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Rating Agency Methodology and Practice in Asia-Pacific

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Rating Agency Methodology and Practice in Asia

Part I – Rating Methodology

- Context to discussion
 - Value of ratings
 - Rating agency activities in Asia Pacific
- Ratings methodology
 - Overview
 - RBC models
 - ERM

Part II - Predictors of Ratings



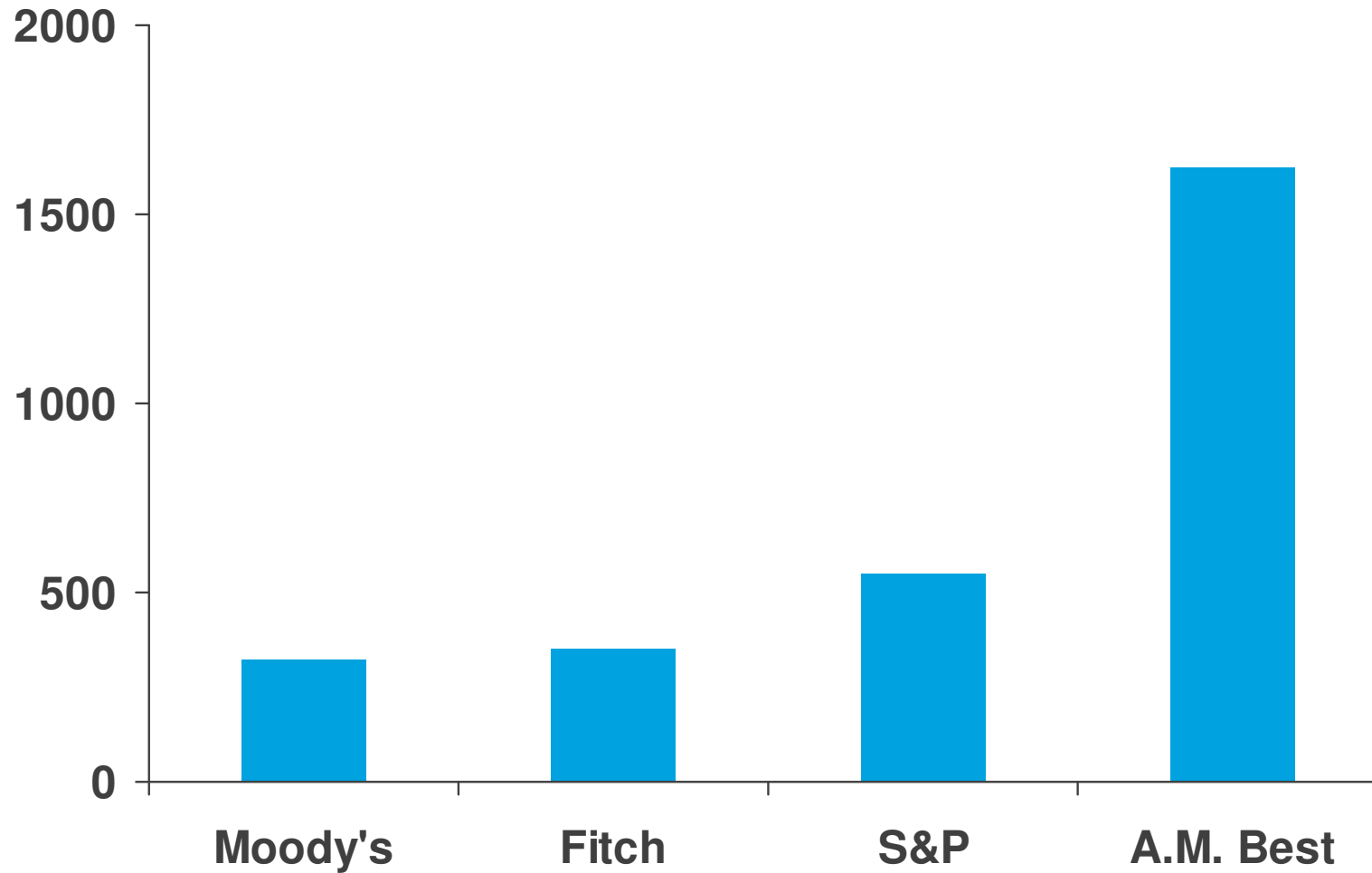
Value of Financial Strength Ratings

- Access to new business, clients and markets
- Competitive advantage over non-rated companies
- Often easier, cheaper access to capital
- Savings on underwriting expenses (collateral, fronting)
- Identification of operational weaknesses
- Sometimes required by regulators

Insurer Financial Strength Ratings Vs. Credit Ratings

Credit Ratings	IFSR
<p>Issuer (CCR) and Issue credit ratings</p> <p>Issuer rating – ability and willingness to pay most senior financial obligations</p> <p>Issue rating – for specific issues and tranches of securities. Based on both issuer’s credit worthiness and characteristics of the security.</p> <p>Issue ratings are usually one or more “notches” below the FSR and ICR, indicating that (re)insurance policy obligations are senior to any other financial obligations</p> <p>Big Three – Fitch, Moody’s, S&P</p>	<p>A credit rating, but only applies to carrier’s ability to meet obligations to (re)insurance policyholders</p> <p>Not specific to any one policy or contract</p> <p>Usually applied only to operating companies, not holding companies</p> <p>Big Four, but value varies by market:</p> <p>Asia: S&P and A.M. Best Europe: S&P N. America: A.M. Best</p>

Global Ratings Coverage
Interactive Insurer Financial Strength Ratings*



Ratings by Country

Stand-alone Life & PC Ratings

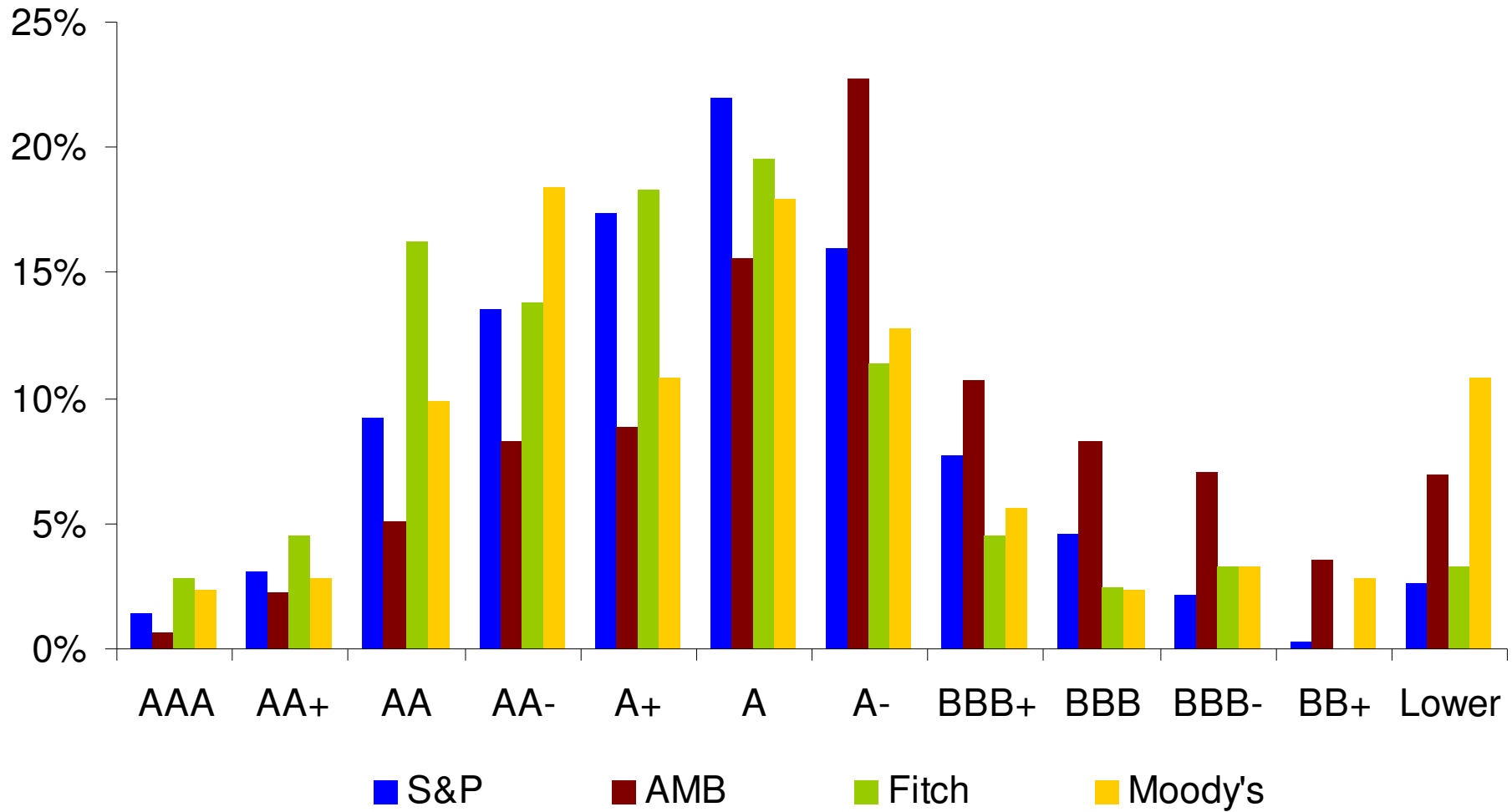
Country	S&P	AMB	Fitch	Moody's
Australia	13	2	4	2
China	1	0	0	2
Hong Kong	6	6	1	0
India	0	3	0	0
Indonesia	0	1	0	0
Japan	24	10	12	15
S. Korea	5	6	1	2

Ratings by Country

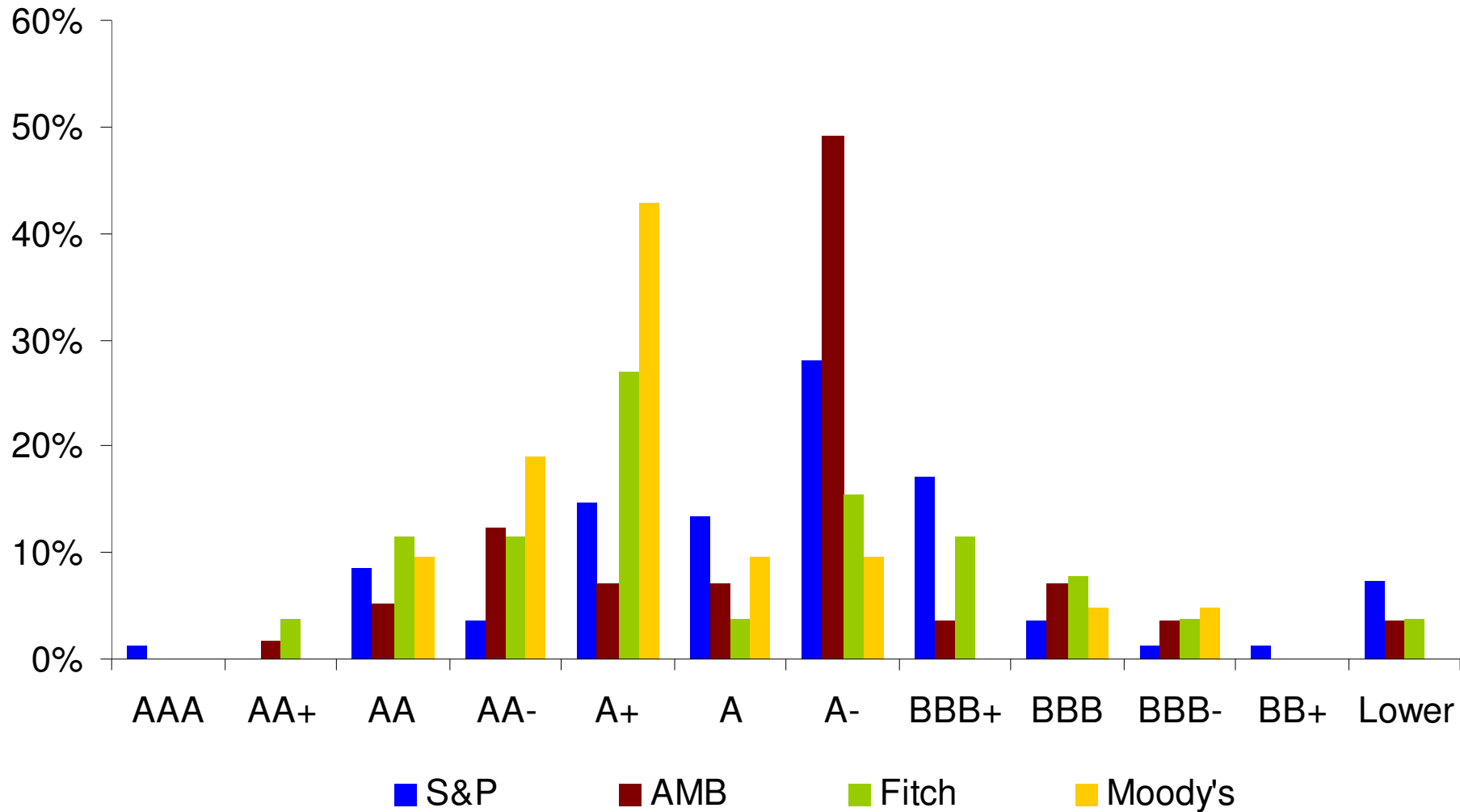
Stand-alone Life & PC Ratings (continued)

Country	S&P	AMB	Fitch	Moody's
Malaysia	0	3	2	0
New Zealand	8	10	2	0
Philippines	1	2	0	0
Singapore	5	4	1	0
Taiwan	9	2	4	3
Thailand	4	1	1	0
Vietnam	0	0	0	0
TOTAL	76	50	28	24

Global Rating Distributions Stand-alone Ratings



Asia Pacific Ratings Distributions Stand-alone Ratings



Ratings in Asia Pacific

Rating Agencies Review Essentially the Same Information

Examples of Ratings “Parity” – more common in developed markets

Company	A.M. Best ICR	Fitch FSR	Moody’s FSR	S&P FSR
Aioi Insurance Co	A+		A1	A+
China International Re	A-	A-		A-
Labuan Re	A-	A-		
Korean Re	A-			A-
Muang Thai Life		BBB+		BBB+
QBE Insurance (Int’l)	A+	A+		A+
Suncorp Metway		A+	A1	A+



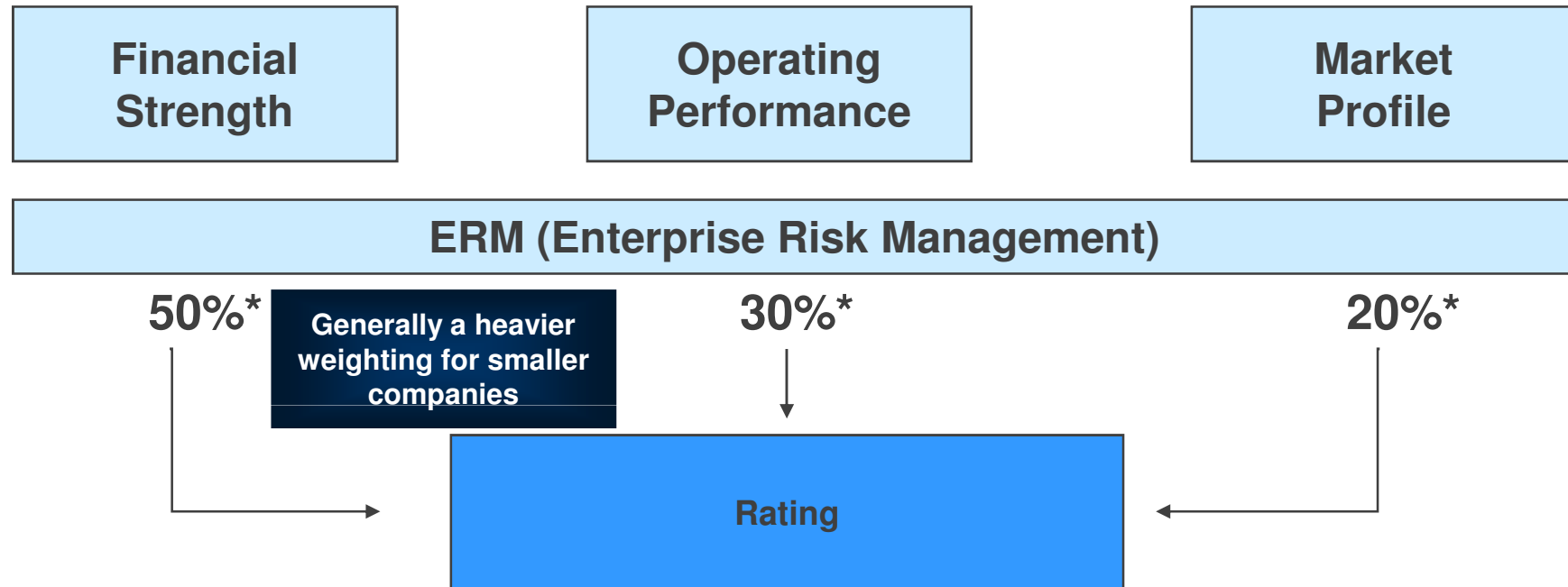
Rating Agency Methodologies

Methodologies and Analytical Factors Key Rating Elements

- Capitalization
- Operating performance
- Asset management
- Business profile
- Enterprise Risk Management

Methodologies and Analytical Factors

A.M. Best Rating Considerations



Balance Sheet Strength

- Leverage
- Capital structure
- Reinsurance program
- Loss reserve adequacy
- Asset quality and diversification

Operating Performance

- Profitability (volatility)
- Revenue composition
- Management experience
- Ability to meet plan

Business Profile

- Market risk
- Competitive market position
- Spread of risk
- Event risk
- Regulatory risk

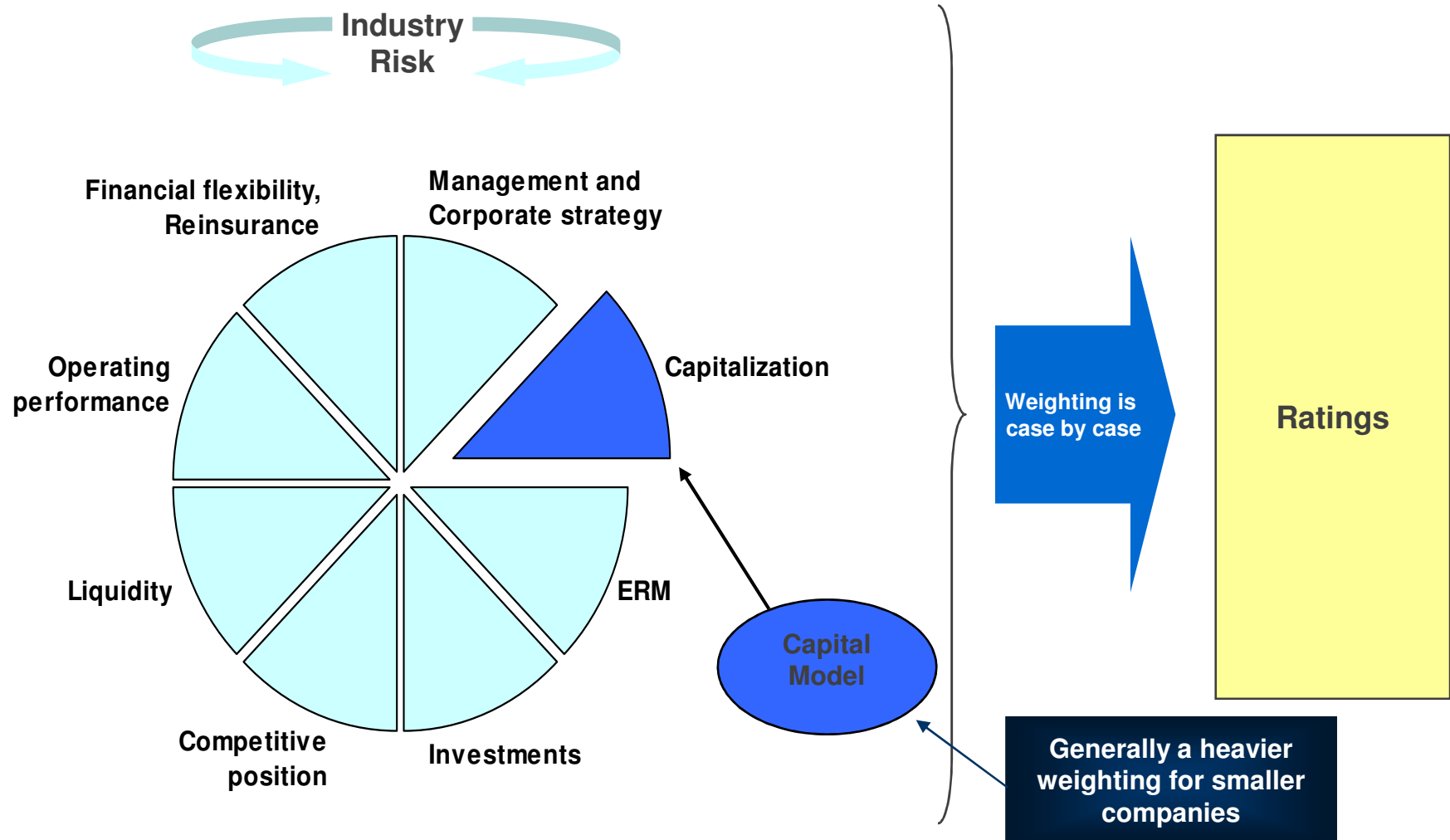
Methodologies and Analytical Factors

A.M. Best Capital Model - BCAR

	Risk Capital
Asset Risk Total	38,305
Underwriting Risk	45,200
Business Risk	1,250
Gross Required Capital	84,755
Less Covariance adjustment	(23,221)
Net Required Capital	61,534
Adjusted Capital (incl. PML)	103,500
AC / NRC	168.2%

Implied Balance-Sheet Strength Rating	Minimum BCAR
A++ (AAA, AA+)	175
A+ (AA, AA-)	160
A (A+, A)	145
A- (A-)	130
B++ (BBB+, BBB)	115

Methodologies and Analytical Factors S&P Capital Model



Methodologies and Analytical Factors S&P's Revised Capital Model

- Factor based, like BCAR, but with factors and resulting target capital values that increase for higher rating levels
- Introduced four risk charge categories for AAA, AA, A and BBB in place of using table of SPCAR ratios corresponding to each rating

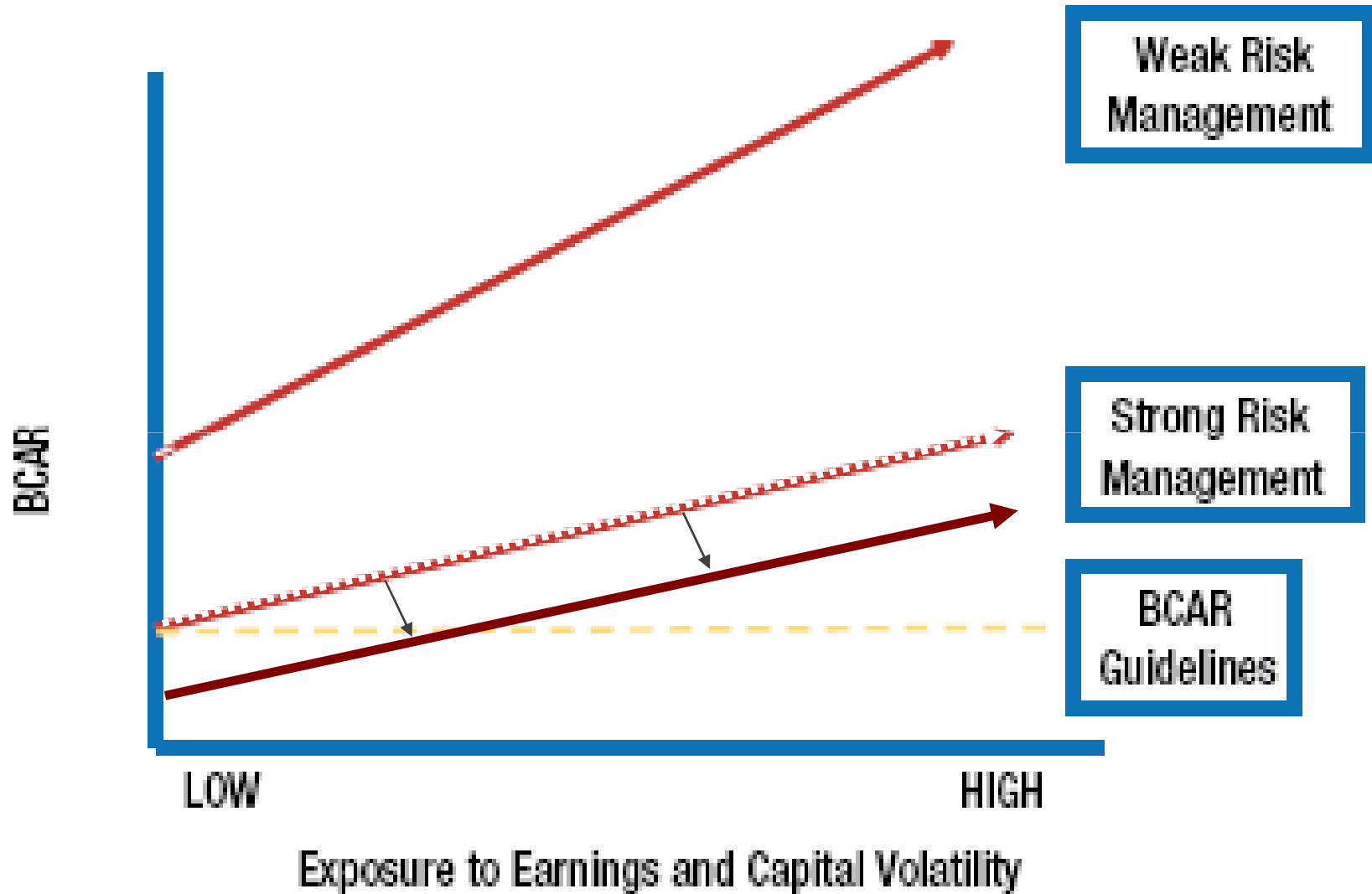
Target Rating Level	AAA	AA	A	BBB	Current Capital Model		
Total adjusted capital	43.0	43.0	43.0	43.0	TAC	a	43.0
Total target capital for asset risks	28.0	24.0	20.0	16.0	C1, C2 risks	b	16.0
Total target capital for liability risks	26.0	24.0	21.0	19.0	C3, C4, C5 risks	c	19.0
Diversification benefit	-4.0	-3.6	-3.1	-2.7	CAR (a-b)/c		142%
Diversified target capital	50.0	44.4	37.9	32.3			A level

(in billion dollars)

Rating Agency Perspective
Impact of ERM on S&P's Ratings

		Significance of Risk			
		Low	-----		High
Quality of Controls	Low				Negative Rating Implications
			Acceptable		
	High	Positive Rating Implications			

Rating Agency Perspective Impact of ERM on A.M. Best's Ratings





Predictors of Ratings

Rating Agency Reaction to 15-20% Decline in Industry Capital

Limited number of rating actions during 2008, early 2009

A.M. Best				S&P			
Reins. rating changes	Previous	Direction	Current	Reins. rating changes	Previous	Direction	Current
Alliance International Re	B++	↑	A-	Hiscox Ins Co	A-	↑	A
Allianz Global AG	A	↑	A+	Lexington Ins	AA+	↓	A+
CCR	A+	↑	A++	Liberty Mutual	A	↓	A-
Hiscox Ins Co (Bermuda)	A-	↑	A	Nacional de Reaseguros	A	↑	A+
Lexington Ins Co	A+	↓	A	New India Assurance	BBpi	↔	NR
Transatlantic Re	A+	↓	A	Secura	AA-	↓	A+
				XL	A+	↓	A
					January 2009		
				Transatlantic Re	AA- CW	↓	A+

A.M. Best				S&P			
Outlook changes	Previous	Direction	Current	Outlook changes	Previous	Direction	Current
CastlePoint Re	A-	↓	A-	ACE	A+	↑	A+
Central Re	A-	↑	A-	African Re	BBB+	↑	BBB+
E+S Ruck	A	↑	A	Asia Insurance Co	A	↓	A
Hannover Ruck	A	↑	A	Atradius Re (Ire)	A	↓	A
Korean Re	A-	↓	A-	Everest Re	AA-	↓	AA- CW
Max Bermuda	A-	↑	A-	Fubon Insurance	A	↓	A
New Castle Re	A-	↓	A-	Kuwait Re	BBB	↑	BBB
New India Assurance	A-	↑	A-	Mapfre Re	AA	↓	AA
PARIS RE	A-	↑	A-	Montpellier Re	A-	↑	A-
Swiss Re	A+	↔	A+ *	Safety National	A	↓	A
				SCOR	A-	↑	A-

* Outlook moved from negative to stable, then back to negative during 2008

Rating Agency Reaction

More actions in 2009 as rating agencies turn negative

A.M. Best	S&P
Fuji Fire to B++ / Neg from A-	Swiss Re to A+ from AA- CW
Swiss Re to A from A+ / Negative	Everest to A+ from AA- CW
Korean Re outlook to Stable from pos	Scor to A from A-
	Berkshire Hathaway outlook to Neg

Reasons for relatively limited rating action:

1. Excess capital built up in 2006-7.
2. Ratings are better due to the expansion and refinement of RBC models and adjustments for PML; stress tests. Companies can lose 10-15% of capital, ceteris paribus, without coming under ratings pressure.
3. Lag effect – a few more major downgrades expected as losses come through financial statements and rating analysts catch up

Balance Sheet Risk is an Important Factor

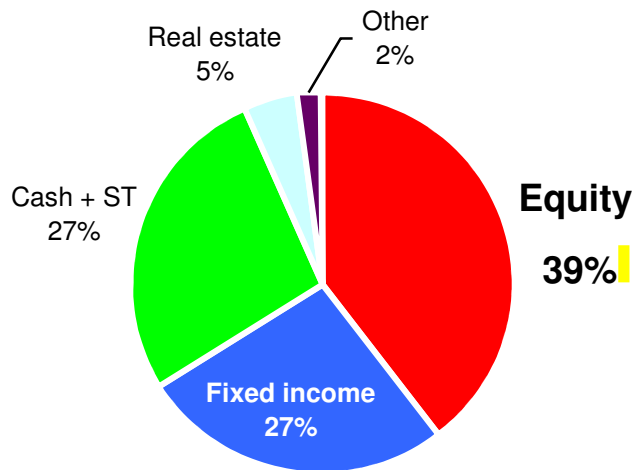
Case Study – Balance Sheet Risk

2002

Company A

Downgraded by four notches (2000—2003)

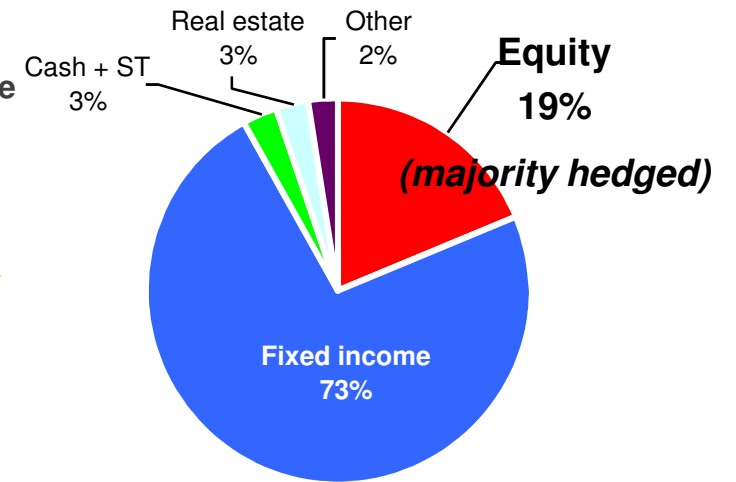
Market loss accounted for one or two notches



Company A

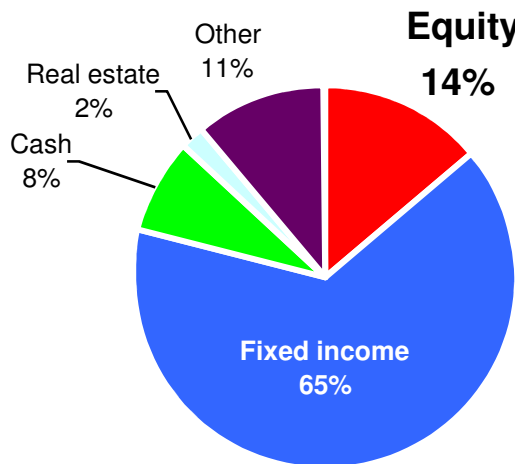
De-risked balance sheet, upgraded; no ratings pressure in 2008

2008



Equity

14%



Company B

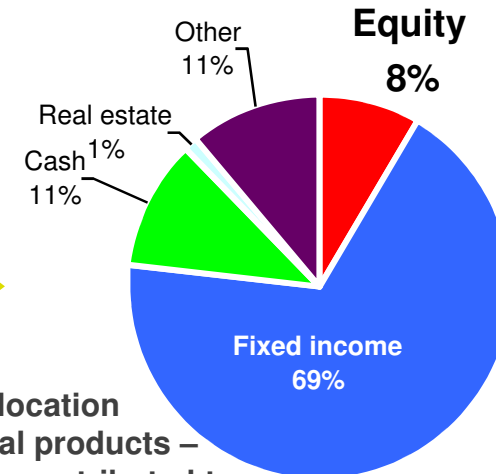
Downgraded by two notches (2000—2003)

Company B

Maintained major allocation to structured financial products – resulting market loss contributed to rating actions in 2008-9

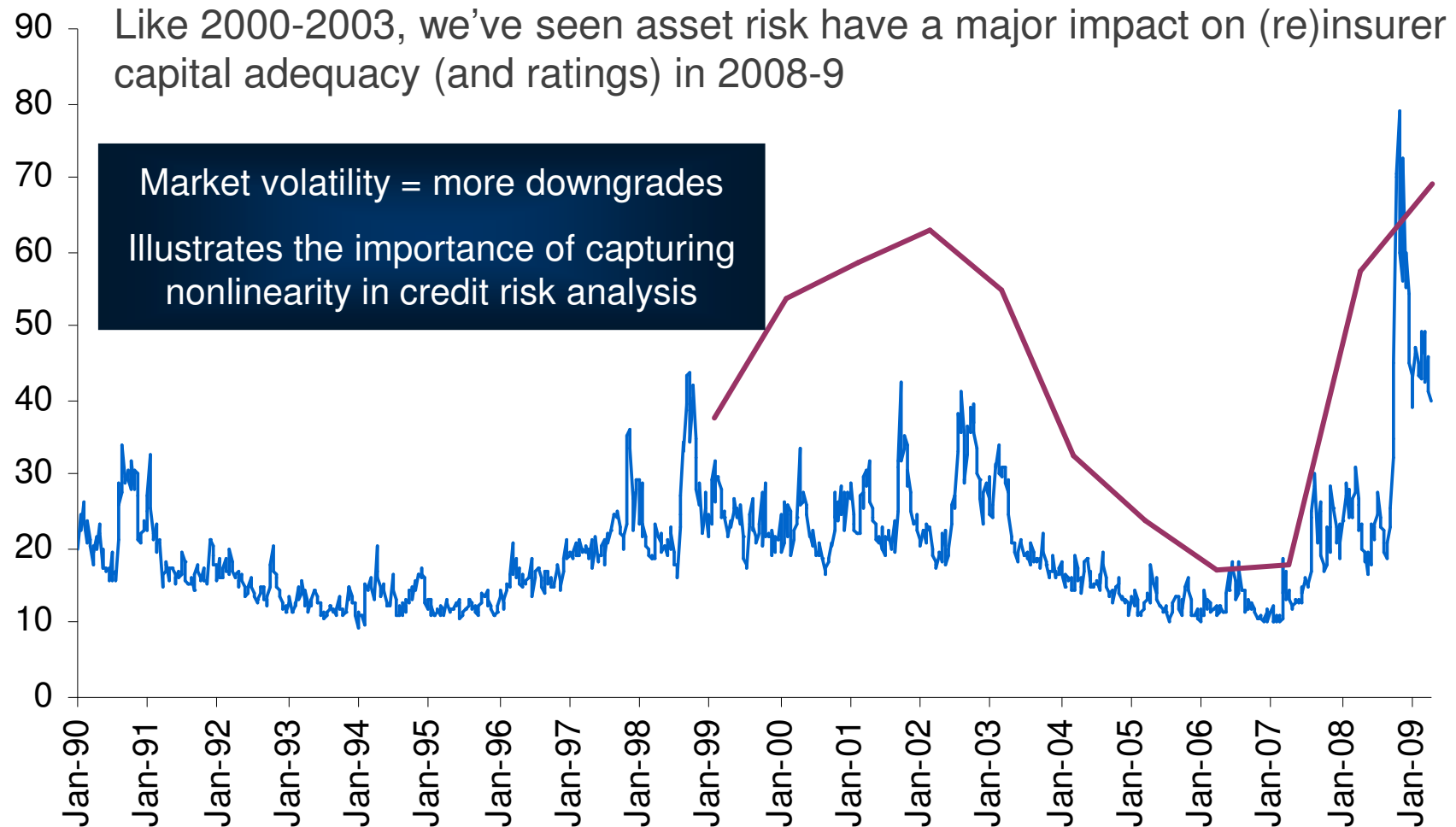
Equity

8%



Volatility is a Major Factor

S&P downgrade ratio compared to VIX – financial companies



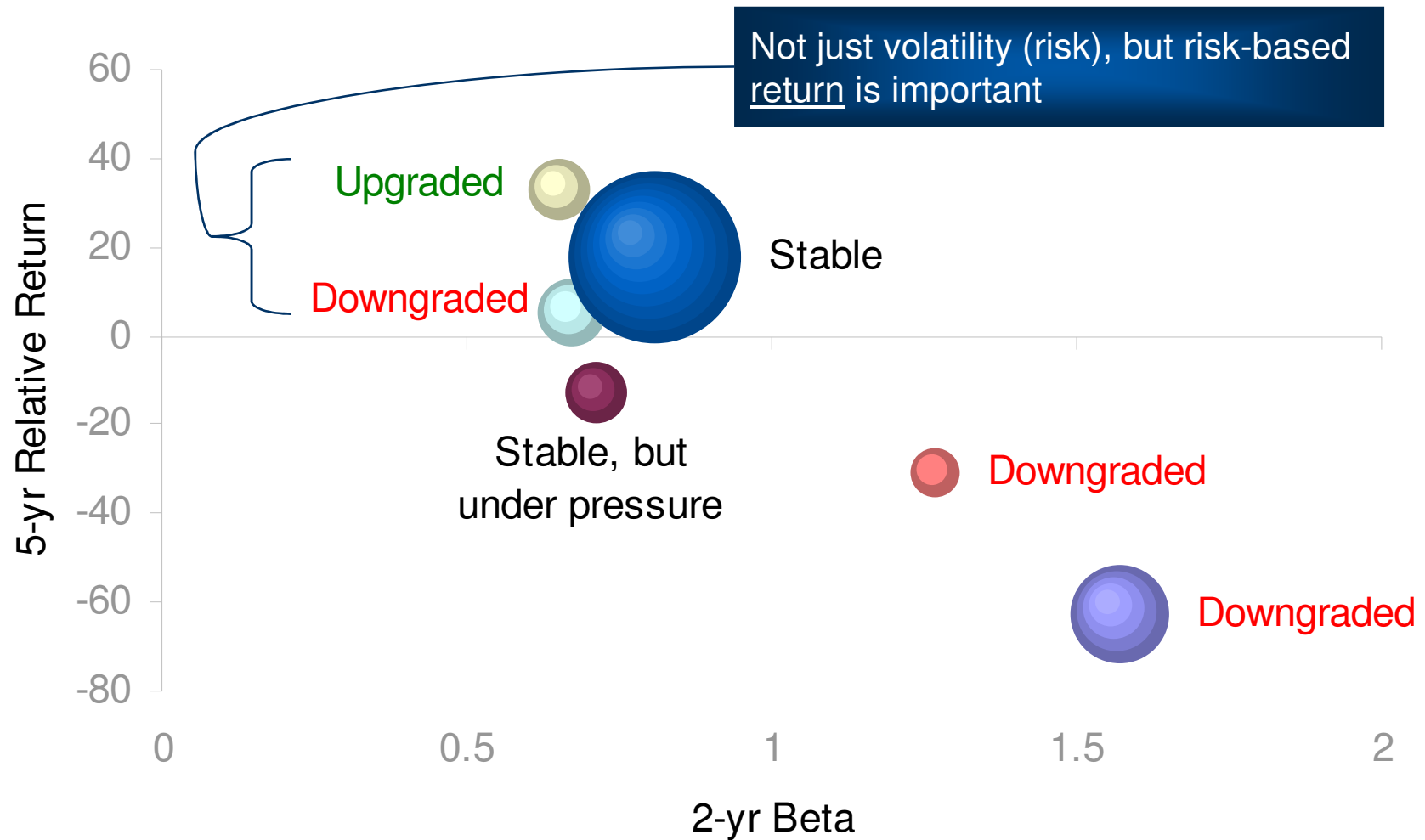
Methodologies and Analytical Factors

Volatility

- Following market volatility and major loss events in 2001-2 and 2005, rating agencies place more emphasis on “volatility” – in conjunction with ERM
 - 57 citations in Best’s January 2008 rating methodology document
 - 30 citations in S&P’s November 2007 methodology document
 - All rating agencies:
 - Volatility cited in 34% of negative IFSR actions (89) in 2008.
 - 30% of negative IFSR actions (already 84) in 1Q2009
- S&P and A.M. Best now explicitly measure volatility of earnings
- Risk factors in BCAR and SPCAR models attempt to account for volatility in lines of business and asset returns

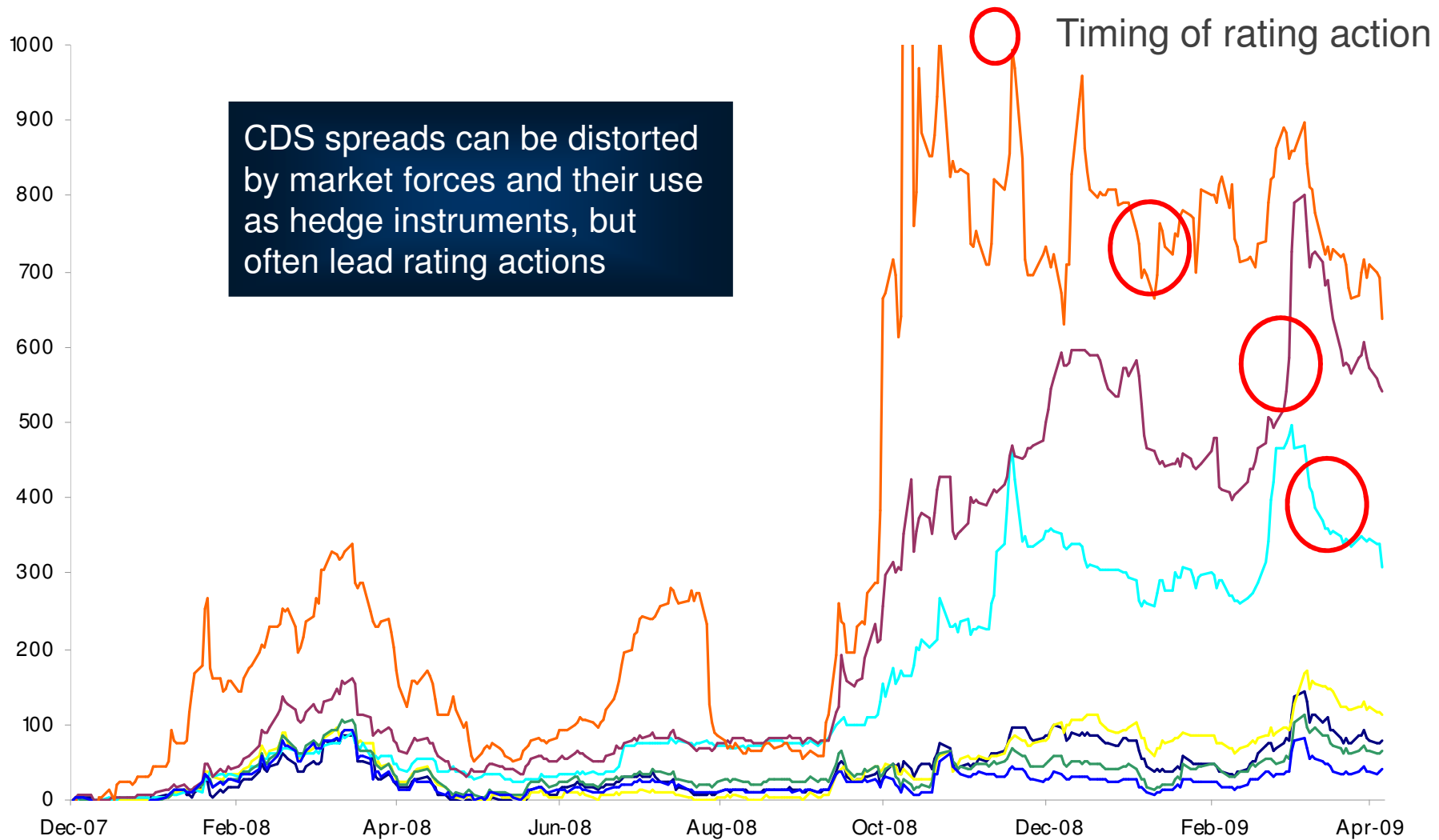
Risk and Relative Return

Case Study – Market volatility and return



More Market Indicators – CDS Spreads

Incorporating market-based metrics can improve ratings / credit risk management





Thank you!

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