

Article Title: ARCHIVE | Criteria | Insurance | Life: Interactive Rating Methodology Data: (EDITOR'S NOTE: —This article is no longer current. It has been superseded by an article titled "Interactive Rating Methodology," which was published on April 22, 2009.) Standard & Poor's Ratings Services rating methodology measures and compares the financial risks of entities undertaking a wide range of business activities. For life insurance companies, these analytical techniques evaluate the financial risks associated not only with historical business activities but with new business initiatives as well. A key factor in the effectiveness of Standard & Poor's methodology is its attention to qualitative factors and future risks facing an insurer. Through discussions with management, Standard & Poor's can better understand how an organization's business, operating, and financial strategies affect its financial strength. Standard & Poor's uses projections in assigning its ratings after extensive discussions with management to understand the underlying factors. Standard & Poor's can gain insight into future financial performance by looking at current and historical performance. However, Standard & Poor's evaluation of a management's strategies, operations, efficiencies, and risk tolerance—as well as the insurer's competitive advantages in the marketplace—will most influence the opinion of future financial performance. Ultimately, the rating decision is a synthesis of important issues that are unique to each company and will drive future financial performance. Even highly rated companies might not score well in some categories of analysis. A rating is not so much a scorecard that shows how well a company did in each analytical category as it is a judgment made about the most important rating factors that will affect a company. The decision about an insurer's future financial strength is based on Standard & Poor's evaluation of the key issues. Standard & Poor's rating methodology profile is used for all insurance rating analyses and is uniform across all types of insurance companies. The profile covers competitive position, management and corporate strategy, operational analysis, investments, capitalization, liquidity, and financial flexibility. In applying its rating methodology for the life insurance sector, Standard & Poor's evaluates the types of insurance written (line of business or sector) by a company and its geographic profile. Standard & Poor's considers how a national or local factor could affect the insurer's operations. For insurance companies that are part of a larger, more diversified group, Standard & Poor's also looks at noninsurance-related activities to assess how favorable or unfavorable these industry conditions might be and the potential effect on the group's overall operations. Key points Standard & Poor's considers in its analysis of insurance company industry risk are: The potential threat of new entrants into the market. The threat of substitute products or services. The competitiveness and volatility of the sector. The potential tail of liabilities (i.e., ease or difficulty in exiting a market) or risk of large losses. In some cases, it might not be possible to exit certain lines of business because of state regulations that require approval or impose penalties for doing so. The bargaining power of insurance buyers and suppliers. The strength of regulatory, legal, and accounting frameworks in which the insurer operates. Broadly speaking, the lower the industry risk, the higher the potential rating on companies in that sector or line of business. Low industry risk implies a favorable operating environment for life insurance companies and annuity writers from a competitive standpoint, a regulatory framework conducive to insurer solvency, and conservative accounting standards. Under these conditions, life insurers would be expected to generate more favorable and less volatile operating results. Although a high industry risk profile does not automatically limit a rating, it is more difficult to demonstrate the earnings strength and stability that characterize highly rated companies.