Article Title: ARCHIVE | Criteria | Insurance | Life: Advance Notice Of Proposed Criteria Change: Updating The Stress Analysis Applied To Insurers' Capital Adequacy Data: (EDITOR'S NOTE: — Standard & Poor's published the criteria article titled, "Analysis Of Insurer Capital Adequacy," on Dec. 18, 2009. This advance notice of proposed criteria change is no longer current.) 1. Standard & Poor's Ratings Services is updating its incremental stress analysis for evaluating insurance companies' capital adequacy. We are incorporating higher levels of stressed loss assumptions for certain asset classes. We are undertaking this updated analysis at this time to better assess the stress losses assumed during our February 2009 analysis based on more current information. These criteria apply higher levels of stressed loss assumptions above the baseline insurance risk-based capital model. Upon implementation of these updated criteria, we expect that some of the incremental stress factors might increase. As was the case earlier this year, this exercise will primarily affect North American life insurance companies. 2. We will not apply incremental stresses to the baseline insurance risk-based capital model where current values are reported on a marked-to-market basis (for example, GAAP/IFRS), reflecting sharp declines in fair value. 3. Standard & Poor's expects to publish the updated criteria detailing loss assumptions for each asset class by confidence level consistent with our ratings, along with any related rating actions, by March 2010. 4. This stress scenario analysis is consistent with the framework introduced in "Understanding Standard & Poor's Rating Definitions," published June 3, 2009, on RatingsDirect. We will apply hypothetical stress scenarios that we will use for promoting ratings comparability. We will use the scenarios as benchmarks for calibrating our criteria across different sectors and over time. The scenarios will not become part of the rating definitions, and they will not be the sole or primary factors in our criteria for determining our ratings on insurance companies. However, they will be an important tool for calibrating our criteria to help maintain comparability across sectors and over time. 5. Based on our view of the current economic conditions, we believe the current environment is consistent with a modest level of stress. The scenario for a particular rating category reflects a level of stress that issuers or obligations rated in that category should, in our view, be able to withstand without defaulting (see "Understanding Standard & Poor's Rating Definitions"). That's not to say we don't expect some issuers to suffer downgrades. On the contrary, we believe that the occurrence of stress conditions that might be characterized as substantial, severe, or extreme likely would lead to a large number of downgrades of rated issuers and obligations. The scenarios do not represent a guarantee that rated entities will not default in those or similar scenarios. 6. For insurers, we naturally would expect relatively little credit deterioration during benign market conditions or periods of only mild or moderate stress. Conversely, insurers and their investment portfolios could suffer greater credit deterioration during times of severe or extreme stress. We expect to reduce these incremental stress charges in the future as the financial and economic conditions return to greater stability. 7. Our analysis will focus on corporate bonds, residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and directly originated commercial real estate loans, which, in total, represent approximately 80% of total invested assets for the North American life insurance sector. For all four asset classes, we plan to incorporate more current information and new discrete analytical tools to assess potential updated stress economic losses. 8. On Nov. 6, 2009, we introduced our U.S. RMBS recovery analytics to complement our current ratings by publishing recovery expectations on specific bonds. We plan to incorporate the results of the recovery analysis into our stress analysis of an insurer's capital adequacy by using the projected recovery at the particular stress level across all confidence interval levels. Our structured finance credit ratings indicate a rank ordering of creditworthiness by primarily addressing the likelihood of default. Our credit ratings do not reflect our view of the magnitude or timing of the ultimate loss. As a result, residential mortgage-backed securities with the same rating could yield different economic results over their life because the holders of these securities might continue to receive significant principal payments, even if the securities initially default. 9. Currently, our insurance capital adequacy stress analysis considers loss expectations for RMBS backed by subprime and Alternative-A collateral, which we derive using our cumulative loss assumptions according to the original rating and vintage (origination year). Our updated capital adequacy stress analysis will incorporate issue-level and recovery ratings, and we will expand it to include prime residential mortgages. As with all risk factors in Standard & Poor's insurance capital adequacy model, confidence intervals will be applied to recovery analytics to ensure higher-rated insurance companies can withstand greater volatility to their underlying cash flows. 10. The updated analysis will also include applying updated loss expectations for corporate bonds, commercial mortgage-backed securities, and directly originated commercial real estate loans. Although we are not changing our baseline insurance risk-based capital adequacy model, we are applying incremental stresses for these asset classes across all confidence levels amid these tough economic conditions. 11. The capital adequacy outcome from the model, as well as from any stress analysis, is only a starting point for judging capital adequacy. We apply qualitative and quantitative considerations as warranted to derive a more complete picture of an insurer's capital position. For the companies that can, in our opinion, increase earnings or raise capital over the next two years to recover from the implied capital strain, we do not expect any rating changes. Similarly, we will continue to use a broad-based analysis for determining an insurer's credit quality. Strengths or weaknesses in other key areas, such as a company's competitive position, management and strategy, investment risk, liquidity risk, operating performance, enterprise risk management, and financial flexibility, can more than offset relative strength or weakness in capital adequacy. The areas of analysis are interconnected and their importance and influence on a rating will differ depending on company-specific circumstances. Related Research "Standard & Poor's Recovery Analysis Provides Additional Insight Into U.S. RMBS Performance," Nov. 6, 2009 "Understanding Standard & Poor's Rating Definitions," June 3, 2009 "Methodology For Incorporating Incremental Stress Factors Into The Capital Adequacy Analysis Of North American Insurers," Feb. 18, 2009 "Risk-Based Insurance Capital Model," Sept. 11, 2008 12. These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.