Article Title: ARCHIVE | Criteria | Insurance | General: Expanded Definition Of Adequate Classification In Enterprise Risk Management Scores Data: (EDITOR'S NOTE: —This article has been superseded by the article titled, "Expanded Definition Of Adequate Classification In Enterprise Risk Management Scores," published on Jan. 28, 2010.) 1. Standard & Poor's Rating Services is refining and adapting its methodology for assessing insurance companies' enterprise risk management (ERM). We are publishing this article to help market participants better understand our approach to scoring companies' ERM processes. This article is related to our criteria article "Principles Of Corporate And Government Ratings," published on June 26, 2007, on RatingsDirect. 2. Standard & Poor's is updating its criteria to expand and subdivide the definition of Adequate as we use it to score a company's ERM capabilities. These criteria will give market participants the ability to differentiate among the large preponderance of companies whose ERM scores are in the Adequate category. We have also supplemented our definition of Excellent ERM. 3. This article supersedes the ERM classifications in "Summary Of Standard & Poor’s Enterprise Risk Management Evaluation Process For Insurers," published on Nov. 26, 2007, on RatingsDirect. Standard & Poor's does not expect any effect on existing ratings as a result of these criteria, which are effective immediately. 4. ERM was added as a new element of insurance company ratings in 2005, joining the other categories of competitive position, management and corporate strategy, operating performance, capitalization, liquidity, investments, and financial flexibility. Standard & Poor's views companies as having weak, adequate, strong or excellent ERM (see table 1). Table 1 Definitions Of ERM Classifications CLASSIFICATION FORMER DEFINITION REVISED DEFINITION Excellent Insurer has extremely strong capabilities to consistently identify, measure, and manage risk exposures and losses within the company's predetermined tolerance guidelines. There is consistent evidence of the enterprise's practice of optimizing risk-adjusted returns. Risk and risk management are always important considerations in the insurer's corporate decision-making. Insurer has, in our opinion, extremely strong capabilities to consistently identify, measure, and manage risk exposures and losses within the company's predetermined tolerance guidelines. Risk control processes are leading edge, applied consistently, and executed effectively. The company continues to develop its risk control processes to integrate new technologies and adapt to the changing environment. There is consistent evidence of the enterprise's practice of optimizing risk-adjusted returns, resulting in an overall stronger financial strength than peers. Risk and risk management heavily influence the insurer's corporate decision-making. Strong Insurer has strong capabilities to consistently identify, measure, and manage risk exposures and losses within the enterprise's predetermined tolerance guidelines. A strong ERM insurer is somewhat more likely to experience unexpected losses that are outside of its tolerance level than an excellent ERM insurer. There is some evidence of the enterprise's practice of optimizing risk-adjusted returns, though it is not as well developed as those of leading industry practitioners. Risk and risk management are usually important considerations in the insurer's corporate decision-making. Insurer has, in our opinion, strong capabilities to consistently identify, measure, and manage risk exposures and losses within the enterprise's predetermined tolerance guidelines. A strong ERM insurer is somewhat more likely to experience unexpected losses that are outside of its tolerance level than an excellent ERM insurer. There is clear evidence of the enterprise's practice of optimizing risk-adjusted returns, though it is not as well developed as those of an excellent ERM insurer. Risk and risk management are important considerations in the insurer's corporate decision-making. Adequate Insurer has capabilities to identify, measure, and manage most major risk exposures and losses, but the process has not been comprehensively extended to all significant risks facing the enterprise. Insurer loss/risk tolerance guidelines are less developed. Execution of its existing risk management programs is sufficient, albeit less comprehensive, than are strong and excellent ERM practices. Unexpected losses are more likely to occur, especially in areas beyond the scope of the existing ERM practices. Risk and risk management are often important considerations in the insurer's corporate decision-making. Insurer has, in our opinion, capabilities to identify, measure, and manage most major risk exposures and losses, but the process has not been comprehensively extended to all significant risks facing the enterprise. Insurer loss/risk tolerance guidelines are less developed. Execution of its existing risk management programs is sufficient, albeit less comprehensive, than are strong and excellent ERM practices. Unexpected losses are more likely to occur, especially in areas beyond the scope of the existing ERM practices. Risk and risk management are often important considerations in the insurer's corporate decision-making.* Weak Insurer has limited capabilities to consistently identify, measure, and manage risk exposures across the company and, thereby, limit losses. Execution of its risk management program is sporadic, and losses cannot be expected to be limited in accordance with a set of predetermined risk/loss tolerance guidelines. Risk and risk management are sometimes considered in the insurer's corporate decision-making. Business managers have yet to adopt a risk management framework, are satisfying regulatory minimums without regularly applying risk management to their business decisions, or have very recently adopted a risk management system that has yet to be tested. Insurer has, in our opinion, limited capabilities to consistently identify, measure, and manage risk exposures across the company and, thereby, limit losses. Execution of its risk management program is sporadic, and losses cannot be expected to be limited in accordance with a set of predetermined risk/loss tolerance guidelines. Risk and risk management are sometimes considered in the insurer's corporate decision-making. Business managers have yet to adopt a risk management framework, are satisfying regulatory minimums without regularly applying risk management to their business decisions, or have very recently adopted a risk management system that has yet to be tested. *Within the Adequate ERM classification, some companies may be further identified as Adequate With Positive Trend or Adequate With Strong Risk Controls. The Adequate With Positive Trend descriptor signifies that the company has demonstrated progress in developing its ERM program, and Standard & Poor's expects that it could revise its opinion of the company’s ERM to Strong in the next six to 24 months. The Adequate With Strong Risk Controls descriptor signifies a company that has established a variety of risk controls that we view in aggregate as Strong. 5. Given the number of companies whose ERM scores fall into the Adequate category, Standard & Poor's believes additional differentiation of these companies' ERM capabilities can be provided based on the scope and progress of their ERM processes. For this reason, there will now be three levels of Adequate as follows: Adequate, Adequate With Strong Risk Controls, and Adequate With Positive Trend (see table 2). A company whose ERM is scored Adequate With Strong Risk Controls should have all of the characteristics of Adequate plus strong controls over all of its material risks. A company whose ERM is scored Adequate With Positive Trend will have all of the characteristics of Adequate With Strong Risk Controls plus risk management culture and strategic risk management scores of at least Strong with the possibility to attain an ERM assessment of Strong within 24 months. Table 2 Expanded Definition Of Adequate Classification CLASSIFICATION DEFINITION Adequate With Strong Risk Controls These companies generally operate with traditional and largely silo-based risk management practices. They have Strong or Excellent risk controls for all material risks but, in our opinion, have not developed an holistic view of their risks through a fully developed economic capital model or other tools. Strong risk controls are a key component to maintaining results within tolerance. Therefore, a company in this category will have demonstrated not only the ability to identify and measure its key risks, but in addition, strong mitigants and controls have been put into place, which enable the company to manage its risk within stated tolerances at a very high level of confidence. Adequate With Positive Trend Further along the ERM capability continuum are those companies that have a Strong assessment for risk management culture and strategic risk management in addition to having all of the characteristics of companies assessed as Adequate With Strong Risk Controls. It is our expectation that a Strong assessment of ERM is possible for these companies within 24 months. 6. 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. 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