



Counterparty Risk and Insurer Selection

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Assessing Insurers Financial Strength

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Agenda

- Moody's framework for rating P&C insurers
- Key rating factors
- Market position, brand and distribution
- Asset quality
- Financial flexibility

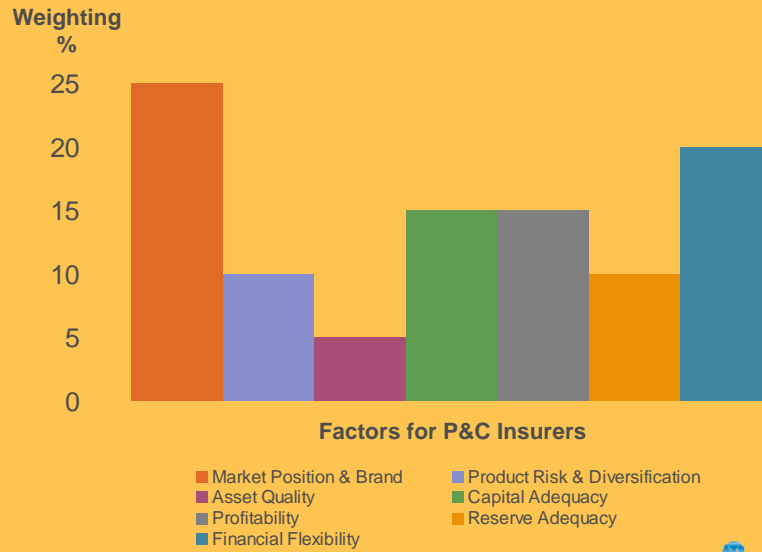


Moody's Framework for Rating P&C Insurers

- Ratings reflect our opinion of long-term relative risk and are, of necessity, forward-looking in nature
- Moody's analytical approach includes significant qualitative and quantitative analysis
- Seven key rating factors underlying an insurer's business and financial profile
- Other factors such as management and governance, sovereign and regulatory considerations
- A company's rating may not be consistent with the rating level guidelines for every rating factor



Assessing P&C Insurers Financial Strength



Market Position, Brand and Distribution

- Market position incorporates a firm's sustainable advantages in its key lines of business
- Considers market share, barriers to entry, scale advantages and control over pricing
- Brand encompasses image and reputation in the market and perception by distributors and end-consumers
- Can have a direct bearing on a company's future profitability and ability to generate capital internally
- Strong companies in this regard are more likely to meet their obligations through varied economic periods



Market Position, Brand and Distribution

	Aaa	Aa	A	Baa	Ba
Market Share Ratio	>10%	5%-10%	2%-5%	1%-2%	<1%
Relative Market Share Ratio	>3x average	1.5x-3x average	.5x-1.5x average	.25x-.5x average	<.25x average
Underwriting expenses as % of net premiums written	<20%	20% - 24%	24% - 28%	28% - 34%	>34%

- We believe that an insurer's absolute and relative size is highly correlated with its market position and brand
- Off-setting the absolute size issue is a company's ability to exercise underwriting discipline



Market Position, Brand and Distribution

- Distribution access and control relates directly to ability to grow revenues, retain business, control costs
- In general, efficient cost structures indicate overall management discipline
- Highly rated companies tend to have more opportunities to take advantage of economies of scale
- Beyond the financial metrics, we consider the diversity in distribution channels



Asset Quality

- P&C insurers' core assets typically concentrated in high quality liquid assets in recognition of uncertainty of liability payout stream
- However, the contrast between European insurance group's 2008 and 2007 reported net income is generally stark and predominantly driven by investment losses
- This is notwithstanding asset de-risking in the earlier part of decade and hedging activity
- High risk assets include below-investment-grade bonds, equities, alternative investments and real estate assets
- Severe equity market falls, but also severe spread widening



Asset Quality

	Aaa	Aa	A	Baa	Ba
High Risk Asset as % of Invested Assets	<10%	10% - 20%	20% - 30%	30% - 40%	>40%
Reinsurance Recoverables as % of Equity	<35%	35% - 70%	70% - 100%	100% - 150%	>150%
Goodwill as % of Equity	<15%	15% - 25%	25% - 35%	35% - 50%	>50%

- A significant asset of uncertain value on the balance sheet of P&C insurers is recoverables from reinsurers
- Goodwill associated with acquisitions is another potentially significant asset of uncertain value



Financial Flexibility

- Financial flexibility – dictated by financial leverage, earnings coverage and access to capital markets – is a key determinant of an insurer’s credit profile
- Financial leverage measures the amount of a company’s capital base that is financed through borrowed money
- Additional adjustments to metrics are sometimes necessary for individual companies
- The debt capacity of an insurer is also defined by its earnings capacity relative to interest expense and preferred dividends



Financial Flexibility

	Aaa	Aa	A	Baa	Ba
Financial Leverage	<20%	20% - 30%	30% - 40%	40% - 50%	>50%
Earnings Coverage – EBIT/ int exp + pref div	>12x	8x – 12x	4x – 8x	2x – 4x	<2x

- Access to capital markets – which can be limited by outsized financial leverage or poor coverage – is important
- Inability to access capital markets, or on attractive terms, can significantly impair financial flexibility in the event of a liquidity crisis or the need to rebuild capital base



Financial Flexibility

- Market's view of insurers has deteriorated, pressuring their financial flexibility
- Although capital adequacy has weakened there has not to-date been a widespread need to access the capital markets, with one or two exceptions
- Turmoil in the capital and credit markets makes financing more expensive
- Some firms with outsized catastrophe losses could encounter difficulties in raising capital following a large event



Credit Risk Analysis

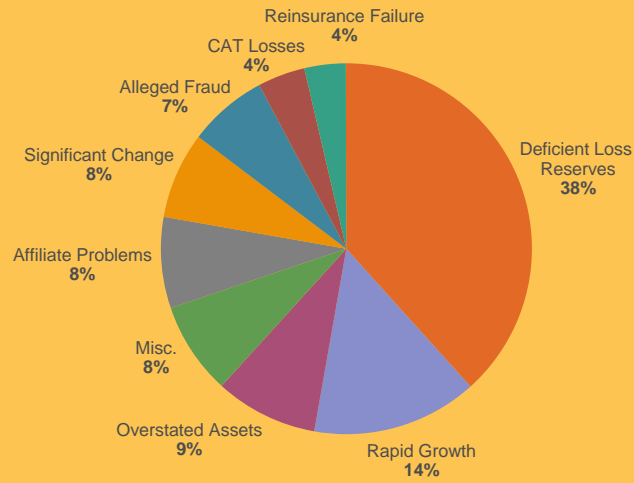
Virtue in Simplicity

David Flandro

Global Business Intelligence

Guy Carpenter

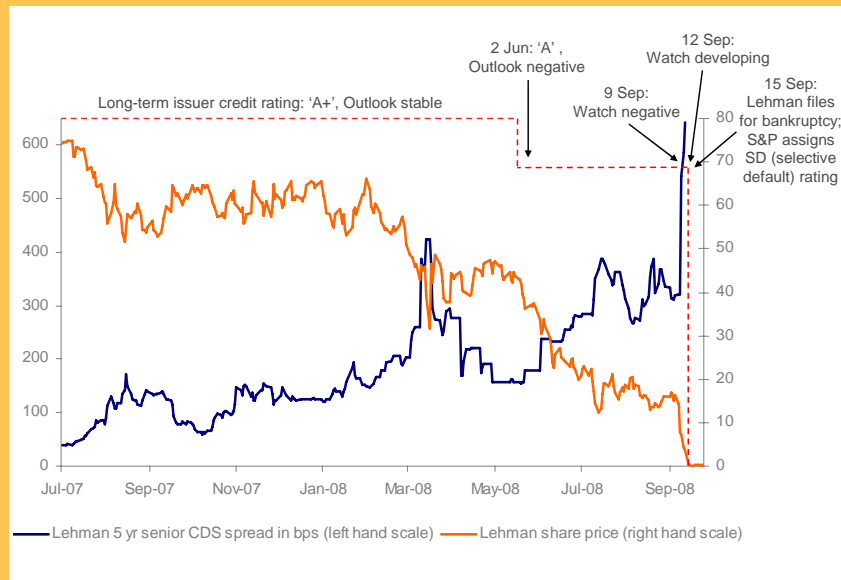
Primary Causes of US P&C Insurer Impairments 1969-2007



Source: AM Best & Co

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Ratings Precipice: Lehman Brothers

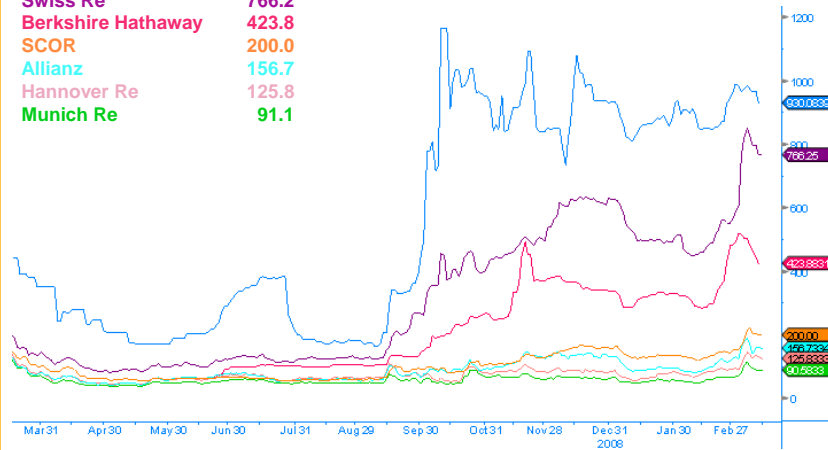


Source: Guy Carpenter, Standard & Poor's, Bloomberg data

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CDS Spreads

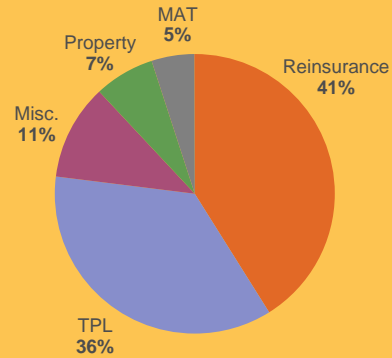
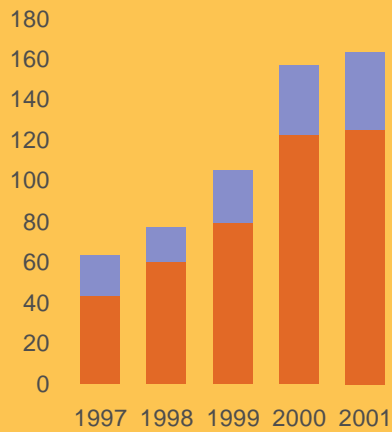
XL Capital	930.1
Swiss Re	766.2
Berkshire Hathaway	423.8
SCOR	200.0
Allianz	156.7
Hannover Re	125.8
Munich Re	91.1



Source: Bloomberg data, March 16, 2009

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Trenwick International Premiums



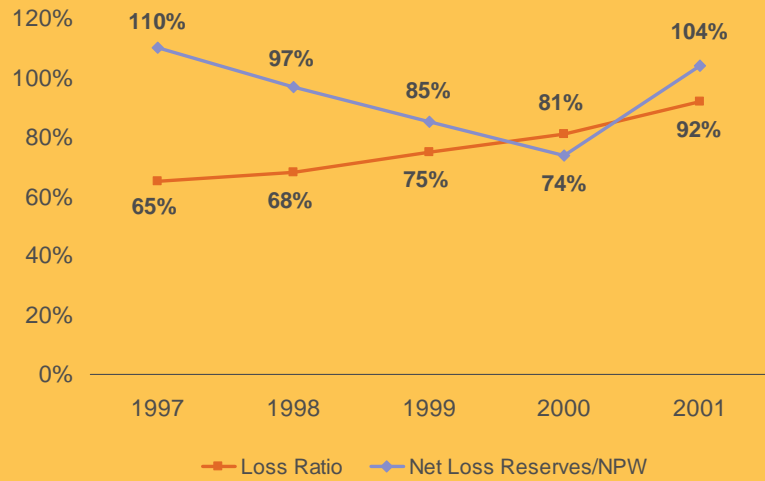
■ Net Premium Written ■ Reinsurance Ceded

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Trenwick International

Loss ratio and claims reserve strength



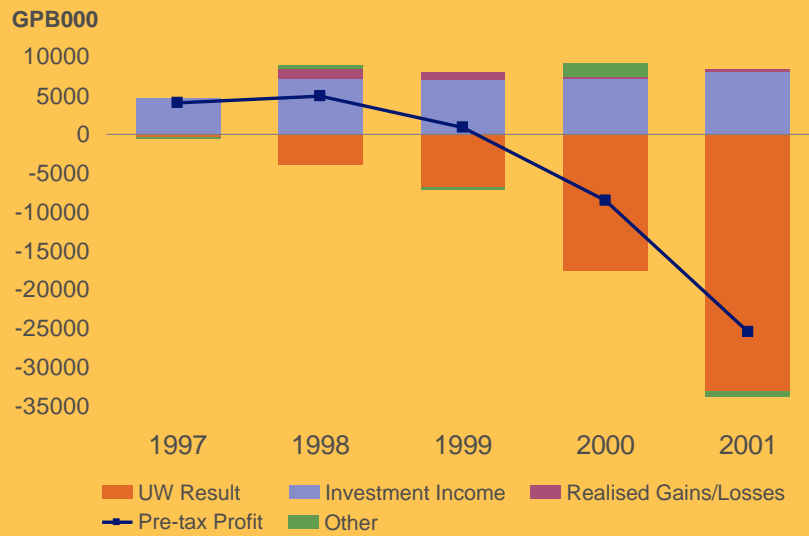
Source: Company report & accounts

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Trenwick International

Sources of earnings

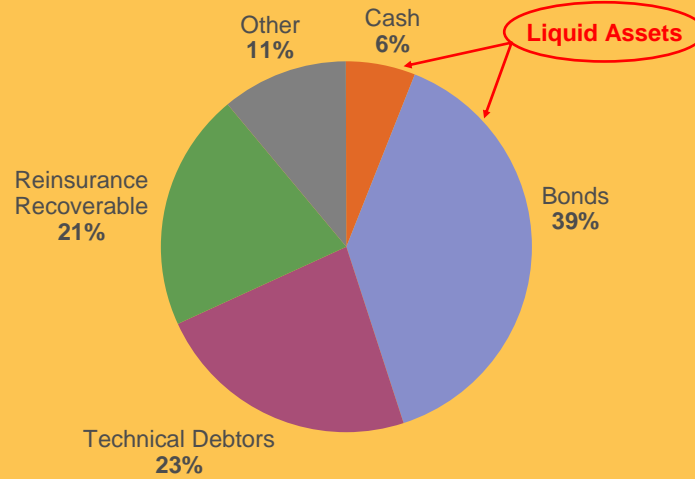


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Asset Mix

Trenwick International Asset Mix 2001



Source: Company report & accounts, Guy Carpenter

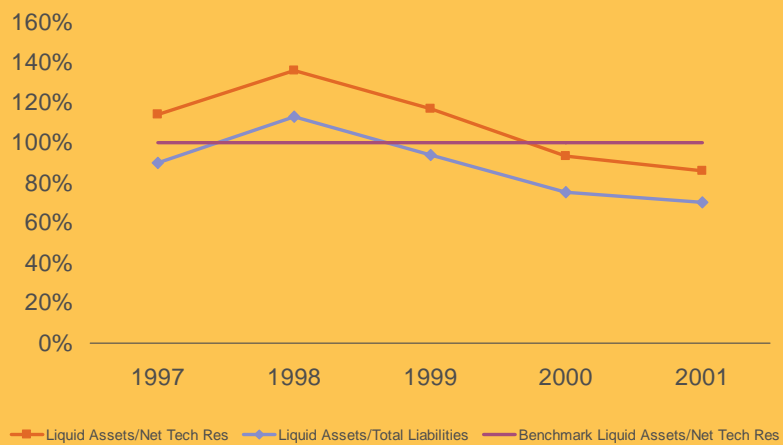
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The Acid Test – Liquidity

Ability to fund current liabilities or sudden cash calls

Trenwick International Liquidity



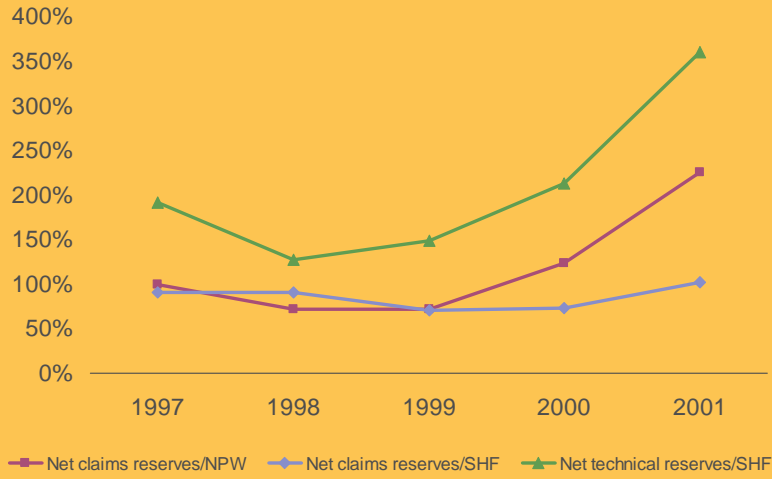
Source: Company report & accounts, Guy Carpenter

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Technical Reserves

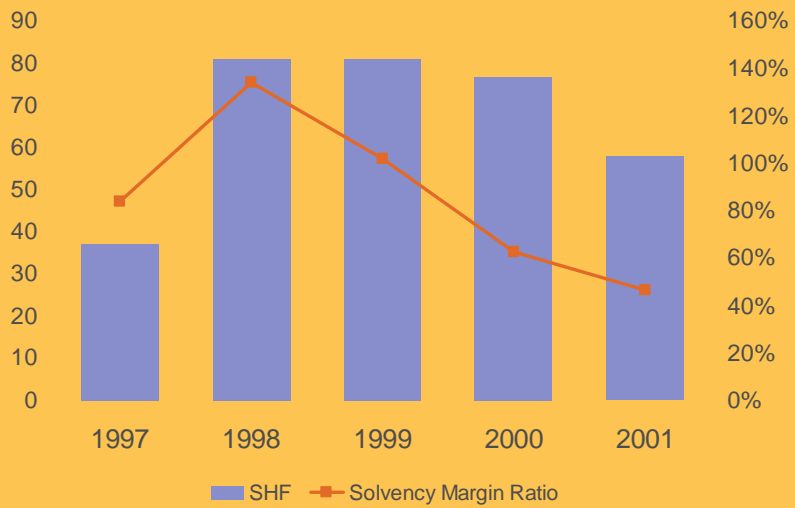
Trenwick International Technical Reserve Ratios



Source: Company report & accounts



Trenwick International Capitalisation



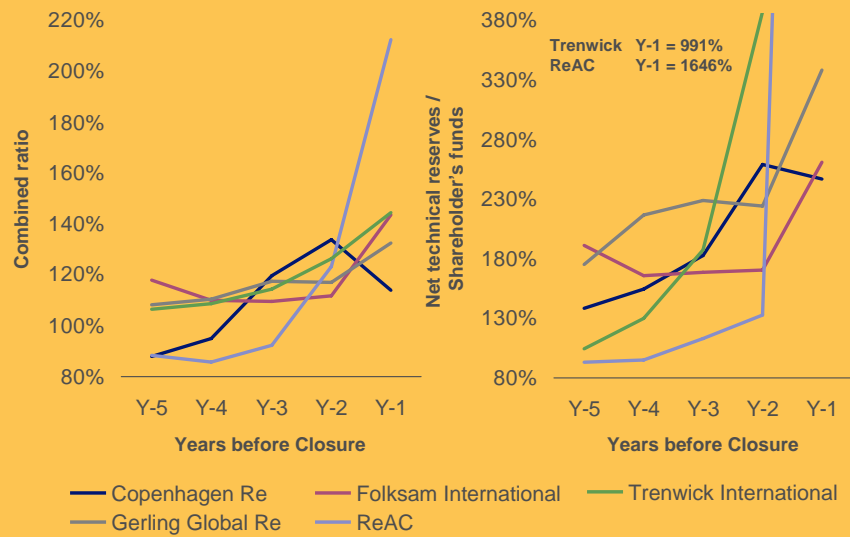
Source: Company report & accounts



Some Indicators of Financial Distress

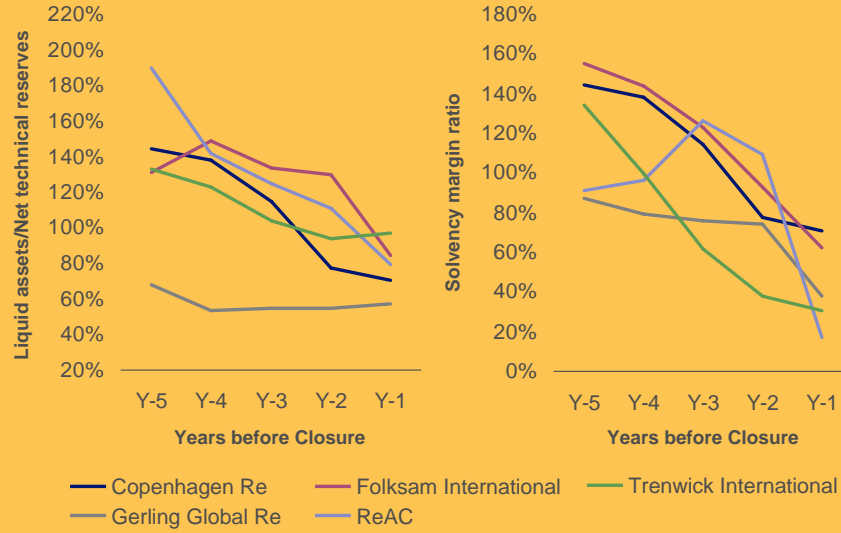


Technical Profitability and Reserve Gearing



Source: Company reports, Guy Carpenter

Liquidity and Solvency



Source: Company reports, Guy Carpenter

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Eight Key Ratios

Quick Performance Tests

Standard

Solvency Margin Ratio	> 80%
Combined Ratio	< 105%
Underwriting Profits / Investment Income	> minus 25%
Pre-tax Return on Equity	> 10%
Liquid Assets / Total Technical Provisions	> 100%
Insurance & Reinsurance Debtors / SHF	< 25%
Non-life Technical Provisions / NPW	> 100%
Non-life Technical Provisions / SHF	< 350%

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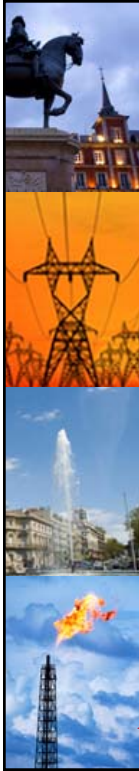
GUY CARPENTER

 MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

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Insurer Counterparty Credit Risk

Audrey Shindler
Senior Insurance Analyst
Scottish Power Ltd



Risky Times

- Turbulent Economic Climate
 - High profile, negative press concerning financial strength and stability of financial companies, including insurers
 - Concerns over solvency, ability to survive
- Increased focus on developing in-house understanding of the level of risk within our insurers, and the level of company exposure to those insurers
 - No longer content to fully rely on external agencies' and advisors' risk assessment of insurers
 - Desire to measure, manage and monitor risk and exposure across insurance programmes
- Credit Risk analysis will form part of the decision-making process for placing new insurance



Insurer Counterparty Credit Risk

- Extension of current Credit Risk Management strategy
 - Borne out of the liberalised Energy Trading markets
 - Developed over a 10-year period
- Counterparty Credit Risk – *“The financial exposure to the business generated by the potential default of a contracting entity in fulfilling their obligations”*
- Credit Risk to insurers is not dissimilar to our view of the exposure typically considered in relation to Energy Trading Counterparties
- Two components to measure:
 - Settlement Exposure
 - Replacement Exposure
- Many challenges in defining and measuring what the replacement exposure is



Risk Assessment

- Insurance traditionally viewed as a “safe” Risk Transfer method
 - Reassessment of level of risk to transfer if a higher probability of default exists
- Risk Assessment of Counterparty
 - Quantitative and Qualitative
 - Key financial ratios
 - Analysis of investment portfolio and performance
 - View on claims payment record
 - Coverage provided
 - International program capability
 - Responsibility on Insurer to provide adequate assurances to Insured
- Counterparty monitoring - dynamic



Risk Limits

- Counterparty Risk Limits
 - Establish view on overall risk/exposure willing to accept with any given counterparty
 - Varies based on assessment of counterparty risk
 - Consideration to expected duration of exposure – higher probability of default over a longer time horizon
- Exposure Measurement and Monitoring
 - Identify exposure by insurer over all policies with open claims or those that remain undeveloped
 - Monitor over time
- Evaluation of internal credit capacity remaining – ability to place more risk (policies) with existing insurer
 - Mindful of other qualitative factors to be considered



Conclusion

- A more considered perspective on Insurance as a Risk Management tool
 - Heightened awareness of the risk that Insurers themselves present
- More emphasis on internal knowledge
 - Risk Assessments
 - Reporting of Insurance exposures
- More emphasis on responsibility of Insurers to assure us
- Future progression
 - Another consideration in decision-making process
 - Greater visibility of risks by management