Rating Methodology

Insurance Company Ratings

Global Master Criteria for Rating Long Term Insurance Companies

Updated May 2018

Related Methodologies

Criteria for Rating Newly Established and Start-Up Insurance Companies, updated May 2018.

Criteria for Rating Cell Captive Insurance Companies, updated May 2018.

Criteria for Rating Insurance Companies' Debt and Hybrid Equity Instruments, updated May 2018.

Introduction

GCR's Financial Strength ("FS") ratings are accorded to companies that conduct life insurance business. The ratings give an independent opinion of an entity's ability to meet policyholder and assumed reinsurance obligations, excluding funds where investment or other risk rests with the policyholder through a contractual agreement. The FS rating is the basis for any other ratings accorded to insurance and reinsurance companies.

The Global Master Criteria for Rating Long Term Insurance and Reinsurance Companies ("Criteria for Rating Long Term Insurance Companies", "the Criteria") is an update to the version published in July 2017. The layout of the methodology was amended to better align it with the report structure, while other changes related to streamlining of certain sections. The changes were not material in nature, and as such the update of this Criteria will not have an impact on any existing ratings. Going forward, this Criteria will be applied to all ratings of long term insurance and reinsurance companies.

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Rating methodology

Overview

GCR's methodologies provide an overview of the frameworks that guide the analytical process. The methodologies explain the key rating factors that are assessed (in terms of their relevance to the rating, and how they are analysed), while also discussing the broad principles incorporated into our assessment. The following guidelines provide a general overview of the quantitative and qualitative factors that GCR considers when analysing an insurance or reinsurance organisation. For the sake of simplicity, this methodology will use the term "insurer(s)" to refer to life insurers and reinsurers.

Rating coverage / Scope of the rating

GCR's FS ratings reflect an opinion on the relative financial strength of insurers. The ratings do not directly consider the entity's quality of service levels or the appropriateness of its product offering, unless these factors directly impact on the organisation's longer term sustainability.

FS as the anchor rating

The financial strength rating forms the basis of GCR's assessment of insurer and reinsurer credit quality. Given that an insurance company's contractual obligations to policyholders usually rank senior to all other obligations, the financial strength rating is normally the highest rating accorded to an insurance organisation. In turn, the rating of a company's debt issues, as well as ratings accorded to an insurer's broader group structure, is influenced by creditworthiness in terms of meeting policyholder obligations.

Support framework

GCR's support framework allows for the transfer of credit strengths of shareholders to underlying insurance company subsidiaries. In this respect, an insurer's standalone credit profile may be notched up if it is viewed to have access to support from its holding company, where it is important to consider the financial strength of the shareholder and its ability and willingness to provide this support when necessary.

GCR's opinions are based on a clear understanding of the fundamentals of the rated organisation and the industry in which it operates. These guidelines are intentionally broad in scope, recognising that the process of assigning credit ratings is a dynamic one, and that each specific entity possesses unique characteristics and assumes varying levels of risk. Whilst appropriate financial and credit metrics will vary amongst companies in different sectors, GCR will benchmark an insurer's financial performance and metrics against market peers. Nevertheless, the individual financial metrics or credit ratios are not considered solely against the peer group, but their strength and relevance is determined by their relationship to all other company characteristics.

The layout of the methodology follows the structure of the analytical process adopted:

1. Operating environment
   1.1. Country overview
   1.2. Industry overview
2. Business profile
   2.1. Corporate profile
   2.2. Competitive position
   2.3. Earnings profile
3. Financial profile
   3.1. Earnings capacity
   3.2. Reinsurance
   3.3. Asset management
   3.4. Capital adequacy
   3.5. Reserving
4. Modifiers
   4.1. Risk management
      i. Enterprise Risk Management ("ERM")
      ii. Corporate governance
      iii. Strategic management
   4.2. Support framework
5. Appendix A: Explanation of national scale versus international scale ratings

1. Operating environment

GCR's assessment of a rated entity's operating environment forms the cornerstone of the credit rating analysis. The relevance of this factor's impact on companies' credit ratings stems from the linkage between broad country and industry factors, and the underlying fundamentals of market participants. Accordingly, GCR assesses the operating environment, in terms of both country risk factors and industry risk factors, in order to gauge the degree to which operating conditions are expected to impact on the credit profiles of related market participants over the rating horizon.

1.1. Country overview

GCR's country assessment addresses economic, political and systematic risk factors that impact on an organisation's operating environment. An analysis of the political and economic environment provides the context against which both the historical performance and future expectations of a rated entity are considered. Economic trends and government policies are analysed to determine their impact on the industry.

Scale and growth prospects
The size, composition and growth prospects of an economy directly impact on the performance of the insurance sector. GCR incorporates the rate of Gross Domestic Product ("GDP") growth into its assessment of economic prospects. This metric is viewed on both single year and multi-year bases. The former contributes to the understanding of review year factors (with the isolation of specific drivers supporting the analysis of operating performance at company level in the review year), while the latter provides a medium and longer term view in order to assess cyclical factors. GDP growth has been strongly related to insurance industry growth prospects, and as such GCR's forward looking opinion on an industry's premium development will be impacted by economic growth forecasts. GCR also places emphasis on understanding potential structural problems facing the economy, which may require policies that depress economic growth (e.g. structurally high inflation).

Sectoral analysis
The scale of the economy, and the level of economic activity, is supported by an assessment of sub-sector activity. In this process, sectors that are most likely to be affected by an adverse movement in the economy are identified, as high exposure to such sectors could result in the deterioration of an insurer's operating performance or balance sheet strength. High growth sectors and industries, in contrast, offer much by way of growth and diversification, although the level of complexity and associated risk of such markets is assessed in order to place operational impact into context.

Macroeconomic variables
Macroeconomic variables that reflect strength and stability of both domestic and external factors are taken into consideration. Inflationary and interest rate trends are observed in terms of broader impacts such as the sustainability of monetary and exchange rates, while also being assessed for the impact the variable have on insured values, claims fluctuations, and earnings capacity. Interest rate movements are also considerations in terms of financial system stability, given the banking industry's interest rate sensitivity.

External sector and global / regional considerations
In instances where insurers operate in multiple regions and/or where there is a high degree of regional interconnectedness, economic analysis may extend beyond country or regional borders to account for global trends where applicable (in terms of expected impact on business or financial risks).

1.2. Industry overview

The industry overview provides an outline of the market-wide factors that GCR views as impacting on the credit profiles of participants. In certain instances, particular risks or structures at either the industry or country level may result in GCR applying an industry rating ceiling, which caps the rating that a participant in a particular market can achieve. The industry analysis consists of elements that are assessed consistently (across all countries, and across both short term and long term sectors), as well as unique factors that are relevant to particular industries.

Insurance penetration and density
Industry penetration (industry Gross Written Premiums ("GWP") as a proportion of GDP) indicates the level of significance of an insurance market within the broader economic context. Insurance density (GWP per capita) illustrates the extent of insurance utilisation by the underlying population. Both measures contribute to an overview of the level of development of the industry within the local context. Industries with higher levels of development tend to exhibit enhanced resilience to external shocks, while providing market participants with a framework more conducive to operational efficiencies. This notwithstanding, attention is paid to the lower underwriting or operating risks related to less developed markets in terms of product risk.

Industry composition
GCR analyses the industry structure and composition, looking at the number of participants (and the resultant level of industry concentration or fragmentation), as well as the relative positioning of those entities in terms of tiered groupings. This informs the level of relative competition within each of these sets, and influence on pricing and other competitive dynamics. Consolidation trends and intermediary functions, if pertinent, will also form part of this overview.

Industry growth trajectory
GCR analyses the basic structure of the market, including its relative size. Industries with scale and strong growth prospects allow for development and enhanced significance within the broader economic framework, while fostering potential for scale efficiencies and risk diversification at company level. Accordingly, industry growth is factored into the market review and outlook.

Industry performance
Industry performance primarily looks at the profitability of the market at the operating level, taking into account the underlying risk composition. Factors such as claims patterns, commission structures and the level of scale efficiencies will support the analysis where relevant.

Barriers to entry
Barriers to entry are viewed from both a regulatory and operational perspective. In terms of the former, barriers take the form of regulatory requirements for granting licenses (inclusive of minimum capital requirements), shareholding structures, and other regulatory hurdles. Operational barriers relate to the existing competitive dynamics of the market and the scope for new entrants, coupled with the availability of requisite resources.

Regulatory environment and transparency
GCR's analysis factors in the insurance supervisory framework. Apart from an understanding of the legislation governing the industry, GCR considers the instruments used to monitor the insurance system, which includes the forms and quality of reporting to the regulatory authorities, as well as the frequency and content of on-site examination and off-site surveillance conducted by supervision authorities. The actions and measures that regulatory authorities are empowered to use in avoiding problems and potential failures of insurers within the system are identified, and the regulatory track record of implementation, intervention, enforcement and/or risk mitigation is examined.

Industry ceiling
An industry rating ceiling may be imposed by GCR should the fundamentals and characteristics of a particular market represent an inherent limitation on the credit rating profile assessed at a rated-entity level. Such rating limitations can include (but are not limited to) systematic risks that impact on all participants, market maturity, limitations in terms of organisational structure and associated capital flexibility, or regulatory disciplines that impact negatively on key criteria and decisions relative to credit rating criteria.

2. Business profile

The assessment of an insurer's business profile considers an insurer's corporate profile, strategic model and objectives, , and an evaluation of the insurer's resultant competitive position.

2.1. Corporate profile

A company's corporate profile provides an overview of the organisation's ownership structure, as well as strategic model, and the translation thereof into critical success factors. Key operational relationships and related recent developments are also examined.

Ownership and structure
GCR assesses the impact of ownership structures by taking into consideration the operational and technical support provided, capital access, flexibility and management, as well as ownership and creditor interests. Such factors may have a direct influence over an entity's capital position and cash flows over time.

Lean capital structure requirements, or demanding return on equity conditions from shareholders, may have an impact capital generation (particularly where a history of large dividend extractions has been demonstrated). Shareholder conflicts that filter through to an insurer's operations and/or balance sheet strength may result in negative rating pressure.

An ownership structure with a demonstrated track record of being conducive to operational and balance sheet strength may have positive rating implications, if viewed to be an enhancement to other fundamental characteristics. Details in terms of the rating upliftment emanating from potential financial support of subsidiaries is discussed in the "Support framework" section.

Strategic overview
The strategic overview describes the key attributes of an insurer's overarching business model, including an assessment of key focus areas, core capabilities and offerings, and related strategic relationships and systems. Relationships giving way to material operational synergies, or allowing for the transfer of discernible technical support and efficiencies, may support such a view. The strategic assessment considers competitive advantages and defensive characteristics.

2.2. Competitive position

The assessment of an insurer's future financial strength is strongly influenced by the entity's competitive position, and the competitive advantages that the insurer has carved out in its chosen market(s). This would have a bearing on sensitivity to industry challenges, cycle management strategy, and superior operating performance.

Over an intermediate to long term horizon, competitive entities would be expected to sustain earnings strength, while defending their market position.

Market position // Business quality and pricing power
A company's market share is an indication of the degree of acceptance in the market and insurance buyers' perceptions of capacity and brand strength. An insurer's market share is considered to be:

- a contributing factor to a company's ability to respond to changing market conditions over time, and manage adverse market conditions;
- a platform for attaining greater cost efficiencies;
- a measure of bargaining power, pricing power, and ability to select higher quality business; and
- a determinant of potential for strong product uptake and business retention.

Market position // Assessment of niche players
Market share is analysed at both a general industry level, as well as a specialist level (should a particular insurer's corporate strategy primarily target a distinct industry sub-segment). Smaller companies with a strong brand and representation in a chosen niche, specialised expertise and/or captive distribution channels are often able to protect their market position and achieve above average profitability. GCR's assessment may take into account the insurer's market position relative to similar niche players, and/or the industry segment.

Peer group analysis
The peer group consists of a set of insurers viewed as comparable on a certain basis, or set of criteria. Most generally, the peer group will consist of players operating in the same sector or market segment. Where relevant and available, peers occupying similar niche markets, or insurers with similar business models, will be compared. If a peer group is too small using these parameters, then it may be expanded to include more broadly comparable insurers.

Peer group modifier
Competitive positioning assesses a particular entity's business profile metrics relative to its peers. In this regard, a peer group comparison may have a positive, negative or neutral rating impact. A favourable rating impact can occur in instances where an entity's criteria compare favourably to its industry-specific peer group. The latter may result in a relative strengthening in market positioning. Conversely, a weaker overall position relative to peers may undermine relative competitiveness.

2.3. Earnings profile

GCR analyses the structure of earnings with reference to product distribution spread, market dispersion, line of business diversification, and where applicable business units. High levels of concentration, in the absence of relevant mitigating factors, may expose an insurer to increased revenue risk.

Product distribution

The business model assessment includes an overview of the linkage between the company's distribution channel structure, market focus, and the underlying product offering. The success and alignment of this distribution and marketing framework contributes to the development and resilience of an insurer's competitive advantages in a chosen market, while facilitating enhanced pricing and distribution controls. The following factors are considered:

- effectiveness of distribution channels and level of diversification;
- market segment analysis, including the scope of differentiation and depth; and policyholder diversification and granularity.

Qualitative assessment of rating factor
The impact of the channel and market linkage impacts on the rating via the assessment of average growth, the operating cost ratio and strategic implementation measures. Beyond this, GCR assesses the distribution channel on a qualitative basis, in order to ascertain the sustainability of the current key variables related to this. GCR also seeks to understand the alignment between the channel structure and strategy, which in turn contributes to the assessment of the achievability of the insurer's budget.

Line of business diversification
The lines of business in which an insurer participates impact on its financial profile due to the varying exposures, volatility and dynamics at play within each class or sub-segment. GCR analyses diversification between lines of business on both gross and net premium bases, as well as the product risk associated there with. Diversification benefits can also be priced into products, providing a competitive advantage over less diversified competitors. The analysis of the line of business diversification is both quantitative and qualitative. Analytical judgement may be applied to the trade-off between product diversification and product focus, should a specialised approach result in concentration that is offset by strategic advantages. Furthermore, the analysis may take into account the impact of scale on overall diversification.

In addition to the above, GCR evaluates the diversification in terms of single versus recurring premiums, the spread between risk and fee-based earnings, and the mix of profit from new sales versus in-force profit to further understand the quality of earnings.

Growth // The relevance of growth to the rating
GCR assesses the impact of an insurer's growth trajectory on market positioning, quantitative rating factors and risk exposures, while assessing the manageability of growth. This is assessed within the context of differing phases of business and operational cycles, as well as broader economic

cycles. That said, low or negative growth cycles aimed at, for example, portfolio clean-up, may positively impact on earnings. In addition to this, specific business models and target markets will also impact on growth objectives and prospects. This notwithstanding, there are times when low or flat growth is considered to be favourable, should it be aimed at optimising longer term operational performance.

3. Financial profile

An insurer's financial profile is reviewed in order to gauge the fundamental financial strengths and capacities available in medium-term operating periods. The assessment of an insurer's financial profile is also viewed relative to the industry and peers.

3.1. Earnings capacity

Profitability, in terms of magnitude, stability, flexibility and sustainability, determines how balance sheet strength will be enhanced, maintained or eroded over time. In this regard, a company's financial performance and flexibility will ultimately drive future balance sheet strength and sustainability. Insurance companies that are able to demonstrate consistent profitability and a lower degree of volatility generally receive a positive assessment of earnings capacity.

Operating profitability assessment
A track record of profitability through rating cycles attests to the relative success of the company's business model and management's ability to adapt to changing market conditions. GCR considers several measures of operating profitability, assessing these with reference to other insurers that operate similar business models under the same market conditions. The following aspects are assessed where applicable:

- pricing and premium rate changes.
- claims management.
- the expense ratio serves as an indicator of operating efficiency (commissions, general insurance expenses and insurance taxes, licenses and fees) relative to total premiums or average premium income ("API")[1]. Expense efficiencies and adequacy of infrastructure to sustain new business volumes are considered.
- the number of policyholder lapses and the concentration of immediately surrenderable liabilities are also analysed, as this measures the insurer's potential vulnerability to normal and stressed economic cycles. In this respect, GCR utilises the percentage of lapses and surrenders compared to premiums underwritten to ascertain any potential insurer premium risks, as well as assessing any developing trends over an appropriate period.
- technical profitability trend by product, division or market segment, at both a gross and net level.
- profitability trend (where applicable on an adjusted basis).

Net profitability assessment
Similar to operating performance, net profitability is assessed through the cycle, to gauge the relative stability and overall earnings strength. Insurers that consistently generate strong net profits are better positioned to sustain credit protection metrics. GCR considers the following aspects:

- investment portfolio performance, with particular emphasis placed on average investment yield and trend over a five year period, including and excluding unrealised investment movements.
- impact of foreign currency fluctuations and management thereof.
- Other sources of sustainable income (where applicable).
- average return on equity and consideration of other net profit metrics, where applicable.

Embedded value
Cognisance is taken of the limitations of certain key measures based on profits earned in the current accounting year, given the long term nature of policyholder contracts. In this regard, GCR recognises embedded value ("EV"), as determined by an independent actuarial consultant, providing a measure (based on certain assumptions) for the present value of the contribution of the covered business to shareholder distributable earnings. At a high level, EV consists of the following components:

- The free surplus attributed to the covered business.
- the required capital identified to support the in-force covered business.
- the present value of future shareholder cash flows from in-force covered business.
- EV excludes the value of future new business, as well as the cost of required capital.
- EV identifies and quantifies key business drivers.

Value of new business
In addition, note is taken of the value of new business ("VNB"), which is a measure of the economic value of the profits expected to emerge from new business net of the cost of supporting capital. This forward looking calculation provides insight into the lifetime value created though new sales, assisting in both product development and pricing decisions. It is noted, however, that analysing both EV and VNB requires a significant amount of qualitative judgment to distinguish between aspects influenced by management and generic market factors that affect

[1] API is based on 100% of recurring premiums and 10% of single premiums.

performance across the whole sector. Furthermore, the assumptions used by management in calculating the above valuations may differ between insurers, making direct comparative analysis impractical. Accordingly, the valuations are used by GCR as insight into the insurers' management structure and expectations for the future prospects of the business.

3.2. Reinsurance

Reinsurance is used to support underwriting capacity and solvency, as a capital management mechanism, and as balance sheet protection against adverse claims experience. Prudent use of reinsurance as a means of limiting capital erosion is viewed as a positive rating factor, while retention of large portions of risk relative to capital can result in negative ratings pressure. Simultaneously, the creditworthiness of the reinsurance partners is assessed..

Reinsurance structure and counterparties
GCR analyses the reinsurance structure relative to the nature and size of underlying risk exposures, as well as the diversification and credit quality of the reinsurance counterparties. Specific factors that are analysed include, where applicable:

- the scope of reinsurance cover relative to the risks underwritten.
- net retention per risk and event as a percentage of capital.
- use of facultative reinsurance.
- changes to treaty terms, capacity and participants on the treaties.
- premium retention trends and strategy going forward.
- reinsurance trade off in terms of technical profitability over a three to five year time horizon.

Catastrophe risk
Catastrophe risk holds potential for high severity event losses to occur unexpectedly, resulting in rapid erosion of policyholder protection. The potential shift in the frequency of such events heightens the need for increased supervision of this risk component going forward. GCR assesses insurers' catastrophe risk management, taking into account data quality, exposure monitoring techniques and process controls.

Group accumulation risk
Cognisance is also taken of the insurance company's exposure to group life business, as well as the possibility of any accumulation risk. Therefore, the protection measures in place to eliminate, or lessen, the adverse impact on capital are evaluated. The extent of the utilisation of catastrophe modelling tools, monitoring of aggregate loss exposure and a well-defined catastrophe risk-management program, may be taken into account where relevant.

3.3. Asset management

The size, quality and composition of the investment portfolio has an impact on an insurer's profitability and capital levels, and is a component in the analysis of balance sheet strength. GCR positively considers balance sheets that match policyholder liabilities with investment classes that are relatively liquid and subject to a lower degree of market volatility, assuming that reserving is sufficiently prudent, higher ratings will generally be accorded to companies that match policyholder liabilities with investment classes that are relatively liquid and subject to a lower degree of market volatility. This trade-off is examined within the context of asset liability matching requirements. Companies with a short track record and those that are susceptible to greater operating volatility would be expected to maintain more conservative investment portfolios, given their lower tolerance for market fluctuations and potential reliance on investment returns to support capital accumulation.

Investment strategy An insurer's investment strategy guides the deployment of funds into various asset classes and management of credit and concentration risks. In this regard, asset allocation provides a view of the insurer's ability to meet operational cash flow needs, match appropriate assets to various liabilities, and preserve value. The formalization of an investment policy, and adherence thereto over time, is viewed positively by GCR.

Liquidity profile
From a liquidity perspective, the company's ability to fund short term cash flow requirements with strong, sustainable and consistent operating cash flow generation is assessed. Furthermore, the rating would consider the extent to which foreign currency denominated liabilities are backed by investments that mitigate currency risk, where applicable. Liquidity metrics may be analysed under base and stressed scenarios when relevant. Diversification of banking counterparty risk may also be measured, carrying increased significance in environments exhibiting weaker financial system stability.

Liquidity // Government debt
GCR typically recognises domestic government debt in liquidity ratios, on the basis that government-issued instruments are typically a proxy for risk-free securities, or at least securities exhibiting characteristics of minimal risk. This notwithstanding, in countries with an elevated level of political or economic risk that points to a weakening in sovereign willingness and ability to meet financial obligations in a domestic context, government debt will be treated as a normal bond instrument, with relevant capital charges applied based on applicable debt ratings.

Asset-liability matching ("ALM")
GCR takes cognisance of the need for insurers to match the maturity profile of assets with the

concomitant liabilities. Mismatch of assets and liabilities, whether by nature or term, are considered, albeit subject to the level of free assets or other protection measures in place. Clearly defined ALM guidelines may mitigate liquidity risk facing an insurer.

Asset quality
GCR's analysis of asset quality considers the size of the overall investment portfolio and exposure to higher risk investment assets, such as listed equities, unlisted investments, property investments, and advances. The assessment factors in diversification by counterparty, sector and individual security, as well as credit quality of securities. The quality of the overall asset base is also analysed, with particular consideration given to receivables and their impact on cashflow generation. Where an entity has large related party transactions and balances, GCR ensures that the purpose and terms of these transactions are clearly understood, and discounted where appropriate.

GCR looks at a company's ability to satisfy its anticipated term obligations to policyholders and other financial responsibilities without having to liquidate its long term investments or affiliated assets. This includes a measurement of the ratio of a company's total liabilities that are covered by cash and unaffiliated invested assets. In this respect, higher ratings will generally be accorded to companies that have lower exposure to high risk assets, as well as appropriate matching with regards to investment guarantees. However, companies that have a stable, long duration, low-risk liability structure with little embedded optionality, which provides an offset to the increased liquidity risk and volatility of high risk assets, are likely to be able to tolerate a higher proportion of higher risk assets in their investment portfolios. For such companies to maintain high ratings, it would be expected that they have solid capital positions and a stable earnings profile, as well as strong track records and proven expertise in managing more risky asset classes. Companies that have a significant proportion of liabilities that share risks with policyholders also have a higher tolerance for high risk assets because they can pass much of the asset risk on to the policyholders.

Further, where investment guarantees are provided to policyholders, GCR analyses the underlying invested assets to ensure appropriate relation to the guarantees, and/or the shareholder capital held to cover the cost of these guarantees to shareholders under adverse conditions. Cognisance is taken of the fact that in order to enhance policyholder investment returns, there is likely to be some mismatch between the investment guarantees provided and the asset allocation. For a given investment guarantee, a more aggressive asset allocation (e.g. higher equity exposure) would typically result in a higher shareholder capital requirement. Similarly, a more conservative asset allocation (e.g. lower equity exposure) would typically result in a lower shareholder capital requirement.

Quantitative assessment measures of investment and asset risk include:

- higher risk assets as a percentage of total invested assets and capital.
- premium and reinsurance receivables as a percentage of capital.
- aged receivables or other assets that expose the company to undue credit risk, relative to capital.
- the quantum of inter-company loans and related party receivables as a percentage of capital.

3.4. Capital adequacy

Well capitalised insurers are better positioned to withstand adverse changes in the operating, regulatory and economic environment, investment cycles. Accordingly, the strength of a company's balance sheet and its ability to preserve and grow surplus capital is a key determinant of its longer term financial soundness.

The analysis of capital adequacy interacts with other key rating factors that contribute to the holistic credit assessment. For example, capital constraints can also limit an insurer's ability to achieve strategic objectives, which may impact future operating performance.

Capital generation
GCR's assessment of capital adequacy takes into account the consistency imbued in capital from operations. Insurers that have a track record of generating capital internally have an elevated capacity to retain balance sheet strength. This is often complemented by comprehensive management strategies, including conservative dividend distributions/ policies.

Overview of GCR's risk-based capital adequacy assessment
GCR incorporates a risk-based solvency framework into its capital adequacy assessment. Excess capital is viewed as a buffer against adverse developments across an insurer's risk spectrum, and as such the risk-based tool provides an indication of the ability of a company to absorb unfavourable risk deviations. Risk modules cover:

- underwriting exposure- underwriting exposure associated with the quantum and composition of the risk base. Products that expose an insurer to greater reserving uncertainty and potential volatility are viewed to have a higher capital requirement.
- market risk-- capital exposure to variations in market volatility. Where viewed as appropriate, asset haircuts may be applied in order to determine the potential impact on capital, with strained

solvency emanating from aggressive investment positions being factored into the rating decision.
- credit risk—the quality of the insurer's revenue as measured by collectability of premiums. Insurer's with stringent credit policies are better positioned to curtail the erosion of capital quality. and
- operational risk—a buffer required to cater for human and system related errors.

Regulatory capital considerations
GCR assesses an insurer's capital adequacy in the context of the local regulatory framework. Capitalisation levels that exhibit limited buffers relative to statutory requirements, or register within a band of regulatory sensitivity, may be at risk of supervisory intervention that sees suspension of particular lines or products, or stronger action such as curatorship or license withdrawal.

Actuarial valuation
A key measure used by GCR is the capital adequacy requirement (preferably determined by an independent actuarial consultant), calculating the required minimum amount of capital that has to be retained in shareholder funds to absorb any potential losses that could be incurred within policyholder funds (and therefore ensure that benefit obligations to policyholders would be met) in foreseeable adverse conditions. This incorporates the particular exposure of the insurer's investments and assets to adverse economic and market conditions, such as a rise in interest rates, a decline in equity values, cyclical downturns and above-normal catastrophes. Cognisance is taken of the actuaries' discretion for offsetting certain management actions in response to some of the adverse scenarios modelled. Further, the actuarial assumptions are reviewed regularly to reflect changes in experience and/or expectations. To demonstrate solvency, an insurer is expected to be able to hold an excess of assets over liabilities, which at least cover the capital adequacy requirement once (or as deemed prudent by the appropriate regulatory body).

Capital adequacy and ERM
Each of the key capital adequacy factors is analysed using standardised measures that can be compared with an appropriate peer group or industry benchmark, and GCR's solvency margin guidelines for a particular rating band. In this regard, it is important to obtain a clear understanding of the company's capital management approach, dividend policy, and supplementary capital flexibility considerations such as sources and availability of additional funding and any holding company guarantees that are in place. These factors are used to assess risk management across various fields to supplement capital adequacy calculation.

3.5. Reserving

Companies that make prudent provision for future policyholder obligations are less likely to be impacted by unexpected shocks and capital volatility. GCR assesses reserving levels and trends relative to the underlying risk composition and in the context of industry norms and regulatory requirements.

The company's internal reserving approach and extent to which reserving adequacy is independently assessed, as well as the frequency of these reviews are considered. In addition to the qualitative aspect, the following reserving ratios are used:

- Net technical reserves and reserve transfers relative to net business volumes written, and reserve development over time, where relevant information is available.
- Net reserves as a percentage of shareholders' funds.
- Compliance with regulatory requirements and the relative stringency of these guidelines.

4. Modifiers

ERM, corporate governance, and strategic management, are factors that impact on almost all elements in the credit rating assessment. A robust oversight and directional framework is a contributing factor to creditworthiness.

ERM pertains to a holistic approach to identifying, measuring and managing all of the risks facing an organization. GCR assesses corporate governance and management in order to gauge the combination of strategic flexibility and efficiency available within a framework of strong business practices. The realisation of operational effectiveness derived from such structures is likely to contribute to controlled credit fundamentals, while enhanced market positioning may be borne out of a clear strategic agenda.

4.1. Risk management

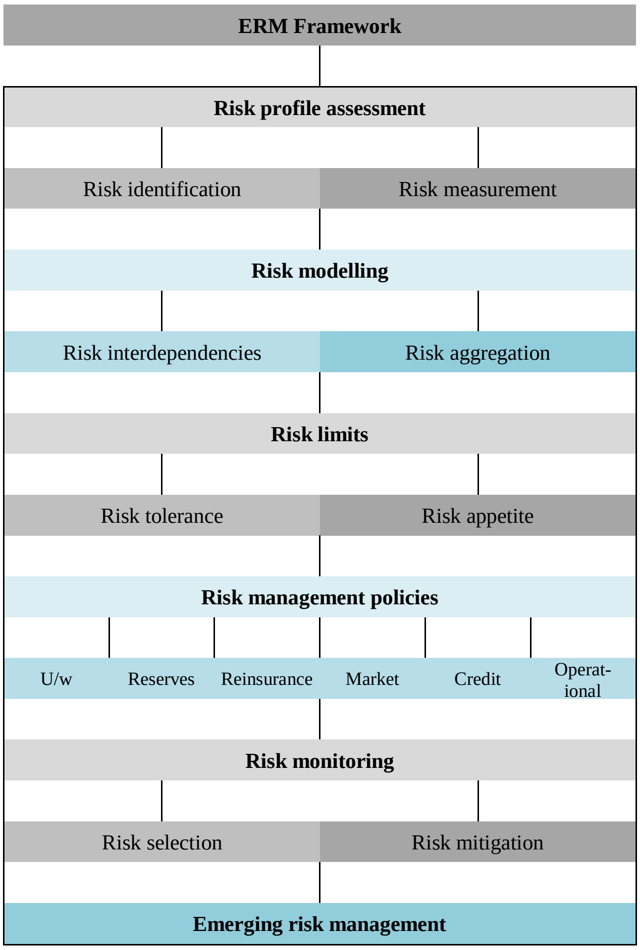
i. Enterprise risk management

A rated entity's demonstrated ability to monitor and control risk can be a rating differentiator. Insurers that develop a formal framework to quantify and manage risk within accepted risk tolerance levels are better equipped to manage potential volatility in earnings and capital.

ERM assessment overview
GCR's assessment of ERM centres on the level of development of an insurer's ERM capabilities, the degree of ERM operational integration, and enterprise-wide implementation track record.

Risk framework
The transition from risk management primarily aimed at facilitating the identification of risks, to a more developed format is key. The latter pertains to the

incorporation of risk measurement and management into strategic and capital management decisions. This is optimised by an effective risk management function that is independent of risk-taking business units.



Risk framework // Reporting and structure
The responsibility for effective ERM policies and procedures ultimately rests with the board and senior management. Responsibility for risk management should be clearly allocated. This may include the appointment of a suitably qualified risk manager, where appropriate and proportionate.

An insurer should be appropriately resourced so that monitoring systems are able to evolve with its business risks and are able to meet the increasing sophistication of ERM requirements and practices.

Risk framework // Group considerations
Cognisance is taken of the ERM functionality within certain group structures, which may differ from a stand-alone entity in terms of the layout, while providing the equivalent level of risk control. In this regard, certain tasks may be performed in higher layers of the group in terms of conventional ERM structuring. GCR takes such structuring into consideration, assessing whether risk is being adequately managed at the appropriate level within the group.

ii. Corporate governance

The effectiveness of robust governance oversight and strategic direction are strongly related to the underlying indicators of an insurer's overall level of creditworthiness. GCR assesses corporate governance and management in order to gauge the combination of strategic flexibility and efficiency available within a framework of solid governance practices. The effectiveness of strategic implementation drives market positioning and competitiveness, with the success of a consistent strategy entrenching competitive positioning and related earnings capacity. The combination of controls and effective management support operational efficiencies and related internal measures, enhancing an entity's current and future operating performance. If an entity has the ability to manage important strategic and operating risks, then management is viewed to play a positive role in determining its operational and financial success. Good governance practices will not, in isolation of other rating factors and criteria, enhance an entity's credit rating. However, poor governance practices and quality of management can contribute to an entity's negative rating assessment and result in a lower rating than otherwise implied by its quantitative credit factors.

Board effectiveness
The governance structure of an entity begins with the board of directors ("BoD"), its composition, and the adequacy of reporting lines. A company should have a board that governs, directs and is in effective control of the company on behalf of its shareholders and stakeholders. The board should act as the focal point for corporate governance, provide effective leadership and oversight based on sound ethical foundations.

Competent, independent and high-performing boards are important to set an entity's strategic direction, challenge executive management's strategy and decisions constructively, and ensure that the entity is run and led effectively in a sustainable way. Effective boards include non-executive and independent members with diverse skills, competences, views and professional experience. The oversight role of the board of directors plays an integral part in how management performance is measured, rewarded and disciplined.

Board of Directors // BoD structure
A board with proper governance principles should elect a chairman who is an independent non-executive director. The chief executive officer ("CEO") of the company should also not fulfil the role of chairman of the board. The board should comprise a balance of power, with a majority of non-executive directors. The majority of non-executive directors should also be independent. The board should report on the effectiveness of the company's system of internal controls, risk management framework, and ensure that the company has an effective and independent audit

committee that is responsible for the internal audit and independent audit of the financial statements. Annual evaluations of the board, its committees and directors (including evaluations of the chairman, CEO and other executive directors) should be performed by the chairman or an independent service provider. The board should ensure that directors and executives are fairly and responsibly remunerated, without creating incentives for excessive risk-taking. The remuneration policy should be approved by shareholders.

Board effectiveness // Support committees
The board should be assisted by specialised committees with well-defined terms of reference. Furthermore, the annual audit must be conducted by reputable external auditors selected by an independent audit committee that have oversight over quality of financial reporting. The board should be well informed of and approve the company's strategies and identify key performance and risk areas.

Jurisdictional considerations
The governance practices are affected by the jurisdictional and competitive environment in which an entity operates, such as regulatory environment, level of financial market development, rule of law standards, conflict of interest and corruption. The degree to which governance practices affect the rating depends on the extent and pervasiveness of the governance issues identified. Corporate governance codes and frameworks exist in many countries but are generally applicable only to companies that issue shares on regulated markets.

iii. Strategic management

ERM's establishment of risk tolerances, and the subsequent development of risk appetite, represents upper and lower limits of an insurer's risk-taking landscape. Within this range, an insurer is viewed as better positioned to limit downside risk, while also taking advantage of beneficial opportunities, if a strong management function guides strategic planning and implementation.

Strategic planning and implementation
GCR assesses an entity's strategic planning process in terms of its alignment with the core competencies and resources within the organisation, while taking into consideration the underlying industry and company-specific risk factors. A demonstrated track record of successful strategic execution within risk tolerance bands points to a strong strategic and risk management function. The inability to execute its business plans effectively is likely to lead to a weakening in an entity's market positioning and poor operating performance. GCR evaluates the attainment of key strategic and financial goals relative to original budgets/forecasts in order to assess the effectiveness of the strategic planning process and the subsequent deployment of necessary skills and resources.

Strategic effectiveness // Management expertise and depth
If an entity has the ability to manage important strategic and operating risks, then management is viewed to play a positive role in determining its operational and financial success. The technical capacity, strategic competence, experience, and track record of the management team directly impact on the effectiveness of strategic management and implementation, and as such contribute to the rating's strategic assessment.

4.2. Support framework

Subsidiary	Upliftment	Conditions
Very high strategic importance	Up to 3 notches above SACP*	Key and integral part of the group's business. Very strong strategic alignment. This includes alignment of: - Branding and marketing - Core activities and products - Target markets and segments A history of success in supporting group objectives. Likelihood of underperformance relative to group targets is low. Material in size relative to the parent / group in absolute terms on a: - Capital basis - Profit basis Capital management and risk management strategies aligned with group. Sale of the subsidiary is highly unlikely.
High strategic importance	Up to 2 notches above SACP*	Important part of the group's strategy. Some strategic alignment. A history of success in supporting group objectives. Likelihood of underperformance relative to group targets is low. Capital management and risk management strategies aligned with group. Sale of the subsidiary is unlikely.
Moderate strategic importance	Up to 1 notch above SACP*	Moderately important part of the group's business. Some strategic alignment. A history of moderate success in supporting group objectives. Sale of the subsidiary is unlikely.
Non-strategic importance	No adjustments	Does not meet the conditions for the above categories.

*SACP = Stand-alone credit profile

GCR's support framework allows for the transfer of credit strengths of shareholders to underlying insurance company subsidiaries. The assessment of extraordinary support that would be expected to be provided to subsidiaries can provide rating upliftment to the stand-alone rating. Mirroring the approach followed with other rating modifiers, the stand-alone FS rating acts as the rating anchor, with additional factors adjusting the base rating.

GCR's assessment of potential support is based on the willingness and ability of the parent company to provide financial support to a subsidiary under adverse conditions. The evaluation of support willingness consists of both qualitative and quantitative factors. These factors are evaluated based on business profile and financial profile considerations that underpin the conclusion pertaining to potential support.

For evaluation purposes, GCR assigns one of four broad categories of strategic importance to each insurance subsidiary, based on the meeting of parallel conditions within this framework:

- Very high strategic importance.
- High strategic importance.
- Moderate strategic importance.
- Non-strategic importance.

This status corresponds to the level of credit support that would be expected to be received from the parent company during adverse operating conditions. GCR may change the strategic category of a subsidiary over time.

Support framework in emerging markets
International groups and entities are increasingly stepping up efforts to enter emerging markets, as a means of increasing diversification benefits, while capturing the growth available (often contrasting the limited expansion opportunities afforded by established markets). This notwithstanding, the operational and risk characteristics of the bulk of emerging markets result in several considerations requiring analytical judgement pertaining to the standing of emerging market offshoots relative to the parent or group entity. Specifically, while such strategies can be viewed as important, they are often not critical to the broader continued success of the international entity, and lack the knock-on effect that operations in more closely related markets can sustain. Furthermore, emerging market subsidiaries often represent a limited proportion of the parent's/group's earnings and capital base, which confines the strategic capital that can be allocated to such entities in adverse conditions. Given this, the status of very high strategic importance is not assigned to the bulk of such subsidiaries.

Appendix A: Explanation of National Scale and International Scale Ratings

GCR's local currency National Scale ratings are designed to enable appropriate differentiation of credit quality within a specific country. Particularly in developing countries, where the sovereign ratings tend to be below investment grade, utilising the International Scale has the consequence of compressing ratings within a limited number of rating bands, thus providing limited differentiation among credits.

In according National Scale ratings, sovereign risk factors are neutralised as it is assumed that all insurers within a given country or jurisdiction will be impacted equally. This allows for ratings to be tiered against an assumed lowest risk rating of 'AAA' within each country or jurisdiction. This lowest risk will normally, although not always, be assigned to the financial commitments issued or guaranteed by the sovereign state. Certain markets may, however, be characterised by inherent limitations that impose a ceiling on the ratings that can be accorded to entities that operate in these markets. National Scale insurance ratings are intended to be comparable only in a single country or jurisdiction (denoted by a special modifier).

On the other hand, GCR's International Scale ratings are tiered against a global pool of insurers. Thus, the highest rating that can be achieved will be limited by the credit quality of the country in which the insurer is domiciled (or conducts the majority of its business). Exceptions can arise where the insurer's rating may pierce the sovereign rating; for example where the entity has significant assets domiciled or revenue sourced offshore, or there are guarantees from foreign entities in place.

Rating insurers on an International Scale introduces additional factors related to sovereign risk, including political risks, the robustness of the legal system and transfer and convertibility risk. While such risks are generally considered when according all insurance ratings, this is done on a more micro level with regard to the specific factors affecting the company or industry under review. For International Scale ratings, a greater macro approach is followed, and the risk factors of the sovereign as a whole are measured against other sovereigns or business jurisdictions.

Political risks are more acute in countries where the democracy is young or even limited. Nevertheless, the principles of good governance and the ability of the government to deliver on development goals are constant across all jurisdictions. Closely related to political risk is societal stability. To the extent there is social instability, the business environment is likely to be negatively impacted and accordingly the ratings of entities in the jurisdiction constrained. To the extent that such factors improve, due to solid economic growth or the successful delivery of development plans, ratings would be positively impacted.

Political stability also adds greatly to the strength of the legal system. History has also shown that changes in government can have a destabilising impact on policies and regulations. Well defined and defensible property rights are critical for a strong business environment; while the absence of such rights or weak enforceability would significantly constrain the International Scale ratings of all entities in the country due to the much higher risk. Even where a sound legal system is in place, GCR is cognisant of the fact that in many developing countries historical case law regarding financial transactions may be lacking. This would introduce increased uncertainty into the enforceability of rights detailed in more complex financial products.

Transfer and convertibility risk relates to the ability of insurers in a country to convert earnings between local and foreign currencies and to transfer funds abroad in the normal course of business. Countries where such risks are high tend to be those where currency controls are in place and approval from the relevant authorities is necessary for cross border transactions to occur. Challenges may also occur in small economies, were the currency market does not have sufficient scale to timeously convert large amounts of currency at the prevailing conversion rate. Transfer and convertibility are of greater concern where an insurer generates the majority of its revenue in the local currency but has foreign currency denominated liabilities. If sufficient funds cannot be converted and transferred cross-border, a default on obligations may occur, even when the entity has sufficient financial resources.

GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S INSURANCE GLOSSARY

Accident	An unplanned event, unexpected and un-designed, which occurs suddenly and at a definite place.
Accounting	A process of recording, summarising, and allocating all items of income and expense of the company and analysing, verifying and reporting the results.
Agency	An insurance sales office which is directed by an agent, manager, independent agent, or company manager.
Assets	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Balance Sheet	Also known as a Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Budget	Financial plan that serves as an estimate of future cost, revenues or both.
Capacity	The largest amount of insurance available from a company. In a broader sense, it can refer to the largest amount of insurance available in the marketplace.
Capital	The sum of money that is invested to generate proceeds.
Capitalisation	The provision of capital for a company, or the conversion of income or assets into capital.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Captive Insurance Company	A company owned solely or in large part by one or more non- insurance entities for the primary purpose of providing insurance coverage to the owner or owners.
Cash	Funds that can be readily spent or used to meet current obligations.
Catastrophe	An event, which causes a loss of extraordinary magnitude.
Claim	A request for payment of a loss, which may come under the terms of an insurance contract.
Commission	A certain percentage of premiums produced that is received or paid out as compensation by an insurer.
Contract	An agreement by which an insurer agrees, for a consideration, to provide benefits, reimburse losses or provide services for an insured. A 'policy' is the written statement of the terms of the contract.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Diversification	Spreading risk by constructing a portfolio that contains different investments, whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Dividend	The portion of a company's after-tax earnings that is distributed to shareholders.
Equity	Equity is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Experience	A term used to describe the relationship, usually expressed as a percent or ratio, of premiums to claims for a plan, coverage, or benefits for a stated time period.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For an insurer, its exposure may also relate to the risk related to policies issued.
Facultative	Facultative reinsurance means reinsurance of individual risks by offer and acceptance wherein the reinsurer retains the “faculty” to accept or reject each risk offered.
Financial Flexibility	The company’s ability to access additional sources of capital funding.
Financial Statements	Presentation of financial data including balance sheets, income statements and statements of cash flow, or any supporting statement that is intended to communicate an entity's financial position at a point in time.
Income Statement	A summary of all the expenditure and income of a company over a set period.
International Scale Rating LC	International local currency (International LC) ratings measure the likelihood of repayment in the currency of the jurisdiction in which the issuer is domiciled. Therefore, the rating does not take into account the possibility that it will not be able to convert local currency into foreign currency or make transfers between sovereign jurisdictions.
Interest	Money paid for the use of money.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Investment Income	The income generated by a company's portfolio of investments.
Investment Portfolio	A collection of investments held by an individual investor or financial institution.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
Liquidity	The speed at which assets can be converted to cash. The ability of an insurer to convert its assets into cash to pay claims if necessary. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Loss	The happening of the event for which insurance pays.
Market Risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
Net Profit	Trading/operating profits after deducting the expenses detailed in the profit and loss account such as interest, tax, depreciation, auditors' fees and directors' fees.
Net Retention	The amount of insurance that a ceding company keeps for its own account and does not reinsure.
Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people or systems or from external events. This includes legal risk, but excludes strategic risk and reputational risk.
Personal Lines	Types of insurance, such as auto or home insurance, for individuals or families rather than for businesses or organisations.
Preference Share	Preference or preferred shares entitle a holder to a first claim on any dividend paid by the company before payment is made on ordinary shares. Such dividends are normally linked to an interest rate and not determined by company profits. Preference shares are normally repayable at par value in the event of liquidation. They do not usually carry voting or pre-emptive rights. Preference shares can be redeemable or perpetual.
Policy	The legal document issued by the company to the policyholder, which outlines the conditions and terms of the insurance.
Policyholder	The person in actual possession of an insurance policy.
Pool	An organisation of insurers or reinsurers through which particular types of risk are underwritten and premiums, losses and expenses are shared in agreed-upon amounts.
Portfolio	All of the insurer’s in-force policies and outstanding losses, with respect to described segments of its business.
Preference Share	Preference or preferred shares entitle a holder to a first claim on any dividend paid by the company before payment is made on ordinary shares. Such dividends are normally linked to an interest rate and not determined by company profits. Preference shares are normally repayable at par value in the event of liquidation. They do not usually carry voting or pre-emptive rights. Preference shares can be redeemable or perpetual.
Premium	The price of insurance protection for a specified risk for a specified period of time.
Rating Horizon	The rating outlook period
Reinstatement	The resumption of coverage under a policy, which has lapsed.

Reinsurance	The practice whereby one party, called the Reinsurer, in consideration of a premium paid to him agrees to indemnify another party, called the Reinsured, for part or all of the liability assumed by the latter party under a policy or policies of insurance, which it has issued. The reinsured may be referred to as the Original or Primary Insurer, or Direct Writing Company, or the Ceding Company.
Reserve	(1) An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders. (2) An amount allocated for a special purpose. Note that a reserve is usually a liability and not an extra fund. On occasion a reserve may be an asset, such as a reserve for taxes not yet due.
Retention	The net amount of risk the ceding company keeps for its own account.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Securities	Various instruments used in the capital market to raise funds.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Short Term	Current; ordinarily less than one year.
Solvency	With regard to insurers, having sufficient assets (capital, surplus, reserves) and being able to satisfy financial requirements (investments, annual reports, examinations) to be eligible to transact insurance business and meet liabilities.
Statutory	Required by or having to do with law or statute.
Statutory Solvency Margin	Gives an indication as to whether the minimum regulatory solvency margin is being met, based on the net statutory assets to statutory net premiums ratio.
Technical Margin	Measures the percentage of net earned premiums remaining after accounting for claims and expenses incurred.
Technical Result	Net premiums earned less net claims incurred and net commission expenses.
Total Capital	The sum of owner's equity and admissible supplementary capital.
Underwriting	The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.