

# Insurance Company Analysis

A three-day workshop for credit risk, origination, fixed income and insurance professionals. The overall goal is to provide participants a systematic approach to credit risk and financial strength analysis for P&C (non-life) and life insurance and reinsurance companies.

## TARGET AUDIENCE

The workshop is designed for fixed income, banking, insurance and credit risk professionals. It is targeted at an intermediate level and assumes a basic understanding of accounting and insurance products. The one-day workshop Introduction to Insurance Financial Statements is designed as a preparation for those with limited experience of insurance accounts.

## COURSE OBJECTIVES

Participants will be equipped to:

- Understand the business and financial risks inherent in the life, non-life and reinsurance industries.
- Use qualitative and quantitative analysis and market indicators to distinguish strong and weak performers by sector and to detect early warning signals of deteriorating financial strength.
- Analyse and stress test financial statements in the context of differing accounting standards and business practices.
- Appreciate how economic, competitive and regulatory issues impact the risk profile, strategy and financial health of an insurance company.
- Apply a structured approach to identify key risks and mitigants when dealing with insurance companies.

## CONTENT

### ANALYTIC OVERVIEW

- Purpose / payback model: a structured approach to credit analysis and its applicability to insurance companies
- Insurance ratings: insurer financial strength and credit ratings, ratings of group members, loss given default, recovery ratings
- Use of debt and equity market indicators to highlight concerns.

### OPERATING ENVIRONMENT

#### Macro-economic and sector issues

- Investment cycles: stock, property, credit markets and volatility
- Causes of recent fluctuations in strength of the life, non-life and reinsurance sectors
- Underwriting cycles in various markets
- Mortality, morbidity and longevity trends
- Climate change; trends in insured losses from catastrophes
- Impact of cultural changes in litigation
- Non-life reserving issues: redundancy or deficiency; asbestosis & environmental liabilities
- Competitive factors: market fragmentation; penetration levels in emerging versus mature markets.

#### Regulation and supervision

- Key methods of regulating insurance companies: minimum solvency margin, investment and business restrictions
- International differences: risk based capital vs. simple solvency measures, EU Solvency I and II, US and other local markets
- Group solvency: Insurance Groups Directive (IGD), double leverage in financial conglomerates, capital requirements of non-insurance businesses
- Degree of comfort from quality of supervision.

## FINANCIAL FUNDAMENTALS

### Statement logic

- Review of key items in financial statements
- Key accounting issues: regulatory returns, IFRS Phase I and II; GAAP and embedded value reporting
- Accounting discretion: write-downs, IFRS Fair Value hierarchy, temporary vs. permanent impairments, IBNR reserving.

### Business risk

- Investment risk: quality and liquidity of the investment portfolio, asset and liability matching, cost of guarantees, derivatives use
- Investment returns: inclusion of realised and unrealised gains and losses, investment return requirements of the life and non-life insurance businesses
- Underwriting risk: assessing the quality and diversity of the underwriting portfolio, loss, expense and combined ratios
- Reserve adequacy: loss reserve development triangles, survival ratios etcetera
- Catastrophe and reinsurance risk: utilisation policy; adequacy of reinsurance cover, credit and dispute risk
- Control of operating expenses, fixed and variable costs.

### Performance risk

- Diversity and stability of income: profitability measures and benchmarks
- Embedded value techniques for measuring and analysing life profitability, profit margins on new business, European Embedded Value (EEV) and Market-Consistent Embedded Value (MCEV), key assumptions.

### Financial risk

- Liquidity: operating cash-flow, liquid investments, liquidity shocks
- Solvency: regulatory requirements and market norms, stress testing; quality and fungibility of capital, alternative capital measures e.g. free asset ratio, operating leverage, asset and liability leverage, rating agency capital models
- Financial leverage, interest cover, use of hybrid capital, refinancing risk, debt servicing ability.

### Early warning signals

- Recognising financial and non-financial indicators of distress
- Accounting discrepancies: areas to check and questions to ask.

## MANAGEMENT AND FRANCHISE

- Framework for assessing management and operational risk
- Organisational concerns: weak affiliates, intra-group support, contagion risk; capital and dividend flows
- Significance of franchise and ownership: mutuals, public, state and private companies.

## STRUCTURE

- Funding needs of insurance companies: who is the borrower / counterparty?
- Hybrid capital securities: structure and type of capital issued; impact on credit standing and other concerns; regulatory and rating agency tolerances for hybrid capital
- Insurance-linked securities: securitisation of risks and of embedded value; use of Insurance SPVs and sidecars
- Capital structure: creditor versus policyholder rights and the impact of ranking and structure.