



International Association for the
Study of Insurance Economics

Études et Dossiers

Extract from

Etudes et Dossiers No. 350

**5th Insurance and Finance Seminar of
The Geneva Association**

8-9 December 2008
London

February 2009

**Working Paper Series of
The Geneva Association**

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Layout & Distribution: Valéria Kozakova

Rating Agencies and their Changing Role in Communicating to Markets

Simon Harris

Changing Role In Communication of Information

- What ratings are and are not
 - Fundamental credit ratings vs quantitative indicators
- Changes to communication : Transparency
 - of rating actions (rating scorecard)
 - of rating approach (methodologies, PR wording)
- What constituents (investors, issuers, brokers) communicate to us



Moody's Investors Service

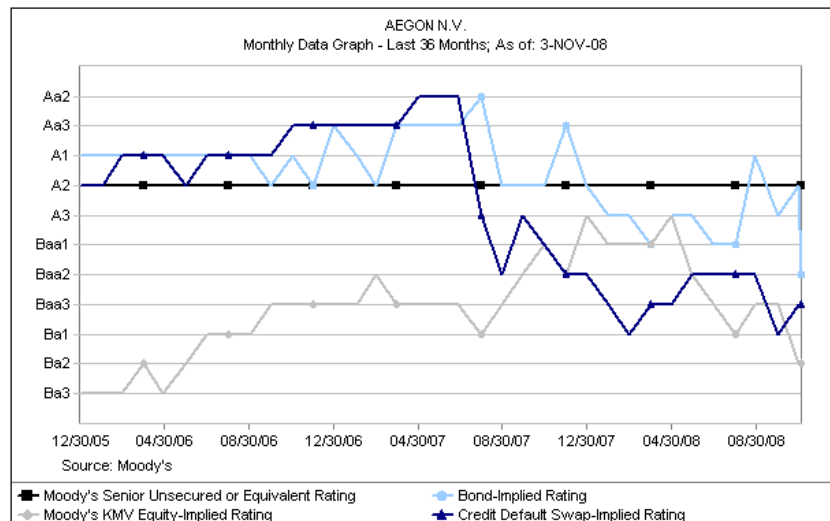
What (fundamental) ratings are

Fundamental Insurance Ratings	Financial strength : "Opinions of the company's ability to repay punctually their senior policyholders' claims and obligations"	Debt ratings : "Reflect the companies' abilities to meet their obligations to repay interest and principal on outstanding obligations to fixed-income investors "	Relative default risk, over time and between names Rate through the cycle, long-term stability Not connected to asset price
Quantitative Ratings (eg Moody's KMV)	Default estimates based on market-derived statistics (equity prices, bond yields, CDS)	Short-term estimates, volatile, move daily	Automated, model-driven



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Example Fundamental vs Quantitative : Aegon



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Changes to Communication : Transparency of Methodology

Rating Factors

P&C Insurance Ltd. (Publ)[1]

Financial Strength Rating Scorecard [1]	Aaa	Aa	A	Baa	< Baa	Score	[2]Adjusted Score
Business Profile							Aa A
Market Position, Brand and Distribution (25%)							Aa A
Market Share Ratio	X						
Relative Market Share Ratio			X				
Expense Ratio % NPV			X				
Product Focus and Diversification (10%)							A A
Product Focus			X				
P&C Product Diversification				X			
Geographic Diversification					X		
Financial Profile							A A
Asset Quality (5%)							Aa Aa
High Risk Assets % Invested Assets [1]			13.7%				
Reinsurance Recoverable % Equity [3]	19.9%						
Goodwill % Equity [3][4]			15.0%				
Capital Adequacy (15%)							A A
Gross Underwriting Leverage [5]				4.3x			
Profitability (15%)							Baa A
Return on Equity (5 yr. avg.) [6]			12.1%				
Sharpe Ratio of Growth in Net Income (5 yr.) [6]					Negative		
Reserve Adequacy (10%)							Aa A
Adv(Pav) Reserve Dev. % Beg. Reserves (5 yr. avg.) [7]			0.8%				
Financial Flexibility (20%)							Aa Aa
Financial Leverage [3]			21.9%				
Earnings Coverage (5 yr. avg.) [8]			10.6x				
Aggregate Profile							A1 A2



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- Transparent methodologies with rating metrics for life, P&C, reinsurance
- Clear rating drivers and metrics for virtually all credits
- Updated semi-annually and after any rating action

Changes to Communication: Transparency of Rating Decisions

- Reflecting market volatility and sensitivity, much emphasis placed on suitability of wording of press releases and statements
- High profile press comments are reviewed by Moody's Senior Management and Communications to ensure clarity of message & lack of ambiguity
- Aim to provide clear rating drivers and rating change expectations, where appropriate



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Communication : What we hear from the market...

- We regularly interact with issuers and major market participants to evaluate
 - What they want more of
 - What they want less of
 - What we can do better
 - What we should change, what should stay the same
 - What their perception is of the Insurance industry
- Feedback from nearly 200 attendees at 2 x conferences in November (London / Zurich)



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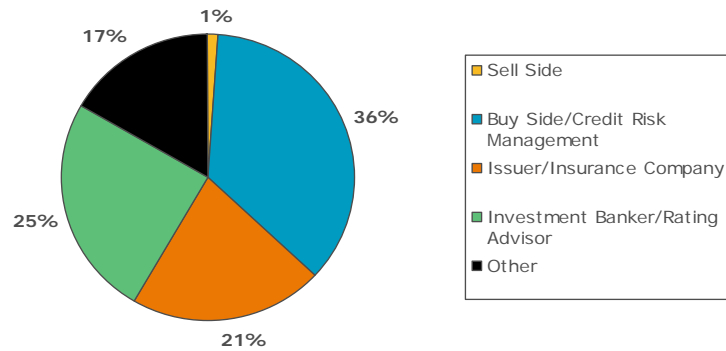
Generic feedback to Moody's

- Ratings Scales – investors prefer to have fundamental and structured finance ratings on the same rating scale
- Regulation – regulatory oversight of rating agencies is undoubtedly increasing
- Objective Credit Opinions – particularly in difficult and volatile times, high value placed on objective, expert opinion
- Insurance - generally remains a poorly-understood sector amongst fixed-income analysts; education and information a high priority



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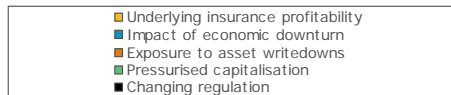
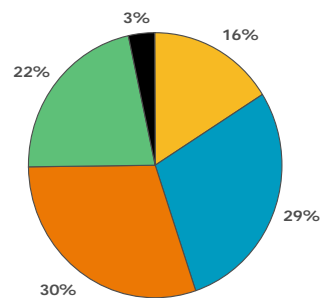
Investor & Issuer Feedback – Who Were They?



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Q : What is your biggest concern for the insurance industry in the short/medium-term?

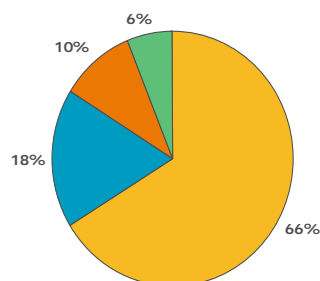
- a) underlying insurance profitability
- b) business impact of prolonged economic downturn
- c) exposure to asset writedowns
- d) pressured capital
- e) changing regulation



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Q : How do you compare the risk profiles of European Insurers and Banks?

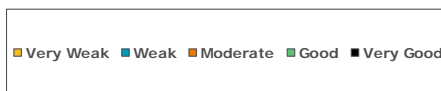
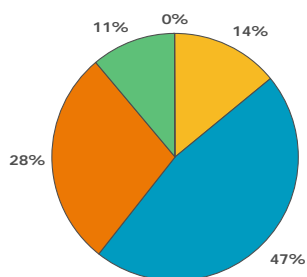
- a) Insurers have lower risk profiles than banks
- b) Insurers have similar risk profiles to banks
- c) Insurers have higher risk profiles than banks
- d) I don't like insurers or banks



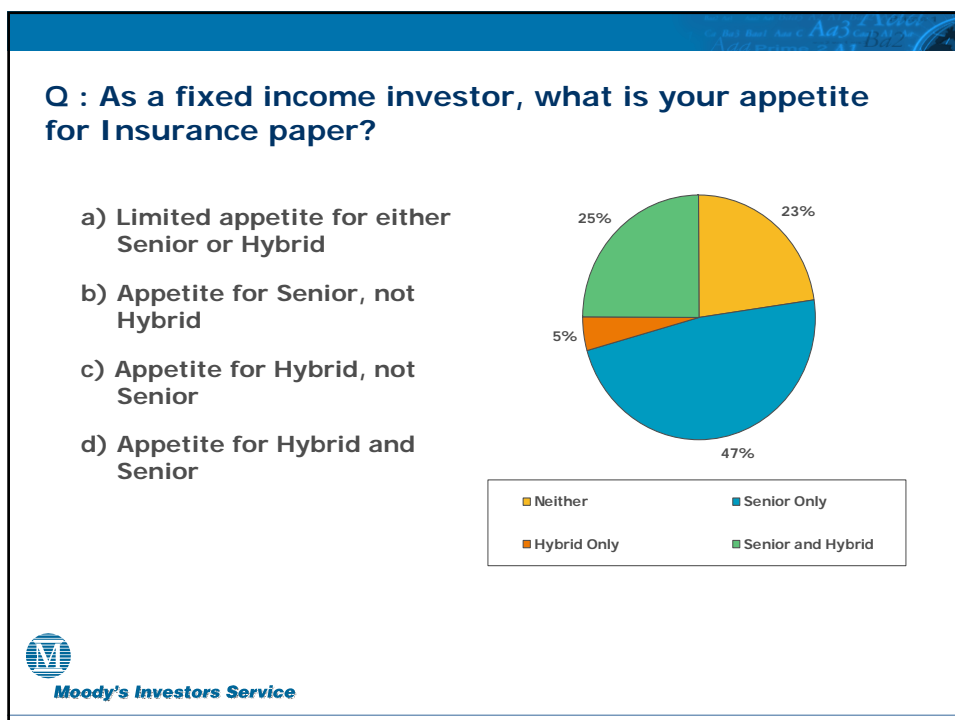
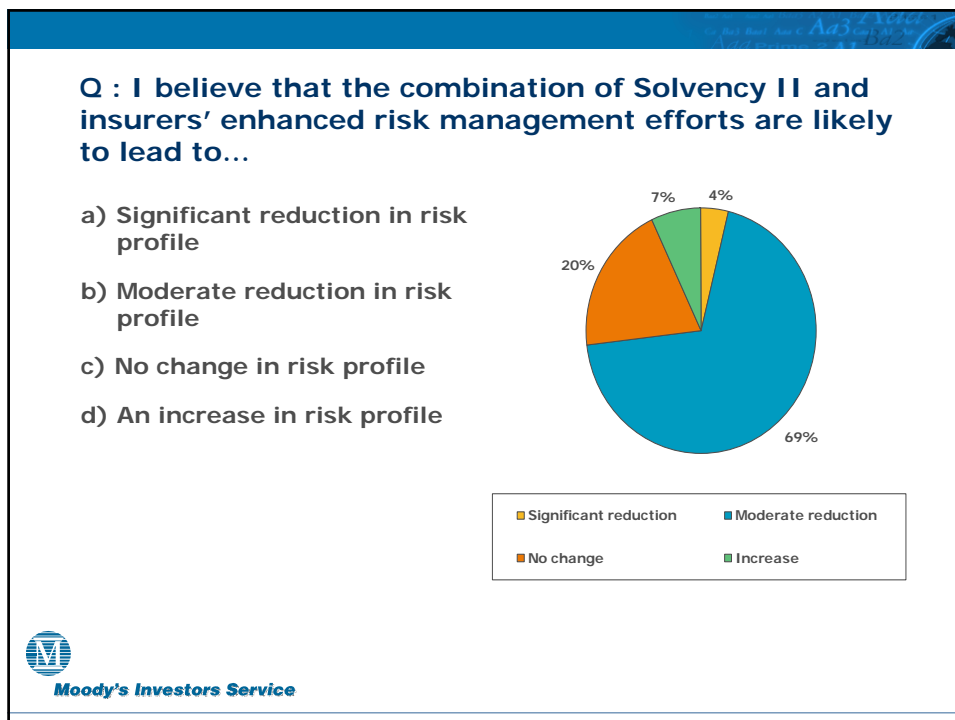
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Q : What is your view on the transparency and understandability of Insurance accounting and regulation?

- a) Very Weak
- b) Weak
- c) Moderate
- d) Good
- e) Very Good



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Conclusions

- Ratings continue to be based on through-the-cycle fundamental analysis
- We have enhanced the transparency of our rating methodologies and communication to the market
- Moody's continues to work hard in reaching out to major issuer and investor constituencies
- Insurance investors are still out there, but they need some convincing



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