framework, while others requested more clarity on its application. The CRA is an adjustment we may apply when determining the stand-alone credit profile (SACP) of up to one notch in either direction based on our comparable ratings analysis to capture a more holistic view of creditworthiness. The CRA 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. After further consideration, we determined not to add further guidance around the CRA to avoid narrowing its potential application to any examples provided, whereas the intent of the CRA in the criteria is more expansive.

Business risk profile and competitive position

Respondents spoke to a variety of topics regarding our assessment of an insurer's business risk profile (BRP) and competitive position, including the limits imposed within the framework stemming from business diversity and the use of reinsurance, the potential for decreased transparency resulting from the removal of subfactors from the IRM, greater consideration for benefits that may be attributable to the mutual ownership structure, benchmarks for the assessment of certain ratios, business diversification, and clarification of how operating results are assessed.

No substantive changes were made based on these comments. We incorporated editorial changes where we deemed necessary to clarify our intent in the criteria and guidance. We believe the framework provides sufficient flexibility to capture the relevant drivers of creditworthiness, encompassing the specifics of particular insurers or insurance sectors, including consideration of the insurance industry and country risk assessment (IICRA), the credit impacts of business diversification (or lack thereof), and the specific attributes of reinsurance programs. As to the mutual structure of entities, we believe there are both potential positives and negatives to this type of structure, but ultimately the framework is sufficiently flexible to allow for consideration of relevant rating drivers for different ownership structures. Although we have removed subfactors and increased the scope for analytical adjustments, we believe the framework will enhance transparency by allowing greater focus on the key drivers of the ratings. With regard to the use of ratios, we have included those ratios and benchmarks we believe are most pertinent in the criteria and guidance to inform our assessments.

With regard to the requests for clarification of how the modifiers affect the BRP assessment, and how business segments would be defined, we modified the examples provided in the criteria to add clarity and incorporated a link from the discussion of business diversity in the criteria to the glossary to aid in transparency.

A number of respondents also commented that they were unclear how operating performance would affect a bond insurer's competitive position. In line with our proposal, our final criteria incorporate our assessment of the aspects of creditworthiness previously addressed through operating performance into the profitability portion of competitive position to align bond insurers with all other insurance sectors.

In addition, several commenters spoke to what was perceived to be a size bias in the criteria. We acknowledge consideration of the size of capital and other elements within the framework. However, very small companies may be inherently more susceptible to adverse business conditions, less able to capitalize on good business conditions, or otherwise limited due to their size and their capabilities. We determined the framework incorporates a reasonable balance between granularity and judgement.

IICRA

We received feedback suggesting the classifications we use for the IICRA and how we perform the assessment is not clear. Respondents also requested a tabular breakdown of the risks inherent within insurance lines of business, as well as further clarity regarding country risk for global sectors and the use of the moderately low industry risk category. Although we determined not to add a tabular breakdown, to add clarity we included further examples of risks we could consider in the guidance document, and we modified what moderately low typically means in our assessment. We also clarified the example in the criteria of how the IICRA is applied in determining the BRP assessment. Otherwise, we believe the criteria and guidance already addressed other comments raised.

Capital and earnings assessment

Respondents commented on various aspects of the capital and earnings (C&E) assessment, including requests for further guidance on how we consider earnings in our C&E assessment; the results from internal issuer capital models; greater consideration for how regulators view the issuer's capital; the limits to C&E scores resulting from the issuer's capital base; and how qualitative assessments may affect the capital model results, including the non-symmetrical approach to positive and negative adjustments.

Although we did not make substantive changes to our approach in assessing C&E, we clarified that the application of table 8 of the criteria as detailed in table 1 of "Guidance: Insurers Rating Methodology," published July 1, 2019, applies to all insurers other than bond and mortgage insurers. Further, we clarified in the guidance how we apply our projections for changes in the capital base (which includes earnings), and business growth or contraction or changes in the risk profile in determining the prospective total adjusted capital (TAC) and risk-based capital (RBC) requirements, respectively.

With regard to the typical limits to C&E scores, we believe smaller insurers may be more susceptible to exogenous shocks that can impair capital. For the purposes of considering these limits, we base our assessment of capital on TAC as defined in the relevant capital model criteria.

In the final criteria and in line with our proposal, the consideration of limits to C&E scores for bond insurers is based on TAC rather than ending capital, which is post-stress.

We determined the non-symmetrical approach to adjustments to the C&E assessment was appropriate given the methodology and assumptions in the risk-based capital model criteria.

We had originally proposed to fully supersede the criteria "Methodology: Treatment Of U.S. Life Insurance Reserves And Reserve Financing Transactions," published March 12, 2015. We will now retain these criteria to ensure clarity in the specific treatment of U.S. life insurance reserves in our C&E assessment.

Risk exposure

Some respondents noted the guidance focused only on what could cause a weaker assessment rather than providing a positive impact on our C&E assessment. In response, we incorporated changes into table 9 of the criteria to clarify our intent. We also clarified that we consider risk correlations between investments and insured exposures when assessing risk concentrations.

Respondents requested the risk exposure modifier consider overstated risks or diversification benefits not adequately reflected in the C&E assessment, and requested that the impact should be symmetrical insofar as providing the same potential positive and negative impact. We also received feedback requesting further clarity around how risk exposure categories would be aggregated, the particular metrics used in the assessment, and what constitutes a material exposure.

We clarified when we would consider a risk to be material. Otherwise, the criteria allow for the C&E assessment to be modified, typically by one category stronger or up to two categories weaker, if we determine the C&E assessment for a given insurer is materially understated or overstated, respectively. We determined the non-symmetrical approach to our risk exposure assessment was appropriate relative to considerations already captured in the C&E assessment, and given the definition of risk exposure. Further clarity regarding the particular risk drivers for a specific insurer would be referenced, if relevant and material, in the respective insurer analytical report. We determined the criteria was clear in our approach to assessing risk exposure and made no further substantive changes.

Enterprise risk management

We received several comments requesting retention of the stand-alone enterprise risk management (ERM) assessment, with some commenters suggesting there may be a loss of analytic value if we were to eliminate it. Additionally, we received feedback regarding the lack of an explicit link between competitive position and ERM, as well as requests for clarification as to how internal capital model results would be considered, how the assessment for asset-liability management (ALM) risk controls would be assessed without an explicit ERM score, and how ERM would positively or negatively affect our analysis.

We believe integrating our evaluation of an insurer's ERM processes and procedures into the framework reflects that ERM frameworks have advanced in sophistication across the globe in recent years, and even simpler frameworks may consider a holistic and companywide view of risk. We believe it is appropriate to embed the relevant components of ERM directly into the rating framework, rather than maintain a stand-alone assessment. The IRM will thus ensure a more integrated discussion and analysis of the positive and negative ERM considerations in our rating of insurers. Accordingly, we made no changes based on the comments requesting we maintain a stand-alone ERM assessment. We have incorporated the assessment of ALM risk controls as an appendix in our capital model criteria "Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model," published June 7, 2010.

Although we otherwise made no substantive changes, we incorporated a definition of risk appetite in the glossary to help clarify that we consider an insurer's approach to risk-return optimization as part of our assessment of an insurer's profitability within competitive position. For certain insurers, we will continue to assess their internal capital models under our economic capital model criteria.

Funding structure and financial leverage

We received feedback requesting we allow a positive modifier for funding structure to the financial risk profile (FRP) assessment. Respondents also commented on the use of reported equity in the calculation of financial leverage, as well as on the treatment of particular elements, such as operating leases, pension deficits, and equity-like reserves. Some commenters indicated use of reported equity could result in increased volatility in the ratio, might reduce comparability, or might otherwise reflect noneconomic results. Although we acknowledge that use of reported equity may increase volatility of the ratio, we determined that it aided in the transparency of the calculation.

The FRP assessment is based on our analysis of the insurer's C&E, modified by risk exposure and funding structure. We may assess funding structure as neutral, moderately negative, or negative. The guidance provides more specific information as to how we apply the criteria, which indicate that if a company is willing and able to change its capital structure, such as through a demonstrated ability to raise equity through public markets in times of stress, we may view this as a potential mitigant to the risk from leverage identified in the funding structure assessment. We believe this approach, combined with the prospective nature or our analysis and the ability to apply adjustments depending on the insurer's circumstances, captures the appropriate elements necessary to evaluating an insurance company's FRP. Accordingly, we made no substantive change based on the request to allow a positive modifier to the FRP for funding structure.

We clarified that we may determine reported equity to be understated, and therefore the financial leverage ratio overstated, when we believe significant redundancies exist in reported liabilities--for example, contingency or other equity-like reserves. We made other clarifications with regard to the definition and treatment of operational leverage, as well as noncontrolling interests. Other commenters indicated disagreement with inclusion of certain elements, such as pension deficits and leases, as debt-like. We did not make any changes based on these particular comments, given we continue to believe these are correctly viewed as debt-like in nature. Otherwise, we believe the criteria and associated guidance allow for consideration of issuer-specific factors that may affect the financial leverage ratio.

Management and governance

Some respondents requested we consider allowing for a positive assessment of governance to positively affect the rating. We believe the elements for consideration of governance have been appropriately captured within the framework and thus no change is warranted specific to providing uplift to the modifier or to the rating. Other respondents indicated a belief that environmental and social risks should be explicitly mentioned in the criteria. We note, however, that, in our view, environmental, social, and governance risks are best captured through the relevant key rating factors, such as competitive position, C&E, risk exposure, and governance, ensuring the consideration of these elements to the extent they are relevant and material to the rating on an insurer.

The assessment of management and governance remains an important part of our framework. We have embedded our assessment of management, and the extent to which management succeeds in executing its business and financial strategies, directly in the framework. Disaggregating management and governance factors supports a greater focus on the risks posed by governance deficiencies, which can significantly affect the overall rating. The criteria article "Management And Governance Credit Factors For Corporate Entities And Insurers," published Nov. 13, 2012, will no longer apply to insurance entities.

Liquidity

We received several comments regarding the assessment of liquidity and the respective asset haircuts. Some respondents also expressed a belief that strong or exceptional liquidity should be viewed as a differentiator, and that a positive adjustment should be incorporated into the assessment. We do not believe that exceptional liquidity enhances an issuer's long-term creditworthiness. We believe the approach to asset haircuts, liability factors, and benchmarks provide sufficient risk differentiation to identify liquidity risks under our framework. Further, we only include certain backup facilities that specifically mitigate the liquidity stress captured in the liquidity ratio. We believe such facilities mitigate liquidity risks and are appropriate to include in our analysis. The framework provides sufficient scope to reflect issuer-specific considerations and enhances global consistency in our analytical approach. Therefore, we did not make changes in response to these comments. However, we have incorporated further guidance on application of the asset risk haircuts to rated bonds and deposits at rated banks to clarify that references to ratings include public, private, confidential, or mapped ratings, or credit estimates, assessments, or other measures of creditworthiness that are broadly equivalent to ratings either 'BBB-' or higher or in the 'CCC' category or lower.

Exercising analytical judgment

We received comments requesting specific details on how we will exercise analytical judgment in applying the criteria. We believe the criteria allow for sufficient analytical flexibility in considering the complexity and diversity of insurance entities. The guidance document provides some detail as to how we will exercise analytical judgement established in the criteria. The rationale for a particular rating and the rating drivers are disclosed in the related ratings publication. Accordingly, we made no changes to the criteria based on these comments.

Other points of clarification

We received other comments that were largely application-type editorial comments--that is, comments about how the criteria would be applied rather than comments specific to the proposal itself. In addition, we received comments requesting we require a single accounting methodology for consideration under our criteria, or expressing concern regarding accounting changes. The framework does not require a particular method of reporting; rather, we look through the methods of reporting to focus on what we consider to be the underlying economic drivers of transactions and businesses. We considered the clarifications needed to address other questions and comments received and, where we determined it would be helpful, have incorporated these into the final criteria and guidance. We also incorporated editorial revisions, where appropriate, to improve the readability and clarify the intent of the criteria and the guidance. We finalized and published our guidance article as a separate document "Guidance: Insurers Rating Methodology," on July 1, 2019.

This report does not constitute a rating action.

Contact List

ANALYTICAL CONTACTS

Simon Ashworth
London
(44) 20-7176-7243
simon.ashworth@spglobal.com

ANALYTICAL CONTACTS

Taos D Fudji
Milan
(39) 02-72111-276
taos.fudji@spglobal.com

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Ali Karakuyu
London
(44) 20-7176-7301
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Hardeep S Manku
Toronto
(1) 416-507-2547
hardeep.manku@spglobal.com

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Peggy H Poon, CFA
New York
(1) 212-438-8617
peggy.poon@spglobal.com

ANALYTICAL CONTACTS

Eunice Tan
Hong Kong
(852) 2533-3553
eunice.tan@spglobal.com

CRITERIA CONTACTS

Steven Ader
New York
(1) 212-438-1447
steven.ader@spglobal.com

CRITERIA CONTACTS

Michelle M Brennan
London
(44) 20-7176-7205
michelle.brennan@spglobal.com

CRITERIA CONTACTS

Mark Button
London
(44) 20-7176-7045
mark.button@spglobal.com

CRITERIA CONTACTS

Ron A Joas, CPA
New York
(1) 212-438-3131
ron.joas@spglobal.com