

MOODY'S

INVESTORS SERVICE

RATING METHODOLOGY Insurance Brokers and Service Companies

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This rating methodology replaces "Insurance Brokers and Service Companies", last updated on September 27, 2017. We have added further detail on rating insurance brokers and service companies with limited financial history and updated some outdated links.

Summary

We maintain ratings on insurance brokers and related service companies. These ratings represent our opinions of creditworthiness considering both the business and financial fundamentals of each rated entity. The purpose of this methodology is to enhance the transparency of the rating process by identifying and discussing the key factors that are considered in the assignment of ratings.

The methodology is designed to explain senior unsecured debt ratings or long-term issuer ratings of investment-grade issuers, and corporate family ratings of speculative-grade issuers. Other ratings that may be assigned within a group, e.g., for distinct entities or obligations, are determined through our notching practices relative to these initial ratings.

The methodology focuses on three key rating factors:

- » Business Profile
- » Profitability
- » Financial Flexibility

For each factor, we identify objective metrics or subfactors that help differentiate credit quality among issuers. We show idealized ranges for each metric along the credit rating scale. We also discuss measures that, while not explicitly calibrated to the rating scale, could indicate relative strength or weakness with regard to that rating factor. The methodology is not meant to cover all factors that might affect a rating.

THIS METHODOLOGY WAS UPDATED ON APRIL 2, 2019. WE HAVE UPDATED A REFERENCE TO MARKET-IMPLIED RATINGS ON PAGE 12.

Rated Universe

The insurance brokerage and service sector encompasses insurance distribution, consulting, claims processing and other administrative services across various lines of property and casualty insurance, life insurance, retirement services and health insurance. Some firms conduct business worldwide in virtually all markets with an active insurance trade. Other firms operate in a single region or country.

The sector typically has a stable credit profile based on valuable service offerings, low capital requirements, low balance sheet risk, and steady cash flow supported by a largely variable cost structure. Insurance brokers and service companies provide clients with advice, solutions and specialized services in the increasingly complex fields of risk and human resource management. These sector strengths are often tempered by aggressive financial leverage among privately held firms, price softening in certain lines of insurance, integration risk associated with acquisitions, and potential liabilities arising from errors and omissions.

There is a clear split in credit quality between the publicly traded brokers, with investment-grade ratings, and private firms, with speculative-grade ratings. Virtually all the private brokers and service companies in the portfolio have undergone leveraged buyouts or leveraged recapitalizations, sponsored by private equity investors, resulting in high financial leverage and limited fixed charge coverage.

The largest public brokers serve global and national accounts through international networks and specialized industry teams, as well as serving the middle market. Private brokers and service companies include retail brokers serving middle-market and smaller accounts within one or two countries; wholesale brokers that distribute specialty products through retail brokers in various markets; claims processors serving insurance carriers and self-insured entities; and providers of various product warranties and related services.

Rating Framework

Our credit ratings for insurance brokers and service companies reflect our opinions of relative risk surrounding the payment of long-term obligations. We consider an issuer's past, current and future performance, including its ability to continue as a going concern and generate sufficient earnings and cash flow to meet those long-term obligations. Our approach is both quantitative and qualitative, and it incorporates the perspectives and judgments of analysts with varying backgrounds.

In the following sections, we discuss our scorecard and the three key rating factors at the heart of our quantitative analysis. The factor discussion explains why each factor is important to the rating process, and how we measure and interpret the underlying metrics. For each metric, we show numerical ranges that correspond to given rating categories – Aaa/Aa through Ca. While the methodology provides a general rating framework, it is unlikely that a company's actual rating will match the rating level guidelines for every metric. Analysts consider these rating level guidelines along with other factors, such as management, governance, regulation and litigation, when assigning ratings.

Scorecard

As part of the rating process for a given issuer, the analyst completes a scorecard, as shown in Exhibit 1. The scorecard shows the relevant credit metrics derived from the issuer's recent historical results along with our estimated ranges for these metrics over the next 12-18 months. For both the historical and forward-looking metrics, the scorecard indicates the corresponding rating category (Aaa/Aa through Ca) per the rating level guidelines. The scorecard uses these metric scores to calculate preliminary scores for the issuer as a whole (weighted average factor scores)¹ on both a historical and forward-looking basis.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

¹ For this sector, the weighted average factor score is synonymous with the scorecard outcome.

To the extent that a company's actual rating differs materially from its weighted average factor scores, possible explanations include: (i) upward or downward pressure on the rating, (ii) a rating committee's view that certain of the scorecard factors/metrics should carry higher or lower weights based on the issuer's unique facts and circumstances, or (iii) a rating committee's upward or downward adjustments to the calculated scores based on considerations beyond the scope of the scorecard. Such considerations could include management characteristics, governance, risk management, regulation, litigation, accounting policies, or support received from or provided to affiliates.

To generate forward-looking metrics (or metric ranges) for a given issuer, analysts consider our general economic forecast, our industry outlooks for insurance brokers and insurance carriers, the issuer's historical credit metrics and trends, and any recent or pending events likely to affect the issuer's credit profile. Analysts also consider stress scenarios, such as declining revenues and profit margins in an economic downturn, combined with credit tightening that raises the cost and reduces the availability of debt funding. Additional issuer-specific stresses might include client or producer defections following a merger, the loss of a major carrier relationship, or a large litigation charge.

The forward-looking metrics generally reflect our expectations for issuer performance based on our central forecasts for economic and insurance market conditions. However, stress scenarios could highlight unusual vulnerabilities for that issuer, signaling the potential for a sharp decline in credit quality. In that case, we would position the rating such that if the stresses were to unfold over the medium term, we would not have to lower the rating by more than a few notches, thereby enhancing ratings stability.

EXHIBIT 1

Scorecard

Insurance Brokers and Service Companies [1]	Reporting Period [Date]		Moody's 12-18 Month Forward View [2]	
	Metric	Score	Metric	Score
Business Profile (30%)				
Total Revenues (\$ Mil) (LTM)				
Diversification Score (#)				
Profitability (20%)				
EBITDA Margin (%) (3-Yr Avg)				
Net Profit Margin (%) (3-Yr Avg)				
Sharpe Ratio of Net Profit Margin (x) (5-Yr)				
Financial Flexibility (50%)				
Debt / EBITDA (x) (LTM)				
(EBITDA - Capex) Cvr of Interest (x) (LTM)				
Free Cash Flow % Debt (LTM)				
Aggregate Credit Profile				
Weighted Average Factor Score				
Rating Assigned				

[1] The scorecard, together with consideration of other factors by the rating committee, is used to determine senior unsecured debt ratings of investment-grade issuers and corporate family ratings of speculative-grade issuers. All figures reflect Moody's standard accounting adjustments.

[2] This represents Moody's forward view, not the issuer's, and unless noted in the text, does not incorporate significant acquisitions or divestitures.

Source: Moody's Investors Service

Key Rating Factors

Business Profile (30% weight)

Why It Matters

An issuer's business profile encompasses a range of quantitative and qualitative elements that can distinguish it from its peers. Our business profile assessment begins with simple measures of size (total revenues) and diversification. Typically, a larger, more diversified firm can adapt to changing market conditions and withstand challenges from a variety of sources – market, financial, regulatory, legal – better than a smaller, less diversified firm.

For example, large insurance brokers are distinguished by their global networks as well as their industry and product specialties. These brokers also compete for middle-market and smaller accounts, but have a more sustainable advantage in serving global and national accounts.

Mid-sized and smaller brokers and service companies often serve niche markets, developing expertise and client relationships that represent important strengths. However, the large number of such firms heightens the competition among them. Also, these firms are prone to mergers and buyouts, often resulting in high financial leverage. Most of the mid-sized and smaller firms operate in one or two national markets, not globally, and have fewer distinct business segments than the industry leaders, making them more vulnerable to market disruptions in those areas.

Relevant Metrics

- » **Total Revenues (\$ Mil):** Total reported revenues in millions of dollars (last 12 months)
- » **Diversification Score (#):** Sum of (i) number of reportable business segments/sub-segments that represent more than 10% of revenues, and (ii) number of reportable geographic regions/countries that represent more than 10% of revenues

EXHIBIT 2

Business Profile Metrics

Insurance Brokers and Service Companies	Aaa/Aa	A	Baa	Ba	B	Caa	Ca
Total Revenues (\$ Mil) (LTM)	> 20,000	20,000 - 7,500	7,500 - 2,500	2,500 - 1,000	1,000 - 400	400 - 200	< 200
Diversification Score (#)	> 9	9 - 7	7 - 5	5 - 3	3 - 1		

Source: Moody's Investors Service

Interpreting the Metrics

Total revenues are a fair indicator of market presence among insurance brokers and service companies. For claims processors and other administrative service providers, we consider revenues in the context of the overall markets served. A sustainable leading position in a modest-sized market could cause an upward adjustment to a company's rating.

Broad business and geographic diversification help companies withstand weakness in a particular market. It is unlikely that all business units will perform especially well or especially badly at the same time. Our diversification score counts the number of distinct business segments/sub-segments and geographic areas that represent more than 10% of a company's consolidated revenues. Two or more smaller units that together represent more than 10% of revenues would also boost the diversification score. We recognize that diversified revenues do not necessarily translate to diversified profits. Consistently unprofitable segments or regions could cause a downward adjustment to a company's rating.

Additional Measures

Other important elements of a company's business profile include organic revenue growth, the pace and nature of acquisitions, client and producer retention rates, the number of products and services sold per client, concentrations of business among specific clients or insurance carriers, and the level of contingent commissions. Positive organic revenue growth helps a company keep pace with core expense growth and generate equity, whereas a decline in organic revenues could lead to difficulties in covering basic costs and retaining equity. Acquisitions involve integration risk and contingent exposures, although some brokers have dedicated teams to manage small and mid-sized acquisitions. High client retention rates suggest that the brokerage firm delivers valuable products and services. Moreover, it is usually more cost effective to retain clients and producers than to acquire new ones. Cross-selling multiple products to existing clients enhances client loyalty and retention rates. Finally, business concentrations among clients or insurance carriers can expose a broker or service company to a business disruption in the event of a few lost relationships. Insurance brokerage activities are typically quite granular, but some insurance service providers have meaningful business concentrations with select parties.

Profitability (20% weight)

Why It Matters

Profitability determines a firm's ability to compete for business, service debt and generate equity. Over time, it either enhances or detracts from the credit profile. Profitability drives the firm's ability to hire and retain employees, invest in systems, attract financing and make acquisitions. The rating methodology looks at both operating (unleveraged) profitability as well as net profitability after financing costs, amortization, depreciation and taxes. We also look at the stability of profits to gauge how sustainable the results are and how attractive the business might be to lenders and owners.

Relevant Metrics

- » **EBITDA Margin (%)**: Earnings before interest, taxes, depreciation and amortization, as a percentage of total revenues (three-year average)
- » **Net Profit Margin (%)**: Net profit as a percentage of total revenues (three-year average)
- » **Sharpe Ratio of Net Profit Margin (x)**: Mean of net profit margin divided by standard deviation of net profit margin (five-year period)

EXHIBIT 3

Profitability Metrics

Insurance Brokers and Service Companies [1]	Aaa/Aa	A	Baa	Ba	B	Caa	Ca
EBITDA Margin (%) (3-Yr Avg)	> 35%	35% - 30%	30% - 25%	25% - 20%	20% - 15%	15% - 10%	< 10%
Net Profit Margin (%) (3-Yr Avg)	> 15%	15% - 10%	10% - 6%	6% - 3%	3% - 0%	0% - -5%	< -5%
Sharpe Ratio of Net Profit Margin (x) (5-Yr)	> 8x	8x - 6x	6x - 4x	4x - 2x	2x - 0x	0x - -2x	< -2x

[1] All figures reflect Moody's standard accounting adjustments.

Source: Moody's Investors Service

Interpreting the Metrics

The EBITDA margin reflects a company's ability to convert revenues to unleveraged operating income, which can then be applied to financing costs and capital expenditures. A high margin generally indicates some combination of pricing power and efficient operations, whereas a low margin indicates the opposite. This margin can be heavily affected by the company's business mix. For instance, the EBITDA margin of a specialty property and casualty insurance broker would likely be higher and more cyclical than that of an employee benefits service provider.

The net profit margin reflects not just operating prowess but also financing costs, accruals of depreciation and amortization, and taxes. Net profits can be retained in equity or returned to owners through dividends or share repurchases. The Sharpe ratio of the net profit margin measures the stability of this margin. To achieve a strong and stable net profit margin, a company must have steady operations and manageable financial leverage. The company must also exhibit sound expense and risk controls, avoiding large restructuring charges, asset write-downs and regulatory/litigation costs (e.g., from errors and omissions claims). A pattern of such "unusual" items could cause a downward adjustment to a company's rating.

Quality of EBITDA

Issuers sometimes calculate EBITDA through a top-down approach, consisting of revenues less costs directly associated with generating the revenues. We take a bottom-up approach, calculating EBITDA as the sum of pretax income, interest expense, depreciation and amortization. Our approach can produce more volatile EBITDA margins, particularly for issuers with significant other income or expenses, such as restructuring charges that we deem to be recurring in nature.

Companies entering into leveraged buyouts or other major transactions might calculate EBITDA on a pro forma basis, with various adjustments to historical results, in support of financing proposals. We take a critical look at such presentations, often incorporating just a subset of the proposed adjustments in our own estimates of sustainable EBITDA.

Additional Measures

Other helpful profitability measures include operating margins per business segment, level of contingent commissions, revenues per employee, and the ratio of salaries and benefits to revenues. Operating margins broken down by business segment can facilitate comparisons of like activities from one company to the next. A high level of revenues per employee signals efficient, profitable operations and an ability to attract and retain strong producers. Salaries and benefits make up the largest expense category for insurance brokers, so the ratio of these expenses to revenues is a key driver of profitability.

Financial Flexibility (50% weight)

Why It Matters

Financial flexibility is heavily weighted in our rating methodology for insurance brokers and service companies. An issuer's financial flexibility determines its ability to service and refinance debt, invest in the business, make acquisitions and attract fresh capital. Issuers in this sector usually have few hard assets, but they generate relatively stable EBITDA and cash flow. As such, they typically have control over their financial flexibility metrics.

Relevant Metrics

- » **Debt / EBITDA (x):** Total debt divided by earnings before interest, taxes, depreciation and amortization (last 12 months)
- » **(EBITDA - Capex) Coverage of Interest (x):** Earnings before interest, taxes, depreciation and amortization less capital expenditures, divided by interest expense (last 12 months)
- » **Free Cash Flow % Debt:** Net cash from operations less capital expenditures less stockholder dividends, divided by total debt (last 12 months)

EXHIBIT 4

Financial Flexibility Metrics**Insurance Brokers and Service Companies [1]**

	Aaa/Aa	A	Baa	Ba	B	Caa	Ca
Debt / EBITDA (x) (LTM)	< 1.0x	1.0x - 2.0x	2.0x - 3.0x	3.0x - 4.5x	4.5x - 6.5x	6.5x - 8.5x	> 8.5x
(EBITDA - Capex) Cvr of Interest (x) (LTM)	> 15x	15x - 10x	10x - 6x	6x - 3x	3x - 1x	1x - 0x	< 0x
Free Cash Flow % Debt (LTM)	> 30%	30% - 20%	20% - 12%	12% - 6%	6% - 3%	3% - 1%	< 1%

[1] All figures reflect Moody's standard accounting adjustments.

Source: Moody's Investors Service

Interpreting the Metrics

The debt-to-EBITDA ratio, a commonly cited credit metric in this sector, highlights the amount of debt that must be serviced by cash earnings. The higher the multiple, the greater the burden. For issuers with various classes of debt, the ratio is sometimes broken into components, such as senior secured debt-to-EBITDA and total (secured and unsecured) debt-to-EBITDA. Financial covenants often set caps on one or more leverage metrics.

(EBITDA - capex) coverage of interest shows how comfortably the operations can cover financing costs. A higher ratio indicates greater financial flexibility and vice versa. If this ratio falls below 1x, then the operations do not fully cover interest costs, and the company might need to refinance or renegotiate terms of its obligations to avoid a default. Financial covenants sometimes set floors for one or more coverage metrics.

The free-cash-flow-to-debt ratio shows the magnitude of cash flow available for debt repayment after the issuer covers operating needs, capital expenditures and stockholder dividends, although highly leveraged firms generally do not pay regular stockholder dividends. This ratio can be somewhat volatile from year to year, affected by the timing of significant transactions and working capital flows.

Free cash flow metrics are part of our broader assessment of an issuer's liquidity. We consider all significant sources and uses of cash, particularly over the next 12-18 months. Key sources include operating inflows, committed credit facilities, proceeds from asset sales, and in a stress scenario, potential contributions from owners. Key uses include operating outflows, interest and principal on debt, capital expenditures, acquisitions, including contingent earnout consideration, and potential distributions to owners. The extent to which expected cash sources cover expected cash uses is a vital component of the issuer's credit profile.

For issuers involved in leveraged buyouts, recapitalizations or other transactions that materially change the capital structure, analysts may rely largely on pro forma numbers to calculate financial flexibility metrics. As noted above, we take a critical look at EBITDA when it is calculated on a pro forma basis in support of a financing proposal. The goal is to determine a sustainable level of EBITDA. For an issuer with a more stable capital structure, we consider the trend of financial flexibility metrics over the past few years as well as the issuer's business outlook and appetite for financial leverage.

Additional Measures

Other metrics considered by analysts include EBITDA coverage and EBIT coverage of interest. The various coverage metrics – with EBITDA, (EBITDA - capex) and EBIT in the numerator – track fairly closely with one another, given that insurance brokers generally have moderate levels of capital expenditures and depreciation, although amortization of intangible assets can be significant for acquisitive firms.

We also consider cash and equivalents on hand (excluding amounts that are restricted or held for the benefit of clients) as a source of financial flexibility. Our leverage and coverage metrics are generally based on gross debt and gross interest amounts. However, if an issuer has designated a portion of cash to repay

specific borrowings in the near term, we also consider leverage and coverage metrics net of such borrowings and net of the related interest costs.

Financial Data Sources and Standard Adjustments

The historical financial metrics used in the methodology are typically derived from company financial statements based on Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), all subject to our standard accounting adjustments².

We adjust financial statements to better reflect the underlying economics of transactions and events, and to improve the comparability of financial statements across regions and accounting regimes. The financial metrics described in this methodology are calculated using adjusted data. The most common adjustments in this sector pertain to operating leases, defined benefit pension plans, and to a lesser extent, hybrid securities.

In addition to such standard adjustments, we may also make non-standard adjustments to financial statements for other matters to better reflect the economics and improve comparability among peers. For example, if an acquisitive insurance broker has sizable contingent earnout obligations, payable in cash, we treat the obligations as debt. When making an acquisition, a broker might pay 70%-80% of the consideration at closing and defer the remainder for a few years, with the deferred or contingent amount subject to the performance of the acquired business. Such earnout obligations, recorded at their estimated fair value, often come due ahead of the broker's debts and represent a significant use of cash.

Contingent earnout arrangements can also affect a broker's income statement, because, after completing the acquisition, the broker records any increase (decrease) in the fair value estimate of the earnout as an expense (income). We re-characterize these changes as non-operating expenses (income) where they would otherwise have a significant impact on EBITDA.

Another non-standard adjustment we make is to re-characterize a borrower's minority interest expense as a pretax operating expense if it is significant and paid out through regular minority dividends. Such dividends represent a steady use of the borrower's cash. Moreover, minority holders have a structurally favorable claim on the assets and earnings of the entity in which they hold the minority stake.

In certain cases, we may consider non-GAAP/non-IFRS financial information, including pro forma amounts, in our analysis, particularly for issuers entering into leveraged buyouts, recapitalizations or other transforming events, where we expect the future financial profile to differ materially from historical results.

Notching Practices

The methodology is designed to explain senior unsecured debt ratings or long-term issuer ratings of investment-grade issuers, and corporate family ratings of speculative-grade issuers. A long-term issuer rating is a proxy for a senior unsecured debt rating, often used when an issuer has no senior unsecured debt outstanding. A corporate family rating, used for speculative-grade issuers, signals a group's ability to honor all of its financial obligations; it is assigned as if the group had just one legal entity issuing a single class of debt. Other ratings that may be assigned within a group, e.g., for distinct classes of debt or distinct obligors, are determined with reference to these initial ratings.

² More information about our financial statement adjustments in the analysis of non-financial corporations can be accessed using the link in the Related Publications section of this report.

For investment-grade issuers with multiple classes of debt, we typically rate subordinated debt one notch below the senior unsecured debt, and preferred securities two notches below the senior unsecured debt³. For speculative-grade issuers with multiple classes of debt, we use Moody's "loss given default" (LGD) methodology⁴ to guide notching decisions. The LGD methodology helps us estimate potential losses and recoveries across a range of defaulted obligations based on probability distributions derived from Moody's extensive database of corporate defaults and distressed exchanges.

Other Rating Considerations

The topics discussed below are not well-suited for quantitative measurement but are still integral to the rating process. Any of these qualitative measures could lead to upward or downward adjustments to the weighted average factor score to arrive at a final rating.

Management, Governance and Enterprise Risk

We evaluate an issuer's overall management, governance, and risk management as part of our credit assessment. Areas of focus include:

- » **Key Person Risk:** Heavy dependence on a small group of executives or producers poses the risk of business disruptions should one or more of these individuals depart. Insurance brokerage is primarily a people business, complemented by data and analytics, sales and marketing tools and related operating systems. Brokerage firms often attempt to lure star producers or managers from competitors. Such defections from a small firm with business concentrated among a few producers or managers could impair the firm's revenues and earnings.
- » **Management Strategy:** A consistent strategy that drives steady financial performance is credit positive, whereas a shifting business plan with frequent restructuring charges is credit negative. We consider management's risk appetite, risk management structures and practices, and the extent of board involvement and oversight. We also develop a view on management's likely response to challenges, whether from a weak economy, competitive pressures or contingent exposures.
- » **Financial Policy:** Management appetite for financial leverage plays a large part in an insurance broker's credit profile. Some issuers operate comfortably within their target ranges for financial leverage, whereas others operate at the top of or even above their target ranges. This limits a firm's ability to withstand business or market disruptions. Publicly traded brokers return excess cash to shareholders through a combination of dividends and share buybacks. Financial policies among private brokers are typically guided by borrowing arrangements, which require that a large portion of excess cash be used to pay down debt while limiting the issuers' ability to return cash to shareholders. Certain brokers have issued debt to fund dividends to shareholders, a practice we regard as aggressive and credit negative.
- » **Compensation Policy:** Compensation policies drive management and employee behavior that can help or hurt creditors. Long-term incentive programs based on business profitability, including stock that vests over time, promote long-term value creation that benefits creditors. Yearly compensation plans based on business volume, with significant cash bonuses, can promote short-term risk-taking to the detriment of creditors.

We might adjust an issuer's weighted average factor score up or down to arrive at a final rating if we judge that any of these factors has a material bearing on the overall risk profile.

³ For an explanation of our notching practices, please see the guidance for notching corporate instrument ratings based on differences in security and priority of claim, which can be accessed by using the link in the Related Publications section of this report.

⁴ Access our Loss Given Default (LGD) methodology by using the link in the Related Publications section of this report.

Regulation and Litigation

Insurance brokers and related service companies are subject to licensing requirements and additional regulation under various state and national laws. Intensive scrutiny from state and national regulators can lead to significant financial settlements and business reforms.

Firms have also been subject to litigation related to their brokerage and consulting operations, leading to sizable financial settlements in some cases. In response to these events, brokers have stepped up their compliance and control functions. Still, we regard errors, omissions and other contingent exposures as key risks and important rating considerations for issuers in this sector.

Accounting Policies and Disclosure

Relevant and timely financial information is a critical part of any financial analysis. Although most insurance brokers and service companies prepare financial statements in accordance with GAAP or IFRS, financial information may also be presented with management adjustments that may differ from GAAP or IFRS. Companies entering into leveraged buyouts or other major transactions typically prepare pro forma financial statements to show the transaction effects. We often incorporate such pro forma information in our rating deliberations.

The consistent application of accounting principles is a fundamental presumption of financial analysis. When evaluating such principles, we consider how well financial reporting mirrors economic reality. Where we believe that the economics of a transaction are not consistent with financial reporting, we may adjust financial statements accordingly.

Impact of Parent Company and/or Affiliates

In addition to the intrinsic credit profile of a given issuer, we must assess explicit or implicit support received from or provided to a parent company or affiliate. Such inward or outward support can lead to an upward or downward adjustment to the issuer's rating. The extent of any adjustment pertaining to a parent or affiliate depends on our view of the relative credit strengths of the entities involved; the importance of the subject entity to the overall group; the degree of business integration between the subject entity and the group; the willingness of the support provider to pay when called upon; and, in the case of explicit support, the terms and enforceability of the contract(s), including the potential for termination.

Operating Environment and Sovereign Credit Quality

Although our analysis of insurance brokers and service companies is focused mainly on company-specific characteristics, an important consideration is the extent to which the operating environment within an issuer's home country might constrain its credit profile. Key attributes of the operating environment include economic conditions, institutional framework, government financial strength and susceptibility to event risk, as considered in Moody's sovereign rating assessments. To incorporate the risks of an issuer's operating environment, we typically cap the financial flexibility score of an insurance broker or service company at the sovereign rating of its home country, and we limit the company's overall rating to no more than a notch or two above the sovereign rating.

Insurance Brokers and Service Companies with Limited Financial History

Many rated insurance brokers and service companies have many years of financial history and lengthy operating track records that generally act as the basis for our forward-looking credit analysis. Firms with limited financial history may undergo rapid evolution initially, before developing readily distinguishable and stable operating characteristics. A demonstrable track record can be instrumental in building customer and market trust, which creates franchise value and supports the company's performance during a down-cycle.

The franchise value of start-up insurance brokers and service companies is usually weak, and most tend to lack product depth, market share, operating experience as an institution (rather than as a collection of individuals) and a record of resilience through a full credit cycle. Their systems, policies and procedures tend to be less robust than those of established companies.

For start-ups that lack a financial history of at least several years and in cases of a material transformation in a company's business, such that its financial history does not provide a good indication of future results (collectively, insurance brokers and service companies with limited financial history), existing financial history provides less insight into the future credit profile. In these cases, our baseline projections may reflect more-conservative expectations than management's projections. In addition, we are likely to make downward adjustments to several factors in our scorecard in order to reflect the considerable uncertainty around our baseline expectations of future operations and financial profile. To the extent these risks and uncertainties are not fully captured in the scorecard, they may be reflected in an assigned rating (the senior unsecured debt rating or long-term issuer rating in the case of investment-grade issuers, and the corporate family rating in the case of speculative grade issuers) that is lower than the scorecard-indicated outcome.

Insurance brokers and service companies with limited financial history may benefit from external support. When material, we incorporate that support into our ratings. In assessing the level of expected support, we generally consider whether the company's status as a start-up could affect the willingness of the support provider to step in should support be needed. For a highly publicized start-up subsidiary of a parent with a solid credit profile, we may expect a high level of support. Certain parent companies and affiliates, conversely, could be less willing to provide support if the reputational and financial risks attached to failure of an early-stage business venture were lower than for subsidiaries with a long track record and entrenched businesses in their home markets.

Appendix – Using the Scorecard

The key rating factors and metrics discussed in this methodology are considered when assigning the senior unsecured debt rating or the corporate family rating of an insurance broker or service company. The scorecard is driven by the rating level guidelines for the various metrics, along with the weightings assigned to the metrics and to the broader factors, all as summarized in Exhibit 6.

By referring to the rating level guidelines, the analyst can determine the rating range for each of the metrics in the scorecard. To facilitate calculations, we convert our letter rating scale, ranging from Aaa to Ca, to numerical scores of 1 through 20, as shown in Exhibit 5. A numerical value between 1 and 20 is determined for each credit metric through linear interpolation.

For example, under financial flexibility, a company with a debt-to-EBITDA ratio of 3.3x would map to a numerical score of 11.1 and fall within the Ba range for that metric. A company with a debt-to-EBITDA ratio of 7.5x would map to a numerical score of 18.0 and fall within the Caa range for the metric.

The rating level guidelines and weightings in Exhibit 6 are based on our subjective assessment of the appropriate metric level per rating category, along with the relative importance of each metric and key rating factor. For publicly traded companies, the metrics are normally derived from publicly available GAAP or IFRS financial statements. For privately held companies, the metrics may be derived from non-public GAAP or IFRS financial statements or, in certain cases, from pro forma amounts. Pro forma amounts may be used for an issuer entering into a leveraged buyout, recapitalization or other transforming event.

Assigned ratings may differ from weighted average factor scores for various reasons, including analytic adjustments to key factor scores, adjustments to metric and factor weightings, or consideration of quantitative or qualitative elements beyond the key factors. The scorecard is one of several inputs to the rating process, along with peer comparisons, economic and sector outlooks and market-implied ratings, all helping to shape the analyst's recommendation and the rating committee's ultimate decision.

EXHIBIT 5

Letter Rating	Numerical Score
Aaa	1
Aa1	2
Aa2	3
Aa3	4
A1	5
A2	6
A3	7
Baa1	8
Baa2	9
Baa3	10
Ba1	11
Ba2	12
Ba3	13
B1	14
B2	15
B3	16
Caa1	17
Caa2	18
Caa3	19
Ca	20

Source: Moody's Investors Service

EXHIBIT 6

Scorecard Factors, Metrics & Weights

Insurance Brokers and Service Companies ^[1]	Aaa/Aa	A	Baa	Ba	B	Caa	Ca	Factor Weight	Metric Weight
Business Profile								30%	
Total Revenues (\$ Mil) (LTM)	> 20,000	20,000 - 7,500	7,500 - 2,500	2,500 - 1,000	1,000 - 400	400 - 200	< 200		15.0%
Diversification Score (#)	> 9	9 - 7	7 - 5	5 - 3	3 - 1				15.0%
Profitability								20%	
EBITDA Margin (%) (3-Yr Avg)	> 35%	35% - 30%	30% - 25%	25% - 20%	20% - 15%	15% - 10%	< 10%		5.0%
Net Profit Margin (%) (3-Yr Avg)	> 15%	15% - 10%	10% - 6%	6% - 3%	3% - 0%	0% - -5%	< -5%		7.5%
Sharpe Ratio of Net Profit Margin (x) (5-Yr)	> 8x	8x - 6x	6x - 4x	4x - 2x	2x - 0x	0x - -2x	< -2x		7.5%
Financial Flexibility								50%	
Debt / EBITDA (x) (LTM)	< 1.0x	1.0x - 2.0x	2.0x - 3.0x	3.0x - 4.5x	4.5x - 6.5x	6.5x - 8.5x	> 8.5x		20.0%
(EBITDA - Capex) Cvrg of Interest (x) (LTM)	> 15x	15x - 10x	10x - 6x	6x - 3x	3x - 1x	1x - 0x	< 0x		15.0%
Free Cash Flow % Debt (LTM)	> 30%	30% - 20%	20% - 12%	12% - 6%	6% - 3%	3% - 1%	< 1%		15.0%
Total Weights								100%	100%

[1] All figures reflect Moody's standard accounting adjustments.

Source: Moody's Investors Service

Moody's Related Publications

Credit ratings are primarily determined by sector credit rating methodologies. Certain broad methodological considerations (described in one or more cross-sector rating methodologies) may also be relevant to the determination of credit ratings of issuers and instruments. An index of sector and cross-sector credit rating methodologies can be found [here](#).

For data summarizing the historical robustness and predictive power of credit ratings, please click [here](#).

For further information, please refer to *Rating Symbols and Definitions*, which is available [here](#).

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