Rating Methodology

TRIS RATING
A Strategic Partner of S&P Global

Insurance Rating Methodology

9 September 2022

Narumol Charnchanavivat
narumol@trisrating.com

Annop Supachayanont, CFA
annop@trisrating.com

Thiti Karoonyanont, Ph.D., CFA
thiti@trisrating.com

Suchada Pantu, Ph.D.
suchada@trisrating.com

WWW.TRISRATING.COM

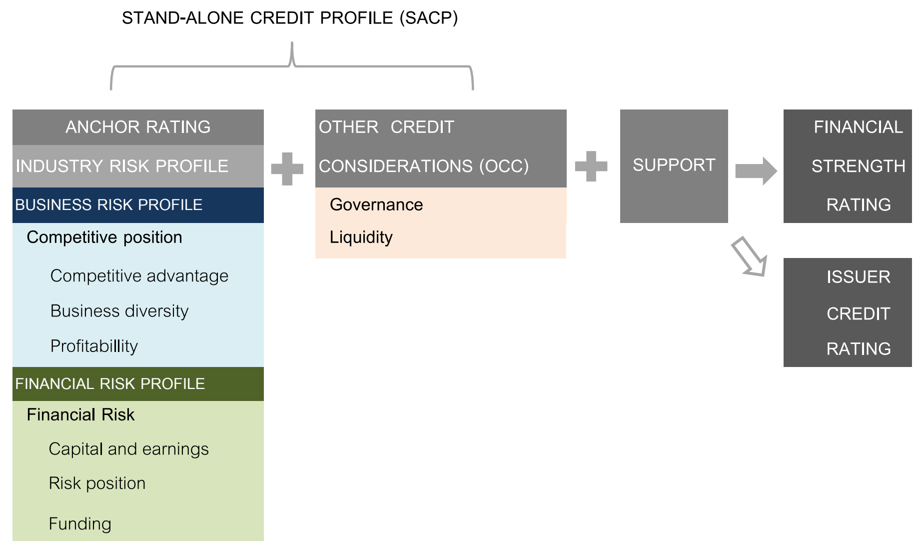
This criteria is an update of the Insurance Rating Methodology published on 17 September 2019, with additional details on how TRIS Rating assigns ratings to an insurance group member (see "Rating an insurance group member" below).

SCOPE OF THE CRITERIA

The criteria apply to life insurance, non-life insurance, and reinsurance companies.

METHODOLOGY

TRIS Rating's insurance rating methodology incorporates assessments of industry risk, business risk and financial risk to derive an anchor rating for an insurer. We then adjust the anchor rating with other credit considerations (OCC) to derive a Stand-Alone Credit Profile (SACP) or stand-alone rating. The SACP is then adjusted by ownership/group support elements to determine the insurer's Financial Strength Rating (FSR), which is generally equal to the Issuer Credit Rating (ICR). FSR indicates an insurer's capacity to meet its policyholder obligations in due course, whereas ICR indicates a company's capacity to meet its obligations with on-time payment of interest and principal.



ANCHOR RATING

Industry Risk Analysis

The first step in determining an anchor rating is to analyze the industry risk profile by assessing the institutional framework, which incorporates mainly regulation and supervision coupled with governance standards. We also review the past track records of the regulator's capacity and authority to take preventive measures to avoid system-wide crises or mitigate impacts arising from failed insurers. Other factors taken into account include barriers to entry, market growth prospects, and the competitive environment.

Business Risk Profile

Competitive Position:

For the business risk profile, we evaluate the insurer's competitive position based on a combination of three major factors: competitive advantage, business diversity, and profitability.

Competitive advantage: We measure competitive advantage for both life and non-life insurers by reviewing four subfactors: market position, brand and reputation, scale and efficiency of operations, and distribution network.

- **Market position.** We use market share and trends in gross written premiums (GWP) as a proxy to measure an insurer's market position. The market shares of life insurers and non-life insurers are evaluated on different scales as the non-life insurance segment is relatively more fragmented. We may also look at the reasons behind any cases where the premium growth rate of a company is significantly stronger or weaker than the industry average.
- **Brand and reputation.** Generally, positive perceptions of a company's reputation may help support its competitive advantage. We believe a positive brand perception paves the way for successful product launches and hence the ability to consistently expand market share and revenue or secure a niche market position.
- **Scale and efficiency.** A larger operational scale and higher efficiency is more likely to translate into lower operating costs. Typically, we would consider companies with a lower expense ratio and higher profitability compared to peers to have greater efficiency, which derives from a scale of operations that is sufficiently large.
- **Distribution network.** Both the strength and diversity of distribution networks are assessed. We view the following features positively: solid bancassurance partnership, either through an ownership structure or long-term contractual partnership; large agency attributes for life insurers or a strong relationship with insurance agents for non-life insurers. Diversified distribution channels may also contribute to revenue stability and growth. We consider premium mix by channel as well as market share in each channel as a gauge.

Business diversity: A well-diversified business model is generally positive if it helps support revenue stability or reduce the volatility of revenue or earnings when there are adverse changes in any particular market. Initially, we measure gross written premium breakdown by product or business line. For monoline insurers, the negative impact on the rating due to concentration risk may be less if the business generates revenue streams that are strong and stable.

Profitability: We assess both the level and volatility of financial performance using various metrics, including return on average assets (ROAA), return on average equity (ROAE), underwriting profitability, and operating profit. For life insurers, we take into account asset allocation strategies and risk appetite when we assess investment yields. For non-life insurers, we use combined ratio and loss ratio as a measure of operating performance (please refer to **Key Financial Ratios** for definitions). We benchmark these financial metrics against peers or the industry average. In addition, when data is available, we evaluate management policy on risk-return optimization by taking into consideration other non-financial elements, for instance, strategies on product risk, product pricing, and reinsurance strategies.

Financial Risk Profile

Financial risk:

An insurer's financial risk profile is based on three key components: capital and earnings, risk position and funding.

Capital and earnings: Capital position indicates the insurer's ability to absorb potential future claims and benefits. We assess capital strength by measuring the capital adequacy ratio (CAR) under the regulatory risk-based capital (RBC) framework, with the size of total adjusted capital (TAC) also being factored in, to derive a preliminary score. The score is then adjusted by financial ratios representing performance warning triggers, i.e. ROAE, combined ratio or changes in TAC, as these are likely to be the first signs of capital deterioration. We also consider other sources of capital volatility, for example, the dividend policy.

Risk Position: In addition to evaluating the risk management structure and policies as well as risk appetite and risk controls, we also assess other aspects of the risk position: 1) investment leverage and portfolio diversification; 2) loss reserve adequacy; and 3) risk mitigation through reinsurance.

- **Investments.** In general, the investment policies of life insurers and non-life insurers follow relatively strict regulatory guidelines. Although we view the guidelines to be conservative, we still need to assess risk relating to investment in terms of leverage and diversification to understand more about the management's risk appetite and the company's ability to generate investment returns. We also measure investment leverage for both life and non-life insurers using the same ratio of high-risk assets (or illiquid assets) to equity but on a different scale due to the diverse balance sheet structure. High-risk assets by our definition are investments with exposure to market risk or liquidity risk. These include, for example, unaffiliated equity investments, speculative-grade or unrated fixed income securities, investments in property, investments in joint ventures and other alternative investments. As for investment diversification, this is judged on the basis of investment portfolio composition.
- **Loss reserve adequacy.** The regulator has established actuarial standards for reserve valuation under the RBC and requires actuaries to certify actuarial reports. The standard is applied to both life and non-life insurers. While we view that actuarial reports provide informative monitoring of reserve adequacy, our own assessment of the reserve adequacy ratio serves as a supplementary view, particularly for non-life businesses.
- **Reinsurance.** Reinsurance risk mitigation is particularly important for non-life insurance due to the uncertainty of loss claims. Thai insurers are required to comply with the regulations on reinsurance, which serves to mitigate risk to an extent. For the reinsurance risk assessment, we review reinsurance strategies, reinsurer selection policies, outstanding reinsurance programs and the reinsurer's profile. We may also estimate the degree of risk retention by comparing net premiums to gross premiums. The number is compared against peers within the same segment. Excessive or modest reinsurance arrangements can be viewed negatively.

Funding: For Thai insurers, the use of financial leverage, measured by financial obligations to financial obligations and equity, is typically considered immaterial as a risk factor. At the same time, we view the ability to access external funds and liquidity, e.g. capital market or banking system credit, as credit positive as it could help mitigate funding risk, if any. In contrast, the presence of large intangible assets (except IT software), goodwill or investments in other insurers relative to equity could be credit negative given capital deduction requirements for these items under the RBC standard.

OTHER CREDIT CONSIDERATIONS

After we derive our anchor rating by combining our assessment of industry risk, business risk and financial risk profiles, we adjust the anchor rating using other credit considerations to determine an insurer's stand-alone credit profile (SACP). These include governance and liquidity.

Governance: We expect that in general a company should uphold good corporate governance principles. If we believe this to be the case for the insurer, we make no adjustment to the anchor rating; otherwise the rating could be penalized. Our evaluation of governance includes but is not limited to the following aspects: risk management structure, risk appetite and control, risk communication and reporting within the organization, independence of the board, and transparency of financial reporting and accounting policies.

Liquidity: We assess liquidity risk using various liquidity ratios, comparing against insurance liabilities. Examples of liquid asset ratios include: liquid assets to insurance contract liabilities (for life insurers); liquid assets to gross or net claim reserves (for non-life insurers). For insurers, liquid assets generally refer to short-term and long-term assets that can be used or liquidated for the purpose of liability payments. These include cash, deposits and all unencumbered investment assets. Other liquidity considerations include asset-liability maturity gap (for life insurers). We may also refer to the liquidity ratio reported to the regulator as a benchmark in applicable cases.

OWNERSHIP AND GROUP SUPPORT

Once we derive the SACP after adjusting the anchor rating using other credit considerations, the final step in the rating process is to assess whether there is a possibility of a rating uplift due to group support (if the insurer is a member of a group) or financial support from the government (if the insurer is a government-related entity, GRE) (please refer to TRIS Rating's **Rating Methodology for GRE**). For an insurer which is a member of a group whose parent has a strong credit profile, there is a possibility of a rating uplift from SACP if we believe that financial support from the parent will be provided to the company in times of need. The level of support, assuming that capacity to support is there, depends partly on the company's status and importance within the group. How we define the company's status indicates the number of notches that the SACP can be enhanced (please refer to our **Group Rating Methodology**). Typically, a company with a stronger credit profile may have its SACP capped by the rating of its "group credit profile" (GCP) due to the possibility of the parent transferring assets and/or cash flows from a stronger subsidiary to support a weaker subsidiary. However, given that Thai insurers are more likely to be financially insulated from the rest of the group due to regulations, the rating of an insurer with a strong credit profile may be higher than that of a GCP rating.

RATING AN INSURANCE GROUP MEMBER

Insurance subsidiary of financial group

TRIS Rating considers an operating insurance subsidiary of a financial group in Thailand as an insulated entity due to the strong regulatory restrictions preventing the entity from supporting the group. This allows the insurer's Financial Strength Rating (FSR) and ICR to be rated above the GCP in cases where the insurer's SACP is higher than the GCP. We would typically assign FSR and ICR higher than the GCP by up to two notches, provided that the insurer's SACP is also higher than the GCP by at least two notches. When the SACP is equal to the GCP or only one notch above the GCP, the FSR and ICR will be assigned at the same level as the SACP. When the SACP is below the GCP, and we expect the insurer to receive extraordinary support from the group, we may equate its FSR and ICR to that of the GCP.

Holding company of insurance group

The ICR assigned to the holding company of a prudentially regulated financial group is typically one notch lower than the GCP (GCP-1), given structural subordination. As for the holding company of an insurance group, our standard notching is two notches below the GCP (GCP-2) due to the stronger regulatory restrictions on dividend payments from operating insurance subsidiaries to the holding company.

For the notching of an insurance group's holding company to be narrower or for the ICR to be equal to the GCP, control of dividend payments by the regulator should be substantially weaker compared to other prudentially regulated entities. Also, we would expect the holding company to be able to service its own obligations by: 1) having control over several diversified and independent major operating entities, and each entity should generate substantial earnings or cash flows so that any disruptions at a single entity would not materially impact the group credit profile or the holding company; 2) generating sufficient cash flows from its own operations or from other operating subsidiaries; or 3) maintaining a significant amount of unencumbered cash or a high-grade fixed-income investment portfolio to meet its financial obligations.

On the contrary, the notching could be wider than two notches if we have concerns over: 1) risks relating to liquidity or balance sheet position or there is a high degree of double leverage (holding company's investments in subsidiaries compared with its own equity); 2) risk of tighter regulation on dividend payments from an operating insurance subsidiary; or 3) there exists external support outside of the group that we believe may not be extended to the holding company, in which case the GCP could be higher than the group SACP, and therefore the notching would be from the group SACP instead of the GCP. The group SACP is defined as the group's creditworthiness in the absence of extraordinary support (or negative

intervention). Generally, the group SACP is equalized to the GCP. However, if we believe that there is the potential for extraordinary support (or negative intervention) available to the group, the GCP could be higher (or lower) than the group SACP.

METHODOLOGY UPDATE

We have added details on how we assign ratings to an insurance group member, including an insurance subsidiary of a financial group and a holding company of an insurance group. See the "Rating an insurance group member" section.

KEY FINANCIAL RATIOS

	Life Insurers	Non-Life Insurers
Return on average assets	Net Income / Average Total Assets	
Return on average equity	Net Income / Average Total Equity	
Investment yield	Investment income / Average investment assets	
Loss ratio		Claim expenses / Earned premium
Expense ratio		(Commission and brokerage expenses + other underwriting expenses + operating expenses) / Earned premium
Combined ratio		(Claim and loss adjustment expenses + Commission and brokerage expenses + other underwriting expenses + operating expenses) / Earned premium
High-risk assets to equity	(Non-investment grade or unrated bonds + deposits at institutions rated at non-investment grades + unaffiliated common stocks + investment units + investment in affiliates, partnerships and joint ventures + alternative investments + real estate (except for own uses) + other assets with valuation volatility or limited liquidity) / Equity	
Loss reserve to premium written		Loss reserves / Premium written
Retention ratio		Net premium written / Gross premium written
Financial leverage ratio	Financial obligations / Financial obligations + Equity	
Liquidity ratio	(Cash + deposits + unencumbered investment assets) / Insurance contract liabilities	

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand. Tel: 0-2098-3000

© Copyright 2022, TRIS Rating Co., Ltd. All rights reserved. Any unauthorized use, disclosure, copying, republication, further transmission, dissemination, redistribution or storing for subsequent use for any purpose, in whole or Any unauthorized use, disclosure, copying, republication, further transmission, dissemination, redistribution, or storing for subsequent use for any purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person, of the credit rating reports or information is prohibited, without the prior written permission of TRIS Rating Co., Ltd. The credit rating is not a statement of fact or a recommendation to buy, sell or hold any debt instruments. It is an expression of opinion regarding credit risks for that instrument or particular company. The opinion expressed in the credit rating does not represent investment or other advice and should therefore not be construed as such. Any rating and information contained in any report written or published by TRIS Rating has been prepared without taking into account any recipient's particular financial needs, circumstances, knowledge and objectives. Therefore, a recipient should assess the appropriateness of such information before making an investment decision based on this information. Information used for the rating has been obtained by TRIS Rating from the company and other sources believed to be reliable. Therefore, TRIS Rating does not guarantee the accuracy, adequacy, or completeness of any such information and will accept no liability for any loss or damage arising from any inaccuracy, inadequacy or incompleteness. Also, TRIS Rating is not responsible for any errors or omissions, the result obtained from, or any actions taken in reliance upon such information. All methodologies used can be found at www.trisrating.com/rating-information/rating-criteria