

A Guide to Understanding Captive Insurance Ratings

An A.M. Best Company presentation for
Delaware Captive Insurance Association, Inc.

May 8, 2012



Presentation Outline

- History of A.M. Best Company
- Value of a Rating
- How Captives are rated
- Rating scales: FSR, ICR, Debt Rating
- Interactive rating process
- The Role of BCAR (Best's Capital Adequacy Ratio model)
- Captive rating process
- Things to remember
- Q&A and contact information



A.M. Best Overview

- Established in 1899, A.M. Best has provided the public with comprehensive and unbiased financial information on insurance companies for more than 100 years.
- Leading worldwide
 - Rating agency
 - Data provider
 - Publishing company
- Began rating:
 - Property insurers in 1906
 - Life insurers in 1928
- In 2005, gained Nationally Recognized Statistical Rating Organization (NRSRO) status by the Division of Market Regulation, U.S. Securities and Exchange Commission.



The Value of an A.M. Best Rating

- Independent third party oversight
- Validate Financial strength and credibility
- Satisfy regulatory requirements
- Enhance access to Reinsurance
- Provides greater flexibility regarding fronting arrangements
- Benchmarking



How Captives are rated differently than Commercial Insurers

- Dedicated team of 5 financial analysts that only cover captives
- Captives and Protected Cell Corporations (cell captives) have a separate rating methodology
- Market profile assessment has the greatest divergence
- Operating performance stresses preservation of capital and reduction of insurance cost to insured's of profitability and return measures
- BCAR treatment



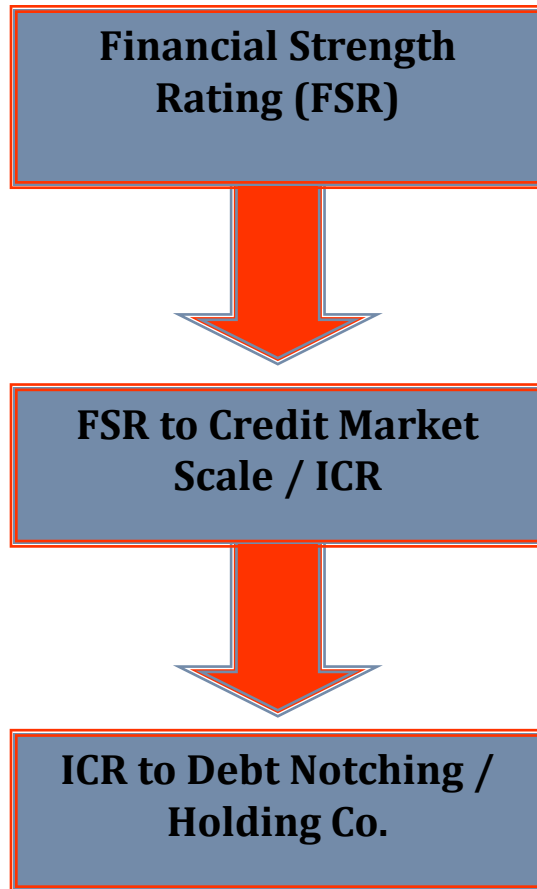
A.M. Best Rating

An A.M. Best rating is based on historical default rates. It's an opinion as to an insurer's financial strength and ability to meet its ongoing obligations to policyholders.

- A Financial Strength Rating (FSR) is assigned to a rated company
- Ratings range from A++ to E



A.M. Best Rating Definitions



A.M. Best's **Financial Strength Rating (FSR)** is an opinion as to an **insurer's** ability to meet its ongoing obligations to **policyholders**.

A.M. Best's **Issuer Credit Rating (ICR)** is an opinion as to the ability of the **issuer's** ability to meet its ongoing **senior financial obligations**.

A.M. Best's **Debt Rating** is an opinion as to the **issuer's** ability to meet its ongoing **financial obligations to security holders** when due.



Rating Correlations

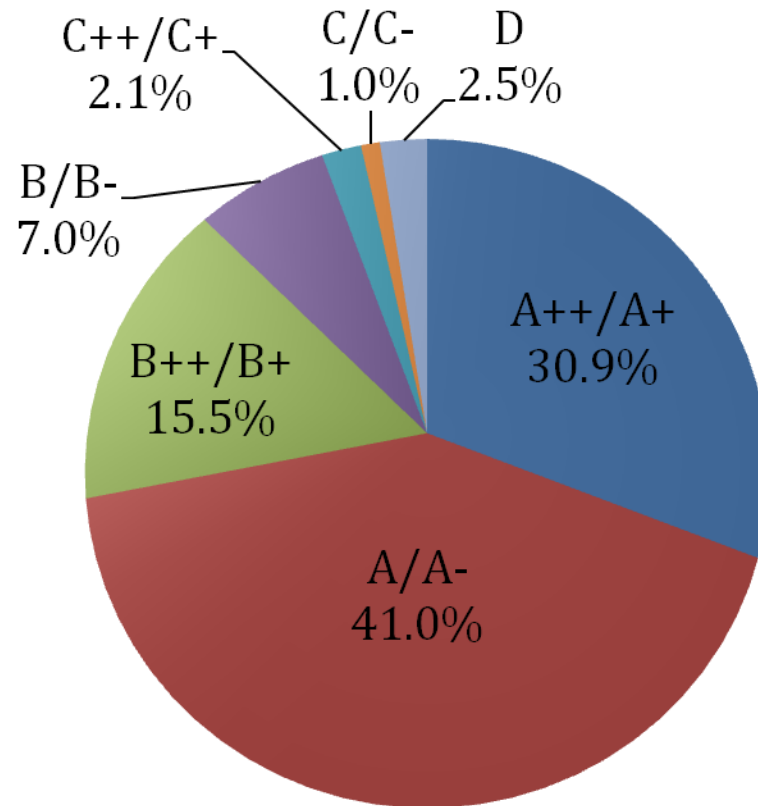
Credit Market Scale to FSR

	FSR	ICR	
Secure	A++	aaa aa+	Investment Grade
	A+	aa aa-	
	A	a+ a	
	A-	a-	
	B++	bbb+ bbb	
	B+	bbb-	

	FSR	ICR	
Vulnerable	B	bb+ bb	Non-Investment Grade
	B-	bb- b+	
	C++	b b-	
	C+	ccc+	
	C	ccc ccc-	
	C-	cc	

Best's Ratings – Historical Rating Distribution

U.S. life/health and property/casualty data from 1977 to 2010.



A.M. Best's Interactive Rating Process

- Information Captured using A.M. Best Proprietary Rating Forms
 - Supplemental Questionnaire, QAR
- Develop Comprehensive Company Database
- A.M. Best meets Senior Company Executives
 - Explore Company's Strategy and Future Direction
- Develop Rating Recommendation



A.M. Best's Interactive Rating Process

- Rating Recommendation
- Peer Review Committee
- Communicated to Company
- President's Letter
- Public reports not published or released until Company has signed off on them



Rating Evaluation Key Components



A.M. Best's Rating Evaluation

Balance Sheet Strength

- Leverage
- Capital Structure/Holding Company
- Quality & Appropriateness of Reinsurance
- Adequacy of Loss Reserves
- Quality & Diversification of Assets
- Liquidity
- Growth
- Risk Adjusted Capitalization (BCAR)



Best's Capital Adequacy Ratio - BCAR

- Comprehensive tool to evaluate risk components simultaneously
- Generates overall estimate of required level of capital to support risks
- Minimum required capital for specific ratings



Sample Capital Guidelines

Rating	BCAR Score	Median
A++	175	242
A+	160	259
A	145	227
A-	130	200
B++	115	161
B+	100	140
B	90	117
B-	80	100
C++/C+	60	83

Exceptions Based on Overall Analysis



A.M. Best's Rating Evaluation Operating Performance

- Level of Profitability
 - Historical
 - Perspective
- Stability/Volatility of Earnings
- Sustainability of Earnings
- Revenue Composition/Quality of Earnings
- Ability to meet plan



A.M. Best's Rating Evaluation Business Profile

- Market Risk
- Spread of Risk
- Event Risk
- Competitive Advantages
- Management



How is the rating derived?

- Ratings are based on **quantitative** measures and **qualitative** information.
- The rating process is interactive
- The rating process is customized
 - One size does not fit all
 - No cookie-cutter rating analysis



Documentation & Expectations

Audited
financial
statements

Actuarial
Report

Reinsurance
and vendor
contracts

Face-to-face
meeting
encouraged

3 to 5-year
projections and
business plan

PML and/or
Terrorism study

Management
bios

Supplemental
Ratings
Questionnaire



Things to Remember...

- Company does not need operating experience
- Net retention to surplus over 10%
- Any basis of accounting is OK
- Actuarial study required to get credit for prior history
- Projected growth should be limited to 15% annually
- Treatment of affiliate reinsurer



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Learn More



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