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S&P Global
China Ratings

Commentary: Understanding S&P Global (China) Ratings Insurance Methodology

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Introduction

The S&P Global (China) Ratings Insurance Methodology is constructed to describe the key areas that we would typically consider when analyzing the credit quality of insurance companies or similar institutions in China.

To assess an insurer's credit quality, we typically start from analyzing its business risk profile (BRP) and financial risk profile (FRP), and combine the assessment of both to determine its anchor. We then derive its standalone credit profile (SACP) based on its anchor and assessments on other factors, such as liquidity position and management and governance. When relevant to an insurer's credit quality, we may also consider the possible external support it may receive from government or group, before arriving at the issuer credit rating (ICR).

This methodology may be used together with other S&P Global (China) Ratings methodologies, such as our General Considerations on Rating Modifiers and Relative Ranking Methodology which considers common external factors that may influence the ICR or issue-level rating.

Methodologies we use are based on applicable S&P Global Ratings Methodologies, but modified where appropriate for use in the domestic application in China. We believe the modifications we have made will provide more granular credit differentiation within the local scale used by S&P Global (China) Ratings.

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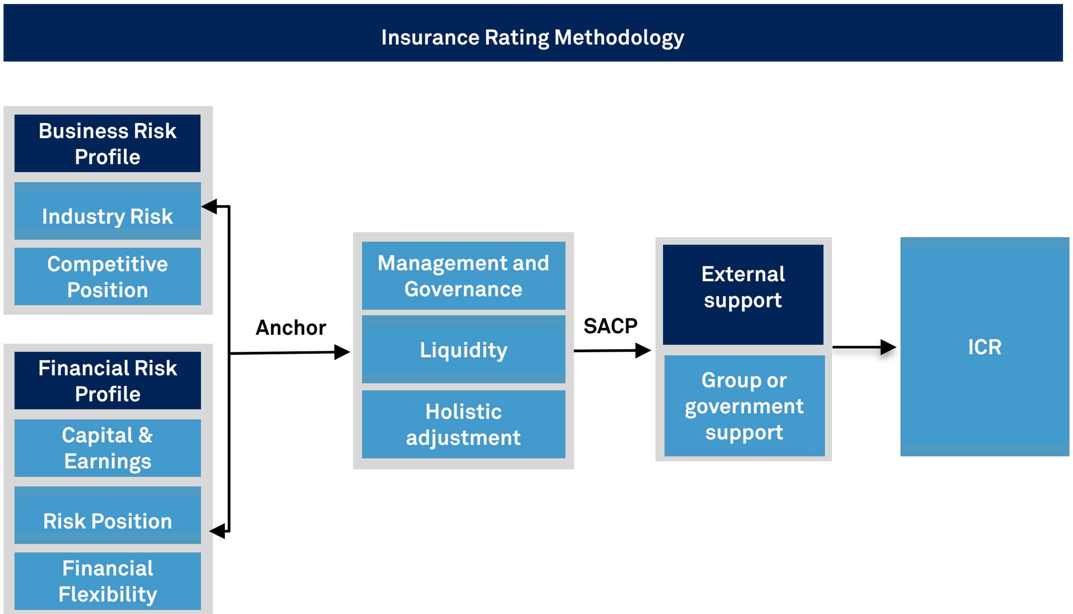
Chart 1



Source: S&P Global (China) Ratings.

Rating Process for an Insurance Company

Industry risk

Industry risk analysis considers the risks typically faced by insurers operating in specific industries such as life insurance or property/casualty (P&C) insurance. The factors we may consider include economic risk, systemic risk, return on equity, product risk, barriers to entry and market growth prospects. Industry risk is typically considered against a six-point scale, with '1' indicating the lowest risk and '6' indicating the highest risk.

Competitive Position

To assess an insurer's competitive position, we typically consider its market position, brand name or reputation, level of controlled distribution channels, diversification, and operating performance. It has six-point scale, with '1' indicating the strongest competitive position and '6' indicating the weakest competitive position.

We typically take market position as a primary driver to achieve a preliminary assessment. We then consider additional factors as supplemental considerations, allowing flexibility to make further adjustments.

Factors that are typically considered positive include:

- Higher market share than peers;
- Strong brand name and good reputation, which provide the insurer significant commercial advantages relative to its peers;
- Consistently high retention (or low lapse) rates;

- The level of distribution channels contributing to approximately half of its premiums or above;
- Wider range of business segments and/or better geographic diversification than peers, which may lead to better revenue stability through the cycle; and
- Operating performance being consistently and materially stronger than that of its peers.

Factors that are typically considered negative include:

- Lower market share than peers;
- Brand name and reputation being less than ideal, bringing commercial disadvantages relative to its peers;
- Consistently low retention (or high lapse) rates;
- One P/C line of business or a single life insurance product type contributing a significant portion of the insurer's gross premium; higher geographic concentration than peers, indicating incremental risk in the wake of a significant slowdown or cessation of business in a region or within the country; and
- Constant and major under-performance.

Business Risk Profile

We typically combine the industry risk and competitive position to arrive at an insurer's BRP. BRP has a six-point scale, with '1' indicating the lowest business risk and '6' indicating the highest business risk. It generally considers the risk inherent in the insurer's operations and therefore the potential sustainable return to be derived from those operations.

Table 1

Business risk profile

Competitive position	Industry risk					
	1	2	3	4	5	6
1	1	1	1	2	3	5
2	1	2	2	3	4	5
3	2	3	3	3	4	6
4	3	4	4	4	5	6
5	4	5	5	5	5	6
6	5	6	6	6	6	6

Source: S&P Global (China) Ratings.

Capital and Earnings

In our capital and earnings analysis, we typically focus on an insurer's ability to absorb losses by considering its capital adequacy prospectively. Capital & earnings scores range from '1' to '6', with '1' indicating the strongest ability and '6' indicating the weakest ability.

Our capital analysis is primarily based on our expectation for an insurer's regulatory solvency ratio over next two years, which is typically our most important metric. During our assessment, we may look at both tier 1 solvency ratio and total solvency ratio. We typically use the former to be the primary driver considering that it contains a majority of high quality core capital, while the latter as a check point to assess whether the insurer is able to meet minimum regulatory requirement, because failing of which may restrict the insurer's business expansion.

As a supplemental analysis of capital strength, we may assess an insurer's profitability to evaluate its internal capital generation capability, and our assessment is forward-looking.

Risk Position

Our risk position analysis typically considers the material risks that capital and earnings analysis does not incorporate, as well as specific risks that capital and earnings analysis has captured but may make an insurer's capital more or less volatile. This may include factors such as risk management, investment portfolio quality/leverage, concentration and foreign exchange exposure, amongst other factors. Risk position scores range from '1' to '5', with '1' indicating the lowest risk and '5' indicating the highest risk.

Risk management is typically our primary driver to evaluate the overall risk position of an insurer. Our assessment typically focuses on the effectiveness of risk management over relevant risk exposures, by considering whether or not risk management may limit losses across all risk categories, and/or mitigate exposures that may lead to volatility.

Factors that are typically considered positive include:

- Having a relatively low risk appetite on its risk underwritten and asset allocation;
- Stringent risk control and effective risk recognition in place to oversee its risk undertaking;
- Good diversification in its products and/or asset allocation so that the insurer can sustain reasonable performance in economic cycles or during capital market fluctuations;
- Minimal or well hedged foreign currency risk;
- Catastrophe risk being insignificant or well protected through reinsurance/retrocession or other approaches; and
- Having good reinsurance protection on insurance risk underwritten.

Factors that are typically considered negative include:

- Having aggressive risk appetite on its risk underwritten or asset allocation;
- Lax risk control or weak risk recognition, so that potential risk may not be monitored in time or adequately;
- Material concentration of its assets on specific industrial sectors or a single obligor;
- Significant unhedged foreign currency exposure; and
- Reinsurance protection being inadequate.

Financial Flexibility

Our analysis of financial flexibility typically considers the balance between an insurer's sources and uses of external capital and liquidity. This factor is generally assessed as 'neutral', 'moderately negative' or 'negative'.

We may use quantitative approaches during our assessment. For example, we may use financial leverage ratio and interest coverage ratio to evaluate an insurer's debt burden and interest payment capability. We usually take a forward-looking view in order to give a prospective opinion by taking into consideration an insurer's funding plan, financial management strategy and funding ability, etc.

Financial Risk Profile

We may adjust an insurer's capital and earnings score based on our assessment on risk position and financial flexibility before arriving at its FRP, as shown in below table. FRP has six point scales, with '1' indicating the lowest financial risk and '6' indicating the highest financial risk.

Table 2

Determining the FRP

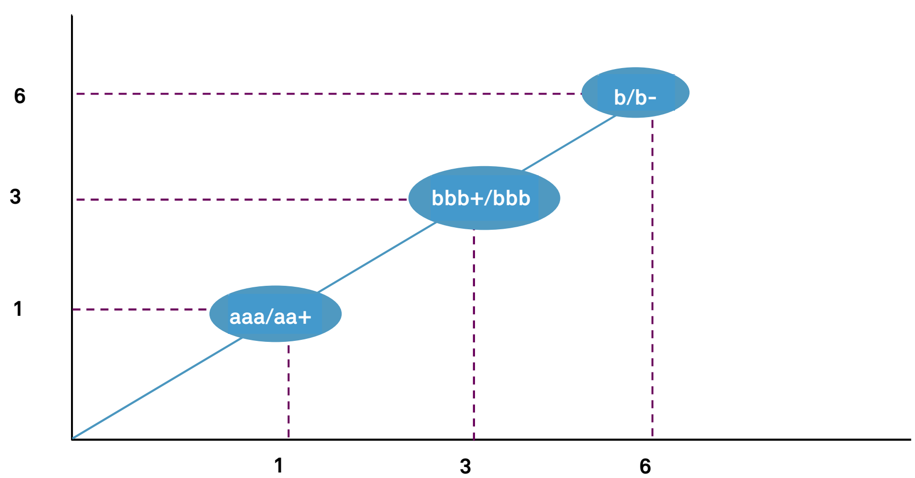
	Capital & Earnings assessment
Risk Position	
1	-1
2	-1/0
3	0/+1
4	+1
5	+2 or more
Financial Flexibility	
Neutral	0
Moderately negative	+1
Negative	+2 or more

Source: S&P Global (China) Ratings.

Anchor

Typically, an insurance company's BRP assessment and FRP assessment are combined to determine its anchor. For example, for an insurance company with both BRP and FRP assessed as '1', its SACP may tend to indicate very strong credit quality, such as the 'aaa'/'aa+' quality. For an insurer with both BRP and FRP assessed as '6', its SACP may tend to indicate very low credit quality, such as the 'b'/'b-' quality.

Chart 2



Source: S&P Global (China) Ratings.

Stand-alone Credit Profile

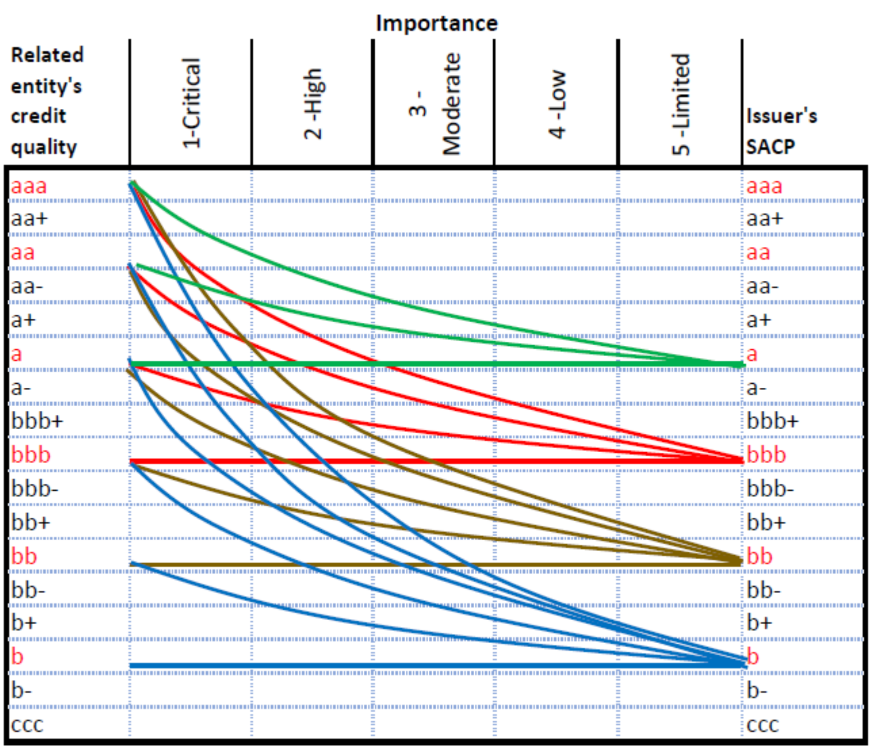
We typically determine the SACP of an insurance company by considering its liquidity, management and governance and a holistic assessment on top of the anchor. We may arrive at an SACP that is higher, lower or the same as the anchor after considering these factors.

For example, an insurer's SACP may be higher than the anchor if there are significantly positive factors that have not been captured in our BRP and FRP analysis. An insurer's SACP may be lower than its anchor if its liquidity position is weak and/or it has weak management and governance that could impact its business or financial stability.

Issuer Credit Rating

We typically derive the ICR by combining the SACP and the support framework, which generally considers group or government influence, if any. Such influence may be in the form of support or intervention, and may therefore support or detract from the issuer's ability to fulfill its financial commitments. In most cases, the effect on credit quality is positive because the group or government has greater resources and therefore stronger credit quality.

We assess the importance level of the entity to the related entity as critical, high, moderate, low, or limited. We believe the strength of support is typically correlated to the level of importance. As the level of importance increases, so does the potential for an uplift to the issuer rating. Each level of importance has a range of outcomes. Our starting point is usually the mid-point of the corresponding section on the curve; however, it may be higher when the importance level is assessed as critical, with the flexibility to adjust up or down within that range. We may determine an outcome which does not fall on the curve when we deem it appropriate.



Source: S&P Global (China) Ratings.

In order to determine the importance level, we typically assess its ownership by related entity, revenue contribution to related entity, senior management and board members appointment by related entity, policy role if it is a government-related entity, and systemic importance in the financial system, amongst other things.

Issue-Level Rating

We may apply S&P Global (China) Ratings General Considerations on Rating Modifiers and Relative Ranking Methodology to determine the issue-level ratings, which could be the same as or different from the ICR.

Typically, an ICR would coincide with our opinion of the creditworthiness of the senior unsecured debt of an issuer, unless there is a large amount of senior secured debt in the capital structure when we may notch down the senior unsecured debt from ICR. Subordinated debt, which is of weaker position in an issuer's capital structure, may be assigned a rating below the ICR.

This document is prepared in both English and Chinese. The English translation is for reference only, and the Chinese version will prevail in the event of any inconsistency between the English version and the Chinese version.