The Impact of Rating Agencies on the Insurance Industry – Fitch Ratings CIPR Webinar

Keith M. Buckley, CFA
Head of Global Insurance / Managing Director

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The Global Rating Agency with Local Market Experience

Who We Are

• Fitch Ratings is a global rating agency committed to providing value beyond the rating through independent and prospective credit opinions, research and data
• We offer a world of knowledge and experience behind every opinion, we transform information to deliver meaning and utility to investors, issuers and other market participants
• Our global expertise draws on local market knowledge and spans the fixed income universe
• The additional context, perspective and insight we provide help investors make important credit judgements with confidence

Key Facts

• Founded in 1913, the Fitch Group has dual headquarters in London and New York and over 2,800 employees globally
• Majority owned by Hearst Corporation
• Diversified financial services group operating across credit ratings, financial data solutions and training

Global Presence

• 37 offices worldwide

Deep Analytical Coverage

<table>
<thead>
<tr>
<th>Diverse Global Issuer Coverage</th>
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<tbody>
<tr>
<td>114 Sovereigns</td>
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<td>3,787 Banks and NBFIs (exc. German co-op &amp; savings banks)</td>
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<td>1,241 Insurance</td>
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<td>2,818 Corporates</td>
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<td>419 Global Infrastructure Projects</td>
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<td>7,400 Structured Finance under surveillance</td>
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<th>Research Distribution</th>
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<td>Powerful distribution platform through fitchratings.com</td>
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<td>1,500+ distinct institutional subscribers</td>
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<td>40,000+ individual users</td>
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<td>Thousands of investors attend corporate events and investor meetings annually</td>
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Fitch rates 383 Property & Casualty Insurance entities in North America
Ratings Process Overview
### Master Insurance Criteria includes

- Key Credit Factors
- Hybrid Securities
- Group Rating Methodology
- Notching Methodology
- Start-up and Run-off Companies
- Short-term Ratings
- Recovery Analysis
- Captive Insurance Companies
- Separate ILS Criteria
### Fitch Ratings: Key Credit Factors

#### Key Qualitative Factors
- Sovereign and country-related constraints
- Industry profile and operating environment
- Business profile
- Ownership
- Corporate governance and management

#### Key Quantitative Factors
- Capitalisation and leverage
- Debt service capabilities and financial flexibility
- Financial performance and earnings
- Investment and asset risk
- Asset/Liability and liquidity management
- Reserve adequacy
- Reinsurance, risk mitigation, catastrophe risk

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#### Ratings Range Based on Industry Profile/Operating Environment

<table>
<thead>
<tr>
<th>IFS Rating Category</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
<th>&lt;BBB</th>
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<td>Non-Life</td>
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<td>Reinsurance lines</td>
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<td>Composite</td>
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<td>Life Insurance</td>
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Fitch Ratings: Sector Credit Factors

**Increases Transparency**

- Supplementary reports describing the key credit factors used to analyze specific sectors and regions
- Including various median financial ratios by rating category, as well as charts that demonstrate how key qualitative factors affect a typical rating range
“Not All Insurer Financial Strength Ratings Are Created Equal”

White Paper on Lack of Comparability of A.M. Best’s ‘A-’ IFS Ratings to Those of Fitch

Published by Fitch in July 2016

Key Conclusion: An ‘A-’ Insurer Financial Strength (IFS) rating from AM Best is most comparable to a ‘BBB’ IFS rating from Fitch (as well as S&P and Moody’s)

We urge ratings users to modify ratings equivalency standards that currently treat ‘A-’ ratings from all agencies the same
Fitch white paper revisited

- Four areas with unquestionable comparability issues at ‘A-’
  - Newly formed (re)insurers
  - High country risk/low sovereign ratings
  - Captives
  - Smaller sized insurers

- In these cases, AM Best often assigns ‘A-’ IFS ratings when Fitch would rate in the ‘BBB’ range
Fitch white paper revisited

- Diven by both criteria and rating scale differences

  - AM Best’s criteria weighs certain risks in a very different manner than Fitch (as well as Moody’s and S&P)

  - For example, Fitch will constrain ratings for start-up and sovereign risks, which we view as material, and AM Best considers less material

  - AM Best’s Financial Strength Rating (FSR)* scale is different, and has fewer categories

  - Thus, certain AM Best rating categories, including ‘A-’, are naturally “larger”

* Note: FSR and IFS are interchangeable terms
We also examined differences in historic statistical ratings performance.

- Fitch, S&P and Moody’s have very similar performance.

- AM Best’s performance appears to be less favorable at ‘A-’.

- In fairness, part of reason is different measurement method, as AM Best reports impairment rates and the other agencies report default rates.
Fitch white paper revisited

- AM Best 10-year impairment rate at ‘A-’ is 6.7%
- Fitch 10-year default rate at ‘A-’ is 2.0%
- A 6.7% impairment rate most closely aligns with Fitch’s ‘BBB’ IFS rating default rate

“…Fitch recognizes impairments are expected to occur at a higher frequency than defaults. However, Fitch also believes the noted differences at ‘A-’ falls outside normal impairment versus default expectations. Nonetheless, readers are cautioned to keep the differences between impairments and defaults in mind when drawing their own conclusions.”
Less than one quarter of respondents felt an ‘A-‘ from A.M. Best and Fitch were comparable.
The Task Force noted that the issue will be reviewed in greater detail during the next evaluation of the appropriate amount of collateral that should be posted for certified reinsurers.
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