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Interactive Ratings Methodology

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Interactive Ratings Methodology

Standard & Poor's Ratings Services' interactive rating methodology assesses the financial risks of entities that undertake a wide range of business activities. For insurance companies, we use this methodology to help evaluate the financial risks associated with both historical business activities and new business initiatives. A key factor in our interactive methodology is evaluating the qualitative factors and risks facing an insurer. Our discussions with management help us better understand how an organization's business, operating, and financial strategies affect its financial strength. We use these discussions with management to understand their businesses before making projections that we use to help us assign a rating.

Though we gain insight into an issuer's future financial performance by looking at current and historical performance, our evaluation of an insurer's strategies, risk management capabilities, operations, efficiencies, and risk tolerance—as well as of the insurer's competitive advantages in the marketplace — will most heavily influence our opinion of its future financial performance.

Standard & Poor's is refining and adapting its methodology and assumptions for the interactive rating methodology for insurance companies, related to "Criteria: Principles Of Corporate And Government Ratings," which we published on June 26, 2007, on RatingsDirect at www.ratingsdirect.com and Standard & Poor's Web site at www.standardandpoors.com. We are publishing this article to help market participants better understand our approach to reviewing insurance companies. This article partly amends and supersedes "Property/Casualty Insurance Criteria: Interactive Rating Methodology," published April 20, 2004; "Life Insurance Criteria: Interactive Rating Methodology," published April 21, 2004; and "Health Insurance Criteria: Interactive Rating Methodology," published April 22, 2004, on RatingsDirect at www.ratingsdirect.com and Standard & Poor's Web site at www.standardandpoors.com.

This article is part of a broad series of measures announced last year to enhance our governance, analytics, dissemination of information, and investor education initiatives. These initiatives are aimed at augmenting our independence, strengthening the rating process, and increasing our transparency to better serve the global markets.

Ultimately, our rating opinion is a synthesis of important factors that are unique to each company. Even highly rated companies might not score well in some categories of analysis. A rating is not so much the product of a scorecard that shows how well a company did in each analytical category as it is a reflection of our judgments about the key rating factors that will most affect a company.

We use our rating methodology profile for all insurance rating analyses and apply it uniformly across all types of insurance companies. The profile takes into account competitive position, management and corporate strategy, enterprise risk management capabilities, operational analysis, investments, capitalization, liquidity, and financial flexibility.

In applying our rating methodology for the insurance and reinsurance sectors, we evaluate the types of insurance a company writes (line of business or sector) and its geographic profile. Standard & Poor's also considers how national and local factors could affect the insurer's operations, as regulatory or legislative changes could easily alter both overall and company-specific risk.

In addition, for insurance companies that are part of a larger, more diversified group, Standard & Poor's looks at noninsurance-related activities to assess how favorable or unfavorable these might be and the potential effect on the group's overall operations.

Key points that we consider in our analysis of insurance company industry risk are:

- The potential threat of new entrants into the market.
- The threat of substitute products or services.
- The competitive advantages and volatility of companies within the sector.
- The potential tail of liabilities (i.e., ease or difficulty in exiting a market) or risk of large losses. In some cases, it might not be possible to exit certain lines of business because of state regulations that require approval or impose penalties for doing so.
- The bargaining power of insurance buyers and suppliers.
- The strength of regulatory, legal, and accounting frameworks within which the insurer operates.

Broadly speaking, the lower the industry risk, the higher the potential rating on companies in that sector or line of business. Low industry risk implies an operating environment that is favorable to insurers from a competitive standpoint, a regulatory framework conducive to supporting insurer solvency, and conservative accounting standards. Under these conditions, we would expect companies to generate more favorable and less volatile operating results. Although a high industry risk profile does not automatically limit a rating, it is more difficult for companies with such a profile to demonstrate the earnings strength and stability that characterize highly rated companies.

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- "Life Insurance Criteria: Liquidity," April 22, 2004.
- "Property/Casualty Insurance Criteria: Liquidity," April 20, 2004.
- "Financial Flexibility," April 22, 2004.
- "Summary Of Standard & Poor's Enterprise Risk Management Evaluation Process For Insurers," Nov. 26, 2007.
- "Refining The Focus Of Insurer Enterprise Risk Management Criteria," June 2, 2006.
- "Evaluating The Enterprise Risk Management Practices Of Insurance Companies," Oct. 17, 2005.

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