

Article Title: ARCHIVE | Criteria | Insurance | General: Assumptions: 2010 Interest Rate Scenarios For U.S. Insurance Risk-Based Capital Model Data: (EDITOR'S NOTE: — This criteria article is no longer current. It has been superseded by the article titled, "2011 Interest Rate Scenarios For U.S. Insurance Risk-Based Capital Model," published April 27, 2011. Previously, this article superseded "Criteria Assumptions: Interest Rate Scenarios Updated For U.S. Insurance Risk-Based Capital Model," published Jan. 27, 2009.)

1. Standard & Poor's Ratings Services is refining and adapting its assumptions for the interest rate scenarios for its U.S. insurance risk-based capital model. We are publishing this article to help market participants better understand our approach to reviewing interest rate scenarios for the U.S. insurance risk-based capital model. This article is related to our criteria articles "Analysis Of Insurer Capital Adequacy," published Dec. 18, 2009, and "Principles Of Corporate And Government Ratings," published June 26, 2007, on RatingsDirect.

SUMMARY OF CRITERIA UPDATE

2. Standard & Poor's is updating its interest rate scenarios used in convexity modeling for its U.S. insurance risk-based capital model. These criteria provide updated interest rates modeled as of year-end 2009.

3. The impact of this update will inform our view of convexity risk as it relates to our analysis of insurers' capital adequacy.

EFFECTIVE DATE AND TRANSITION

4. The criteria outlined in this article are effective immediately.

ASSUMPTIONS

5. Standard & Poor's will use the updated interest rate scenarios to derive interest rate convexity (gamma) risk charges related to options embedded in mortgage-backed securities (MBS), asset-backed securities, and callable bonds that insurance companies hold.

6. Standard & Poor's uses the interest rate scenarios in its risk-based capital model. This capital model is Standard & Poor's primary measure of insurer capital adequacy. The model applies different basis point shifts based on the confidence levels associated with the empirically observed probability of default for the targeted credit rating of the insurance company we are analyzing.

7. The 2010 upward interest rate scenarios (shifts) we are applying in this model are 300 basis points (bps), 260 bps, 240 bps, and 180 bps for the targeted rating categories of 'AAA', 'AA', 'A', and 'BBB', respectively. The 2010 downward interest rate scenarios (shifts) we are applying are negative 300 bps, negative 260 bps, negative 240 bps, and negative 180 bps for the targeted rating categories of 'AAA', 'AA', 'A', and 'BBB', respectively. We will also apply incremental shifts of 50 bps within the upward and downward shifts under both models to determine comprehensively the detrimental impact of negative convexity on the portfolio value.

8. The scenarios applied in the model are based on an empirical study of the historical volatility of the 10-year U.S. Treasury note, which is closely associated with the prepayment experience on MBS securities and, based on our research, is reasonable for the other interest rate-sensitive securities being modeled.

9. Standard & Poor's analyzed monthly yield changes on the 10-year note over the past one-, five-, and 10-year periods. For the model, the volatility movements we are applying are based on confidence levels of 99.9%, 99.71%, 99.41%, and 97.17% based on a 10-year period for targeted insurance company rating categories of 'AAA', 'AA', 'A', and 'BBB', respectively. Upward and downward interest rate shifts are modeled under a geometric assumption that prohibits negative rates. When applying these shifts, companies should floor any modeled rate at 50 bps.

RELATED RESEARCH

Analysis Of Insurer Capital Adequacy, Dec. 18, 2009

Principles Of Corporate And Government Ratings, June 26, 2007

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.