POUND | GATES

CHARTERED INSURANCE BROKERS

# Financial Security of Insurers & Related Issues

This note seeks to help our clients and prospective clients understand issues relating to the financial security of insurers. It provides general information only and each insurer must therefore be considered on their individual merits. Insurer ratings represent no guarantee but they are a guide to the likelihood of an insurer being able to meet its obligations.

We generally refer to ratings provided by the international rating agency Standard & Poor's (S&P). An S&P Insurer Financial Strength Rating is an opinion of the long term financial security of an insurer in respect of its ability to pay claims under its insurance policies. There are other rating agencies, such as AM Best, who use similar methods of assessment but we are not a rating agency and provide no warranty or in any way validate the opinions or assessments of others.

This is what S&P say about their approach: "*S&P's Ratings Services provides a step-by-step summary of how we use our insurance criteria to produce an issuer credit rating or a financial strength rating (ICR or FSR). First, using reported data and our own metrics, we evaluate an insurer's business risk profile and financial risk profile. For the business risk profile, we undertake a detailed analysis of industry and country risk, and competitive position. For the financial risk profile, we examine capital and earnings, risk position, and financial flexibility. Jointly, these two profiles provide the "anchor" to our rating. We then add our assessments of the insurer's enterprise risk management, and management and governance, as well as what we call a "holistic analysis" of its performance. This results in an "indicative stand-alone credit profile" for a company or "indicative group credit profile" for an insurance group. Next we look at the company's liquidity, and then whether it can be rated above the relevant sovereign or sovereigns. At this point, we assign a stand-alone credit profile (SACP) or group credit profile (GCP). This gives our view about the intrinsic creditworthiness of the company or group. If we believe the insurer faces a present risk of default, the SACP or GCP is set according to separate criteria. Finally, we assess the likelihood of group or government support for the company, and assign an ICR or FSR. The criteria apply to all our global insurance ratings in the life, health, property/casualty (also called non-life), and reinsurance sectors. The criteria do not apply to ratings on bond insurers, insurance brokers, and mortgage and title insurers.*"

Insurer ratings, regulatory arrangements and compensation schemes vary across the insurers we use. Should you wish to discuss any issues relating to the insurers we use, do not hesitate to talk to your usual Pound Gates contact.

Insurers rated 'BBB' or higher are regarded by S&P as having financial security characteristics that outweigh any vulnerabilities, and are likely to have the ability to meet financial commitments. An insurer holding one of the following four ratings is deemed to meet this criteria:

**AAA**
An insurer rated 'AAA' has extremely strong financial security characteristics. 'AAA' is the highest insurer financial strength rating.

**AA**
An insurer rated 'AA' has very strong financial security characteristics, differing only slightly from those rated higher.

**A**
An insurer rated 'A' has strong financial security characteristics, but is somewhat more likely to be affected by adverse business conditions than are insurers with higher ratings.

**BBB**
An insurer rated 'BBB' has good financial security characteristics, but is more likely to be affected by adverse business conditions than are higher rated insurers.

An insurer rated 'BB' or lower is regarded by S&P as having vulnerable characteristics that may outweigh its strengths.

**BB**
An insurer rated 'BB' has marginal financial security characteristics. Positive attributes exist, but adverse business conditions could lead to insufficient ability to meet financial commitments.

**B**
An insurer rated 'B' has weak financial security characteristics. Adverse business conditions will likely impair its ability to meet financial commitments.

**CCC**
An insurer rated 'CCC' has very weak financial security characteristics, and is dependent on favourable business conditions to meet financial commitments.

**CC**
An insurer rated 'CC' has extremely weak financial security characteristics and is likely not to meet some of its financial commitments.

**SD or D**
An insurer rated 'SD' or 'D' is in default on one or more of its insurance policy obligations but it is not under regulatory supervision that would involve a rating of 'R'.

**R**
An insurer rated 'R' is under regulatory supervision owing to its financial condition. The rating does not apply to insurers subject only to non-financial actions such as market conduct violations.

**NR**
An insurer designated 'NR' is not rated, which implies no opinion about the insurer's financial security.

Ratings from 'AA' to 'B' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

A detailed explanation of S&P's ratings can be found on their website [www.spglobal.com/ratings](http://www.spglobal.com/ratings)

**Policyholder protection for UK customers - Insurer financial failure**
If a UK insurer regulated by the Prudential Regulation Authority (PRA) (including other insurers subject to TPR (see below)) cannot meet claims against it because it has been placed in liquidation (or provisional liquidation or administration) then eligible UK policyholders are entitled to compensation from the Financial Services Compensation Scheme (FSCS). The PRA and the Financial Conduct Authority (FCA) each make rules which sets out how FSCS cover works. The compensation is financed by a levy on the relevant firms.

Eligible policyholders are:

- Private individuals, sole traders and small businesses (including partnerships, unincorporated or mutual associations) with a turnover below £1,000,000.
- All policyholders in respect of compulsory insurances e.g. Third Party Motor Liability & Employers' Liability.

Compensation for PRA regulated firms (effective from 8 October 2020) is:

- 100% for compulsory insurance, professional indemnity insurance and/or claims arising from death or incapacity of the policyholder due to injury, sickness or infirmity.
- 90% for all other kinds of insurance.

**Temporary Permissions Regime (TPR) and other non-UK authorised insurers**

As part of the transition arrangements for the UK's exit from the EU the FCA has established TPR for firms who are who are regulated by a regulator in the EU (not PRA) but will no longer have "passporting" rights to operate in the UK. As the name implies TPR is a temporary arrangement, currently intended to run until December 2023.

Under the terms of TPR a firm must be part of FSCS arrangements to protect their eligible UK customers.

EU regulated firms that are not subject to TPR, or other non-UK regulated firms, are regulated according to the laws of the country in which they are based and financial failure compensation arrangements, should they exist, will vary from country to country.



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