

Media Release:

# Hotai Insurance Co. Ltd. Downgraded To 'twAA-' On Weakening Capitalization; Ratings On CreditWatch Negative

June 8, 2022

## Overview

- Taiwan-based Hotai Insurance Co. Ltd.'s capitalization has weakened due to substantial claim losses on its COVID-19 pandemic insurance policies.
- We therefore lowered our long-term issuer credit rating and financial strength rating on Hotai Insurance to 'twAA-' from 'twAA'.
- At the same time, we placed the ratings on CreditWatch with negative implications to reflect the potential for further weakening in the company's capitalization over the next few quarters, given uncertainty over the duration of the pandemic outbreak and the company's strategic actions in response to its growing losses.

## Rating Action

Taiwan Ratings Corp. today lowered its long-term issuer credit rating and financial strength rating on **Hotai Insurance Co. Ltd.** to 'twAA-' from 'twAA' and placed the ratings on CreditWatch with negative implications.

## Rationale

**The downgrade reflects our view that current and future claims relating to Hotai Insurance's pandemic insurance policies will weaken the company's capitalization at least to our assessment of strong from very strong previously.** We base this on our calculation of the insurers' risk-based capital, given the growing prevalence of the pandemic in Taiwan and the number of policies the insurer has sold. We believe such claims have already had a material detrimental effect on the insurer's capitalization which has weakened Hotai Insurance's overall credit profile by one rating notch. We assess the insurer has an above-average risk appetite for business growth and capital management, under its overall risk management culture and governance framework.

**At the same time, our placement of the ratings on WatchNeg reflects our view of uncertainty surrounding Hotai Insurance's overall creditworthiness in the very near future.** That's because the rising number of cases in the current domestic outbreak is likely to plateau over the next month. We estimate the insurer's losses on total pandemic claims could be up to new Taiwan dollar (NT\$) 4 billion, which would lead to a material drop in the insurer's total adjusted capital.

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However, there remains high uncertainty over how the pandemic will evolve over the next one to two months. As the result, we believe there is a lack of clarity regarding how Hotai Insurance plans to mitigate the potential impact of these claims through dynamic adjustments to its assets and liabilities. This could include adjustments to its investment asset mix, lowering of liability risks via controlled growth, and other means to enhance overall capitalization.

Under the insurer's currently weaker capitalization, the rating anchor for Hotai Insurance is now 'bbb+/bbb' on a global rating scale, and we choose the higher anchor of 'bbb+' to reflect the relative strength of the insurer's business franchise and distribution channels compared to similar size peers. These factors have helped Hotai Insurance acquire good quality and stable new and renewal auto insurance referrals from its parent Hotai Motor Co. Ltd. group, which is the market leader in Taiwan's auto distribution sector.

### CreditWatch

We aim to resolve the CreditWatch placement after we gain a better understanding of the current pandemic outbreak in Taiwan and its potential impact on Hotai Insurance's capital and earnings. We will also seek clarification of the insurer's risk asset adjustment plan to deal with the pandemic over the next few months.

#### Downside scenario

We could lower the ratings on Hotai Insurance by one or more notches if we see an increased possibility that the company's capital and earnings have deteriorated further. Such deterioration could result from higher losses than we currently predict, or more aggressive capital management than under our current forecast.

We could also lower the ratings by multiple notches if Hotai Insurance cannot maintain its liquidity ratio above 100%, which would indicate that the insurer may not be able to service all its financial and policyholder obligations in a timely manner over the next 12 months.

#### Upside scenario

We could affirm the ratings if we conclude that Hotai Insurance can uphold its capital strength and maintain adequate liquidity over the next one to two years.

### Environmental, Social, And Governance

#### ESG credit indicators: To E-2, S-2, G-3 From E-2, S-2, G-2

Governance factors are now a moderately negative consideration in our credit rating analysis of Hotai Insurance. We now see a more meaningful negative impact of the company's risk management and governance on its capitalization and overall credit profile. Given that Hotai Insurance already had a thin capital buffer relative to its ratings tolerance, we consider the company's risk management and governance contributed to a higher level of capitalization deterioration amid the unexpected market shock from the pandemic outbreak.

## Rating Score Snapshot

Hotai Insurance Co. Ltd.--Ratings Score Snapshot		
	To	From
<b>Business Risk Profile</b>	<b>Satisfactory</b>	<b>Satisfactory</b>
Competitive position	Satisfactory	Satisfactory
IICRA	Intermediate	Intermediate
<b>Financial Risk Profile</b>	<b>Satisfactory</b>	<b>Strong</b>
Capital and earnings	Satisfactory	Strong
Risk exposure	Moderately low	Moderately low
Funding structure	Neutral	Neutral
Anchor	bbb+	a-
<b>Modifiers</b>		
Governance	Neutral	Neutral
Liquidity	Adequate	Adequate
Comparable rating analysis	0	0
Stand-alone credit profile	bbb+	a-
<b>Support</b>		
Group support	0	0
Government support	0	0
<b>Financial Strength Rating</b>	<b>twAA-/WatchNeg/--</b>	<b>twAA/Stable/--</b>

The anchor reflects the relative strength of Hotai Insurance's business franchise and distribution channels compared to similar size peers.

### **Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:**

- Risk management, culture and oversight

## Related Criteria & Research

### Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- Criteria | Insurance | General: Insurers Rating Methodology - July 01, 2019
- General Criteria: Principles Of Credit Ratings - February 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model - June 07, 2010

### Related Research

- Taiwan Ratings' Ratings Definitions – August 10, 2020

(Unless otherwise stated, these articles are published on [www.taiwanratings.com](http://www.taiwanratings.com))

## Ratings List

### Downgraded; CreditWatch Action

	To	From
<b>Hotai Insurance Co. Ltd.</b>		
Issuer credit rating	twAA-/WatchNeg/--	twAA/Stable/--
Financial strength rating	twAA-/WatchNeg/--	twAA/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.taiwanratings.com](http://www.taiwanratings.com) for further information. Complete ratings information is available to subscribers of Rating Research Service at [rrs.taiwanratings.com.tw](http://rrs.taiwanratings.com.tw). All ratings affected by this rating action can be found on Taiwan Ratings' public website at [www.taiwanratings.com](http://www.taiwanratings.com).

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