

Request for comments

Insurance methodology review cycle 2016

Rating-Agentur Expert RA GmbH invites market participants to provide comments on the proposed changes in the Methodology of assigning reliability ratings to insurance companies. During the methodological committee meeting held on the 14th of December 2016 a package of changes in the Methodology of assigning reliability ratings to insurance companies was discussed and approved by the independent members of the Advisory board which will lead to the following changes in the short version of the methodology:

Sources of information

- 1) We propose to change the list of sources of information used for the assessment, namely: to update the current number of used forms in accordance to the Russian accounting standards (RAS-forms) (RAS form №6 – Report on creditworthiness of insurance company (before it was form №9)); to add one additional form as source of information from RAS-forms (RAS form №14 - Report on the structure of assets accepted to cover the equity); to add company’s annual reports for the last three years as an additional source of information.**

Rationale:

By updating the number of the RAS-form, we bring our Methodology in line with the current Russian accounting standards for insurance companies. By including new RAS-form and the annual reports in the list of sources of information, we expand the amount of quantitative and qualitative data used during the rating process, and therefore increase the quality of our assessment.

- 2) We propose to change the principle of prioritizing the source of information in case of mismatch between different sources. If differences between internal financial statements and official reporting forms are found, instead of giving priority to the internal financial statements, we propose to give priority to “the statements that reflect the financial stance of the company more correct in accordance to the Agency’s opinion”.**

Rationale:

Through these changes, (1) we reduce the risk of using distorted or even false financial statement; and (2) give priority to the financial statements that are more reliable in accordance to the professional judgment of the analyst.

Structure of the rating analysis

- 3) We propose to introduce the set of changes for integral factor “Asset quality”, namely: to add two additional indicators and to change the description of some other factors (see below).**

Rationale:

According to our internal and independent market researches, poor quality of assets was the main issue for Russian insurance companies over the last two years. In addition, it was the main reason why licenses of insurance companies were revoked by the Central Bank of Russia over the last two years. Based on this fact, we propose to improve our algorithm for the assessment of the insurance company's assets.

- 3.1) **We propose to split the factor “Stability of the investment portfolio and presence of signs of manipulations with securities portfolio” in two factors: “Stability of the investment portfolio” and “Presence of signs of manipulations with investment portfolio”.**

Rationale:

Through this proposal, we separate one factor into two which describe different characteristics of the investment portfolio, namely, stability of the investment portfolio structure and the presence of manipulations. Therefore, we make our assessment more accurate.

- 3.2) **We propose to add an additional indicator “Investments in real estate”.**

Rationale:

Based on our internal investigations and independent market researches, the high share of overvalued real estate was among the main reasons of license revocation in the Russian insurance market. Based on this, the assessment of investment quality in real estate is proposed as a separate indicator for the section “Asset quality”.

- 3.3) **We propose to add an additional indicator “Not typical assets”.**

Rationale:

As previously mentioned, based on the our internal and independent market researches we identified that the poor quality of the assets and frequent “fake” assets were among the main reasons of license revocation in the Russian insurance market. Based on this, the presence of “not typical assets” in the structure of the insurance company's assets is proposed as a separate indicator for the integral factor “Asset quality”.

- 3.4) **On the basis of changes in the Russian insurance market regulation, we propose to change the names of indicators “Fulfillment of the Prescription №100n” and “Fulfillment of the Prescription №101n” and merge them into one single factor called “Fulfillment of the Prescription №3444-U and №3445-U”.**

Rationale:

Prescription №100-n was replaced by №3444-U in 2015 and prescription №101-n was replaced by №3445-U. The meaning of both regulations remain the same. Prescription №3444-U (before Prescription №100n) describes the list of assets allowed for investments of insurance reserves funds, the order for this investing, the structure of assets allowed for insurance reserves funds investing (including requirements for the maximum allowed share of each type of asset or group of assets in insurance reserves funds, or certain kinds of insurance reserves). Prescription

Nº3445-U (before Prescription Nº101n) describes the list of assets allowed for investments of own funds (capital) of insurance company, the order for the investment process, the structure of assets allowed for own funds (capital) investment (including requirements for the maximum allowed share of each type of asset or group of assets in own funds (capital)). By this proposal, we bring our Methodology in line with the current regulation of the Russian insurance market.

Rating score adjustments for stand alone reliability ratings

- 4) **We propose to introduce the set of changes for the section “Rating score adjustments for stand alone reliability ratings”, namely: to add “other” internal stress- and internal support factors; to add one additional internal stress-factor called “size class”; and to rename two internal stress-factors (see below).**
- 4.1) **We propose to include “other” internal stress- and “other” internal support-factors to the list of possible adjustments for stand alone reliability ratings.**

Rationale:

By proposing this, we (1) give an opportunity to adjust the score on the basis of factors which are not directly mentioned in the methodology and (2) give an opportunity to adjust the score downward or upward if there is one time effect from support/ stress-factor.

- 4.2) **We propose to include one additional internal stress-factor called “size class” to the list of internal stress-factors.**

Rationale:

Based on our internal investigations and independent market researches, the smaller the size of the company, the higher the probability that the financial statements of the company (that are used as a basis of assessment), are distorted on purpose. In addition, small insurance companies are subject of more strict control from the CBR (i.e. risks of license revocation are higher). In this regard, we propose more conservative approach for the assessment of small companies, rated with the high ratings according to our model.

- 4.3) **We propose to rename the stress-factors “Poor quality of management and reporting” to “Corporate governance and quality of reporting” and “Extremely low reputation of the company’s management” to “Reputation of the company’s management”.**

Rationale:

Through this proposal, we make the names of these factors more transparent in terms of understanding the nature of the assessment.

Rating score adjustments for reliability ratings

- 4.4) **We propose to include “other” external stress- and external support-factors to the list of possible adjustments for reliability ratings.**

Rationale:

Through this proposal, we (1) allow for an adjustment of the score on the basis of factors which are not directly mentioned in the methodology and (2) give an opportunity to adjust the score downward or upward if there is one time effect from support / stress-factor.

Annex 1. Range of weights and types of companies

- 5) **We propose to change the range of weights for different groups of companies, increasing weights for section “Asset quality” and at the same time decreasing weights for section “Size factor and market position”.**

Rationale:

Through this proposal, we rebalance our methodological model by taking into account the increased importance of quality of assets for insurance companies (see comment for the point 3).

Please submit your comments to: info@raexpert.eu or compliance@raexpert.eu by the 16th of January 2017. Your response to this consultation will be published unless confidentiality is requested.