Credit FAQ:

Understanding S&P Global Ratings' Request For Comment On Insurers Rating Methodology

December 3, 2018

S&P Global Ratings recently issued a request for comment (RfC) on its proposed rating methodology for insurers (see "Request For Comment: Insurers Rating Methodology," published Dec. 3, 2018).

The intent of the proposed changes to the criteria is to:

- Simplify the criteria by focusing on the key credit factors and risk drivers for insurer creditworthiness;
- Increase the scope for analytical judgement and peer analysis to differentiate creditworthiness;
- Improve transparency of our criteria by consolidating into a single document 10 current criteria articles;
- Enhance consistency of our insurance ratings through greater alignment of our methodologies; and
- Incorporate relevant experience since the last change of our insurance criteria in 2013.

The main proposed changes from our current methodology are as follows:

- We revised the approach to how we combine the business risk profile assessment and the financial risk profile assessment to enable greater differentiation across the rating scale.
- We integrated the key principles of enterprise risk management (ERM) in the relevant key rating factors with no explicit scoring of ERM but with the potential ratings impact of our assessment of risk-related components being more significant.
- We captured the credit impact of management and strategy in the relevant key rating factors of the business and financial risk profiles and increased the focus on the risks posed by governance deficiencies through a separate and distinct governance modifier.
- We simplified the business risk profile assessment by removing explicit scoring of subfactors in competitive position and insurance industry country risk assessment (IICRA), allowing greater scope for analytical judgment.
- We consolidated certain capital and earnings scores and provided greater ability to apply analytical judgement if we believe capital adequacy is over- or understated.

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- Risk exposure replaced risk position, broadening our assessment of the potential impact of exposures upon a company's financial risk profile and including the efficacy of its risk controls.
- Funding structure replaced financial flexibility, focusing on the risks posed by use of leverage, with no explicit uplift for access to capital.
- We enhanced the global consistency of our liquidity analysis.
- We removed explicit caps, to allow more analytical judgement, where appropriate, and reduce the potential for unwarranted ratings volatility.
- We incorporated bond insurers into the scope of the criteria to enhance consistency of ratings across all insurance sectors.

Frequently Asked Questions

Why is the criteria focused on the key rating factors with limited details on the specific application?

We propose to move some text into the proposed guidance document because it meets our definition of guidance and would no longer be considered criteria content. We have included the guidance document as an appendix to the RfC to provide transparency to market participants.

Guidance documents are not criteria because they do not establish a methodological framework for determining credit ratings. They 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 non-fundamental factors that our analysts may consider in the application of criteria, and provide additional guidance on the exercise of analytical judgment under our criteria (see "Criteria And Guidance: Understanding The Difference," published Dec. 15, 2017).

How will ratings be affected if the RfC proposal is adopted?

We expect any changes to insurer ratings to be modest because the underlying principles of our criteria remain largely consistent. We have extensively tested the impact of our proposed criteria. Based on our testing and assuming that these entities maintain their current credit characteristics, less than 5% of ratings will be affected. We estimate that the majority of these rating changes would be within one notch.

Any rating changes resulting from a change in criteria will not take place until after we have published our final criteria.

How will enterprise risk management and management and governance be incorporated into the ratings if they are no longer explicitly scored?

While our proposed rating framework does not include an overarching assessment and individual scoring of ERM and management and governance (M&G), an assessment of the underlying risk-related ratings drivers are viewed as critical components. Therefore, we propose to embed the key elements of ERM and M&G in our key rating factors, such as our assessment of competitive position, risk exposure, and governance.

ERM frameworks have advanced in sophistication across the globe in recent years and even the more simple frameworks may consider a holistic and companywide view of risk. We believe now is the right time to pivot away from ERM as a distinct rating modifier and embed the relevant components of ERM in our assessment of the key rating drivers of insurance company creditworthiness. We believe the proposal will ensure a more integrated discussion and analysis of ERM considerations in our rating of insurers. As a result, the potential ratings impact of our assessment of the components of ERM can be more significant. We believe this change will foster analysis that more effectively integrates ERM considerations in our ratings on insurers.

The assessment of management and governance credit factors remain an important part of our proposed framework as well. Our assessment of management, and the extent to which management succeeds in executing its business and financial strategy, will be directly embedded into our overall view of the company's business and financial risk profiles. The disaggregation of the management and governance factors will also support a greater focus on the risks posed by governance deficiencies. To the extent governance is deficient, it can significantly affect the overall rating.

We also believe the embedding of ERM and M&G will result in greater differentiation for strengths and weaknesses in ERM and M&G.

How does the RfC affect S&P Global Ratings' insurance capital model?

We are not proposing any changes to the capital model criteria (see "Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model," published June 7, 2010) and expect no direct impact on the output from the capital model. However, we are proposing some changes to how we incorporate the model results in our insurance ratings framework. The RfC proposal, if implemented, would also increase scope for judgment in our overall assessment of capital and earnings, highlighting that the precise quantitative output of the model is false precision and gives too little weight to other factors.

We are proposing changes to our criteria for analyzing the capital adequacy of bond insurers (see "Request For Comment: Methodology And Assumptions For Analyzing Bond Insurance Capital Adequacy," published Dec. 3, 2018). If implemented, the proposed criteria would incorporate the asset risk charges from the capital model criteria to achieve consistency with other insurance sectors and enhance the comparability of our ratings. It would also incorporate revised and expanded capital charges for insured bonds to include greater differentiation in recovery expectations for different asset types, sectors, and countries; remove growth assumptions for mature companies; and enhance the methodology we use to determine the rating input for unrated exposures.

Will the change in the calculation of the leverage ratio create volatility in ratings?

We do not anticipate volatility in ratings as a result of using shareholder's equity in the denominator of the ratio. We are proposing to use shareholder's equity to improve transparency in our leverage metrics. Our analysis of a company's funding structure is on a forward-looking basis, and to the extent that material distortions on the balance sheet exist, we will consider whether the ratios are over- or understated and assess the funding structure accordingly.

Why does access to capital no longer provide explicit potential uplift to ratings?

Access to capital no longer provides explicit potential uplift unless we believe there is a high degree of certainty that the insurer will raise capital. In that case, analysts can include expectations of additional capital through the capital and earnings forecast. We believe this approach is more consistent with other parts of our criteria and the approach in other sectors. We also expect that access to markets could provide additional resilience to ratings in a negative company-specific credit event. As market downturns may result in reduced access to capital for all companies, we believe our RfC proposal better captures this dynamic.

Why did you amend the approach to how you combine the business risk profile assessment and the financial risk profile assessment?

By including more options for higher or lower anchor assessments, it improves transparency relative to the current criteria while retaining the scope for analytical judgment that is otherwise present throughout the framework. It also gives the ability to differentiate and provide our views on relative credit risk.

How will the inclusion of bond insurers into the scope of this framework affect bond insurer ratings?

The inclusion of bond insurers into the scope of this framework is expected to increase consistency of ratings with other insurance sectors. Our preliminary testing indicates that their proposed inclusion into this framework, along with the proposed revisions to our criteria for analyzing the capital adequacy of bond insurers is unlikely to affect any existing credit ratings on bond insurers.

What is the process for submitting comments?

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 RfC 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 be sent to
CriteriaComments@spglobal.com
should participants encounter technical difficulties. However, comments should not be sent directly to the contacts listed on the RfC.

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.

This report does not constitute a rating action.

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