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&

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Layout & Distribution: Valéria Kozakova

Rating Agencies Communications Issues

Rob Jones

Agenda

- **Users and uses of ratings**
- **Misuses and abuses of ratings**
- **Getting more value from ratings**
- **Impact of ratings on the management of insurers**
- **Communication between S&P and its rated clients**

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146 Years of Standard & Poor's

1860 Henry Varnum Poor
1922 Ratings on issuances
1944 Standard Statistics

Today –
220,000 issue ratings
4,000 insurers
40 offices
1,200 analysts
200 financial services analysts
50 insurance analysts in Europe

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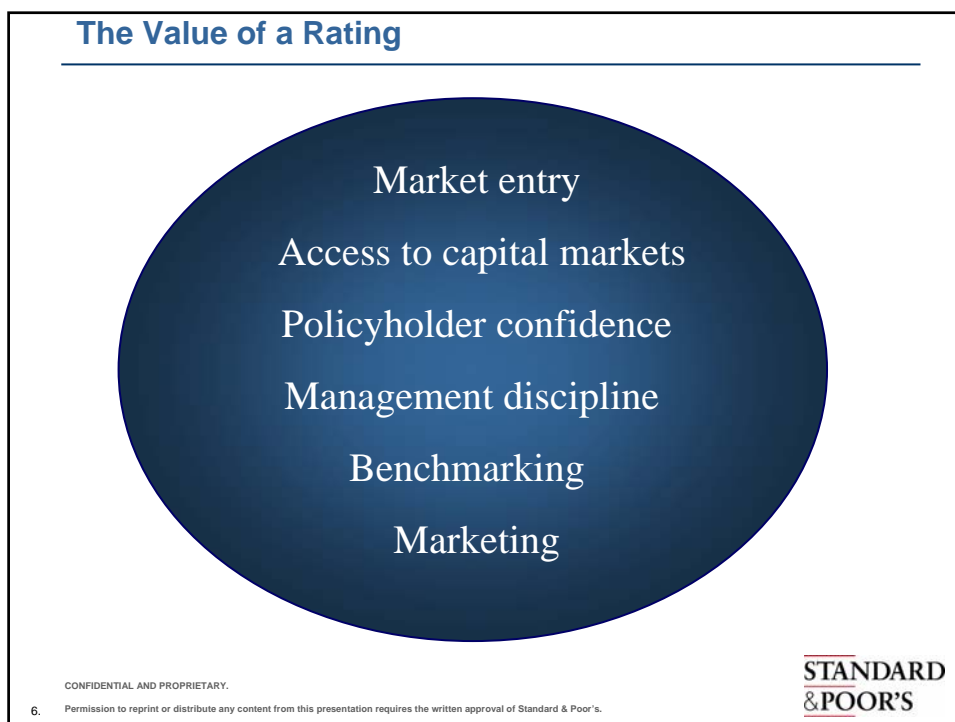
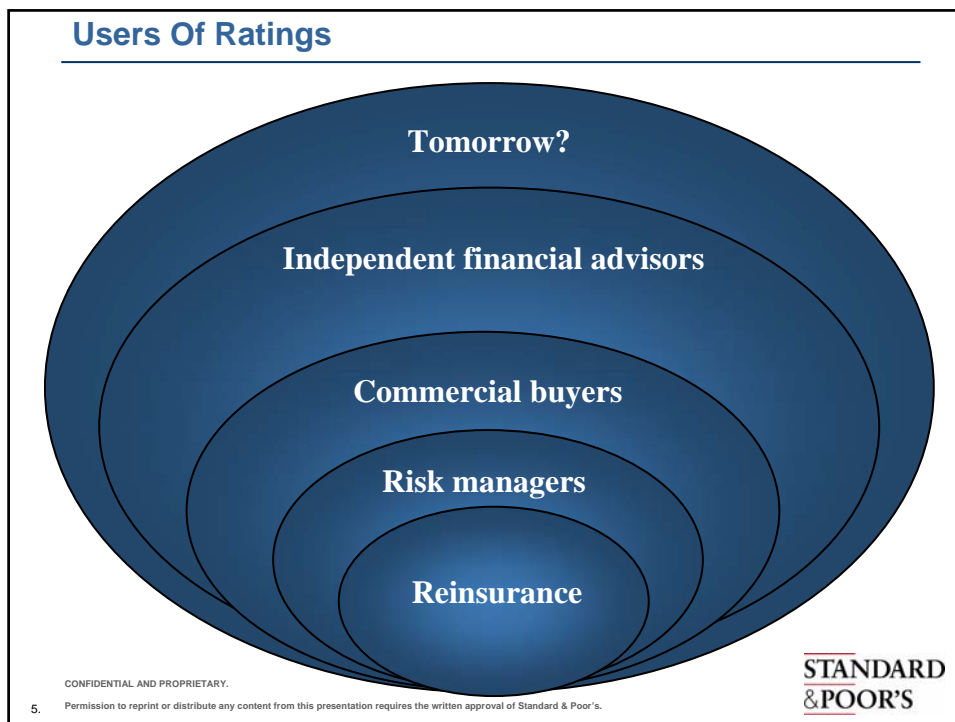
How Did We Get Here?



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Role of Ratings on Insurer Balance Sheets

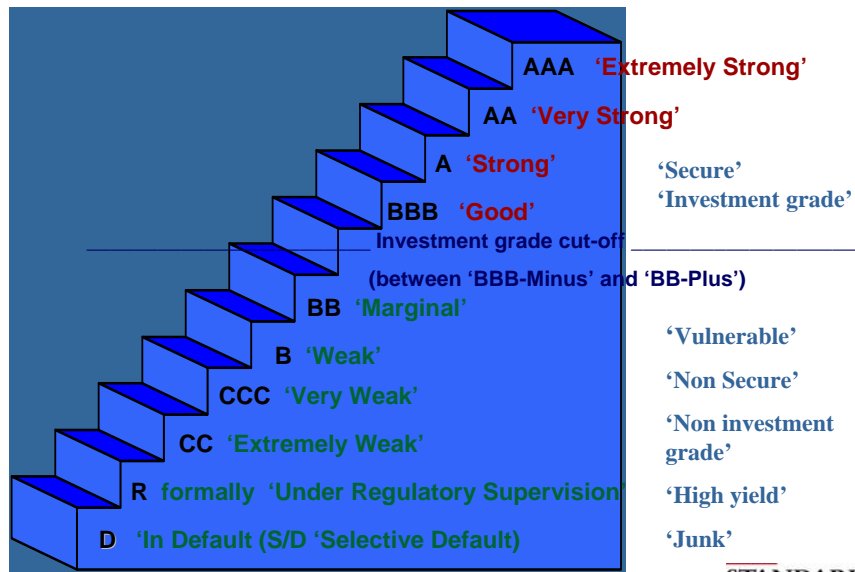
Entity	Assets	Liabilities
Operating company	Government bonds Corporate bonds Bank deposits Reinsurance recoverable Securitisations	Policyholder obligations Hybrid equity Securitisations
Holding company	Bank deposits	Senior debt Hybrid equity

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Standard & Poor's Rating Scale



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Outlook And CreditWatch

Outlook

- Rating trend
- Stable, positive, negative, developing
- Medium term (<2 years) possibility of rating change
- Bi-directional

CreditWatch

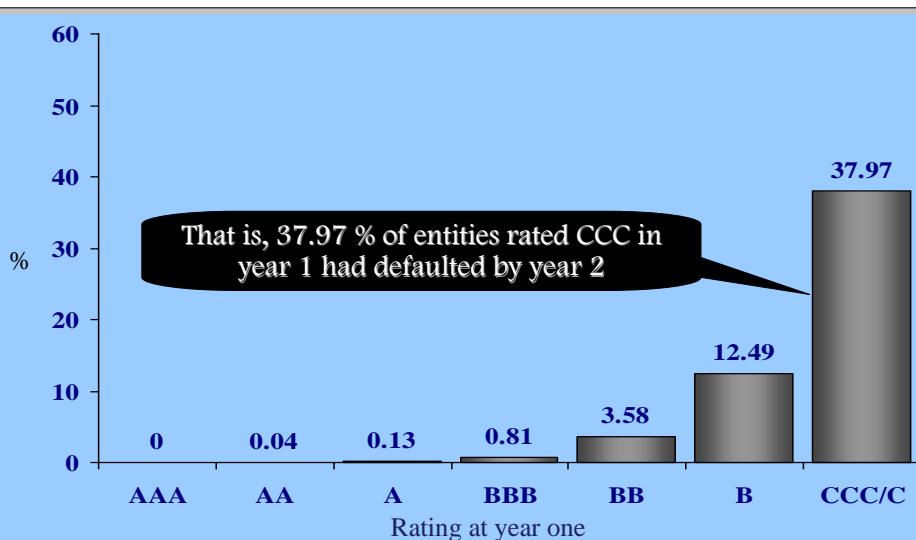
- Normally responds to events
- Positive, negative, developing
- Near term (<3 months) possibility of rating change

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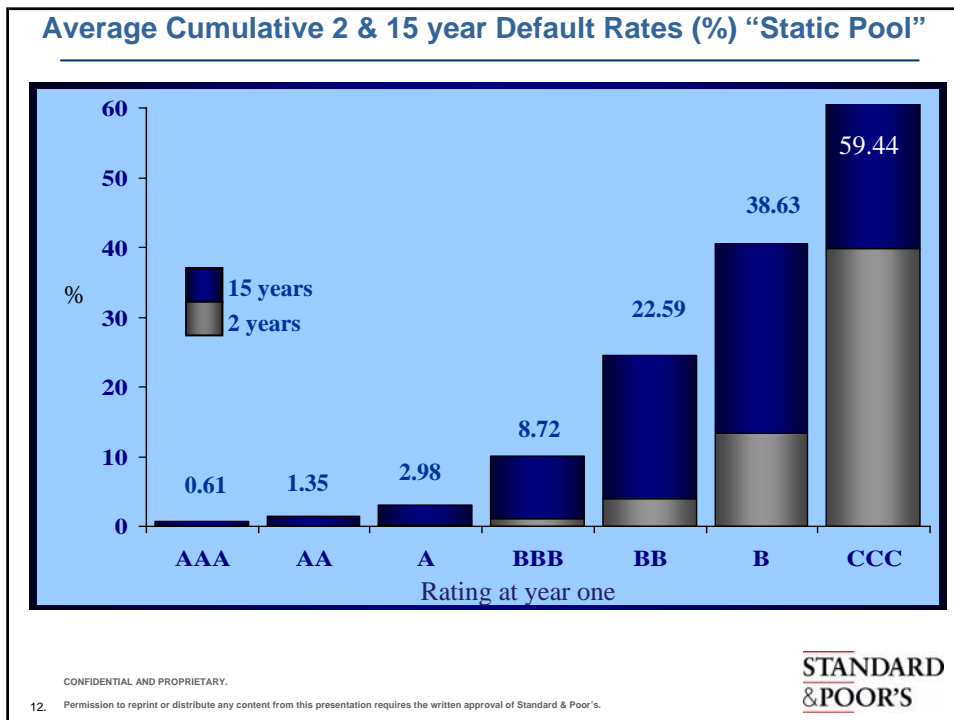
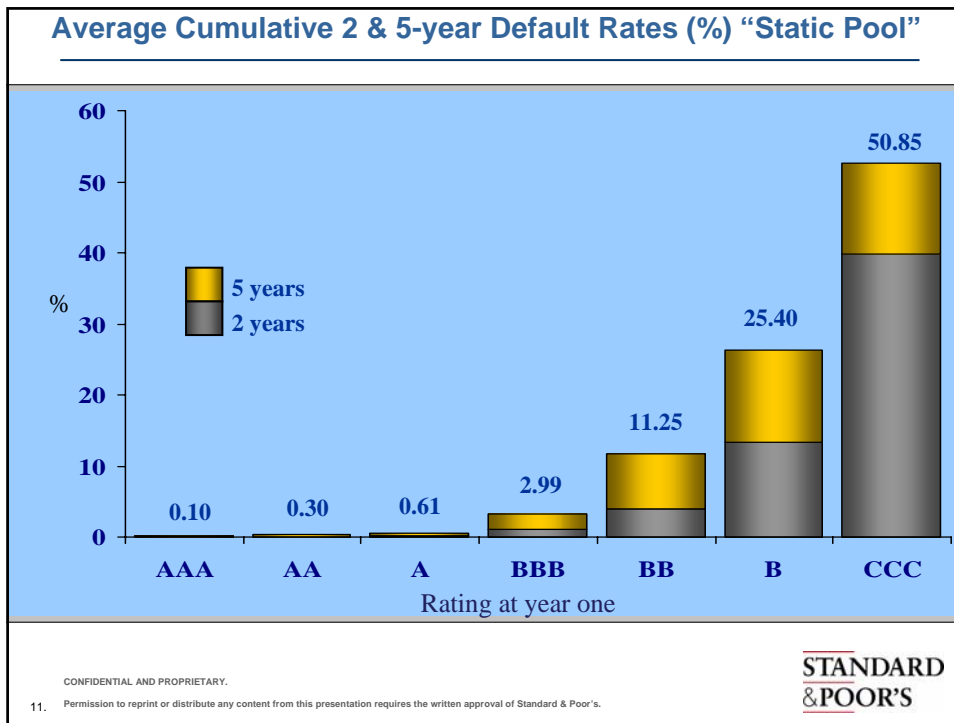
Average Cumulative 2-year Default Rates (%) "Static Pool"



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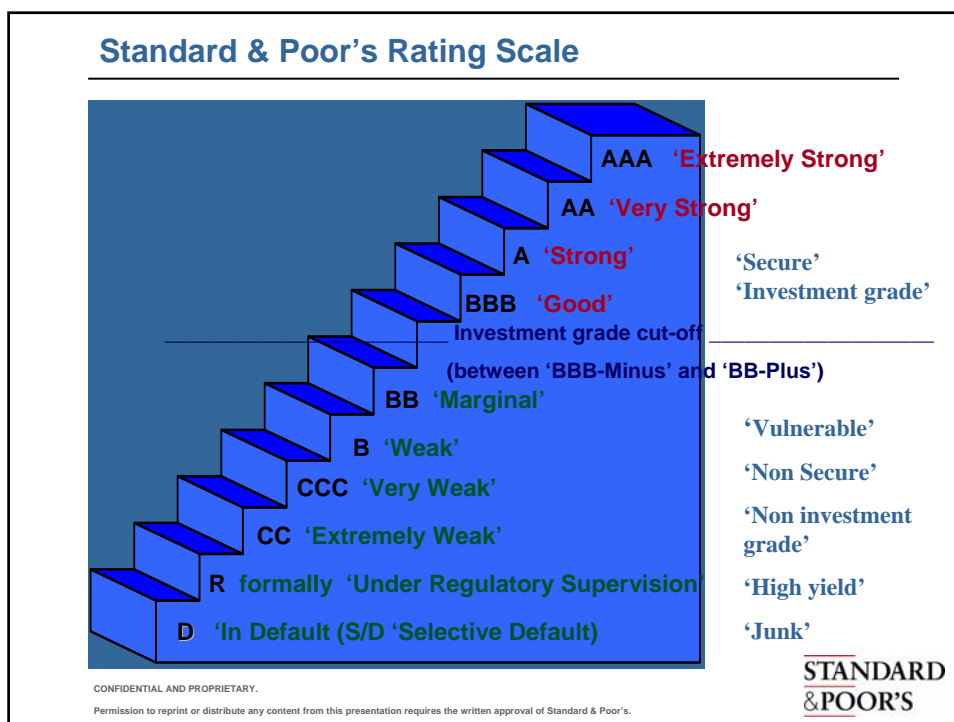


Performance of Ratings: Transitions

Rating at year end (%)									
Initial rating	AAA	AA	A	BBB	BB	B	CCC	D	NR
AAA	89.62	5.92	0.43	0.09	0.03	0.00	0.00	0.00	3.93
AA	0.60	88.29	6.78	0.51	0.05	0.09	0.02	0.01	3.66
A	0.06	2.10	87.79	5.04	0.43	0.17	0.04	0.05	4.33
BBB	0.03	0.23	4.36	84.43	4.15	0.73	0.23	0.26	5.58
BB	0.02	0.06	0.41	5.75	75.98	7.05	1.09	1.22	8.42
B	0.00	0.08	0.27	0.35	4.77	74.15	3.90	5.96	10.53
CCC	0.11	0.00	0.22	0.67	1.45	8.95	51.34	24.72	12.53

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Where Do Insurers Need To Be On The Rating Scale?

'AAA':	Monoline Bond Insurance
'AA-' or Better:	UK With Profits; Group Life; Long-term Savings & Pensions; Life Reinsurance; Long-tail Liability
'A-' or Better:	Non-life Reinsurance; Broker-Driven Business
'BBB-' or Better:	Any company or issuer of debt wishing to avoid non-investment grade status
'B' or Better:	Non-Investment grade issuer selling its paper into wholesale markets
'CCC' or lower:	An insurer/reinsurer actively seeking commutations...

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Rating Equivalence

- **S&P and Fitch**
 - Same symbology
 - Capital market equivalence
- **Moody's**
 - Similar symbology ('AA+' = 'Aa1'; 'BBB-' = 'Baa3')
 - Capital market equivalence
- **Best**
 - Different symbology ('A++', 'A+', 'A', 'A-', 'B++', 'B+', etc)
 - Not recognised in capital markets
 - Insurance markets treat 'A-' as equivalent (although some major brokers equate Best 'A-' with S&P 'BBB' category)

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Getting More Value From Ratings

- Rarely more than a 'passport'
- Pricing rarely reflects reinsurer credit risk – unlike the capital markets
- Changes began in 2003
- Swiss Re January 2006 renewals announcement

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Impact of Ratings on Insurer Management

- Intensive relationship
- Management rating objectives
 - May be public
 - Baked into risk tolerance in Economic Capital models
- Explicit expectations
 - Reinsurer ratings assume cyclical risk is much reduced
 - Price adequacy is more transparent
 - Renewals announcements
 - Rate monitoring
 - Board oversight

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Categories Of Analysis

1. **Industry Risk**
2. **Competitive Position**
3. **Management & Corporate Strategy**
4. **Enterprise Risk Management**
5. **Operating Performance**
6. **Investments**
7. **Liquidity**
8. **Capitalisation**
 1. Capital adequacy
 2. Reserves
 3. Reinsurance ceded
 4. Quality of capital
9. **Financial Flexibility**

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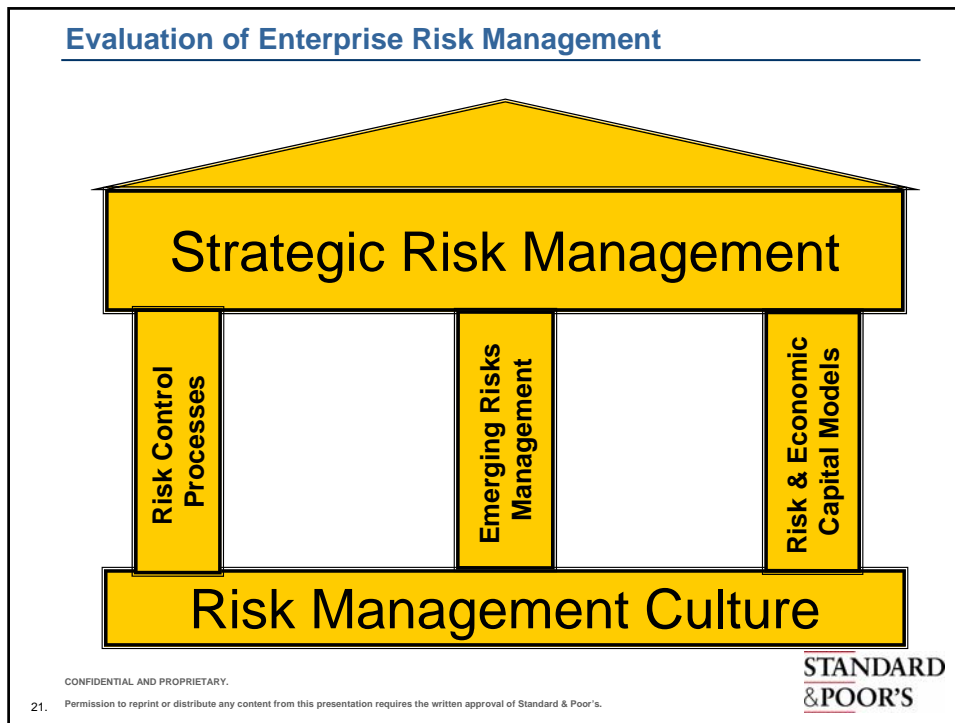
How Sensitive is Rating to Capital Adequacy?

- **It depends!**
- **Medium term view**
- **Quality issues**
- **Absolute size**
- **Many companies have ratings lower than CAR score**
- **Many companies maintained much higher ratings than that implied by CAR score over 2001-2003**

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- ### Enterprise Risk Management
- **Capital incentives**
 - **ERM assessment objectives**
 - **CROs**
 - **Risk tolerance**
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The Interactive Process

- **New ratings process**
- **The management meeting**
- **Other relationship issues**
- **Surveillance issues**

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New Ratings Process

- **Rating request**
- **Assign analyst**
- **Initial information request**
- **Management meeting**
- **Prepare committee presentation**
- **Committee**
- **Acceptance, appeal, rejection**
- **Press release**
- **Full analysis**

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The Management Meeting

Who should be there?

- CEO
- CFO
- Senior underwriters
- Sales / Marketing director
- Chief Investment Officer
- Chief Actuary
- Director responsible for ceded reinsurance
- Rating agency coordinator
- Rating advisor?
- At least two S&P analysts

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Management Meeting Style

Formal multi-media presentation

or

What do you want to know?

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Other Relationship Issues

- **Open (no black box)**
- **Honesty and integrity**
- **No surprises**
- **Coherent presentations**
- **Regular dialogue**
- **Confidentiality**

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Surveillance Issues

- **Surveillance is ongoing**
- **Formal annual management meeting**
- **Withdrawal of rating**
- **Creditwatch**

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What To Do With News?

- **Prior notice**
 - Informal feedback
 - Rating Evaluation Service
 - Provides certainty
 - Simultaneous announcement

- **Little or no notice**
 - Possible unnecessary CreditWatch or outlook change

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Acquisitions

- **Industry track record**
- **Execution risk**
- **Targets typically weaker**

- **Negative bias**
 - Downgrade
 - Negative outlook
 - Removal of positive outlook
 - Maintain stable outlook
 - Currently at upper end of the rating level
 - Target has same or higher rating

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Questions

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