

Insurance Company Analysis

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

The overall goal of this three-day workshop is to provide a systematic approach to credit risk and financial strength analysis of life and non-life insurance and reinsurance companies.

Participants will be equipped to:

- Understand the business and financial risks inherent in the life and non-life insurance 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

This section introduces a structured approach to the credit analysis of insurance and reinsurance companies and explains how insurance companies are assessed by different market participants.

- 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
- Case studies*: purpose and payback sources for a major insurance group; using capital market data to identify insurers which are in or out of favour with investors.

OPERATING ENVIRONMENT

The goal of this section is to review key macro-economic and sector trends which may impact adversely or favourably on certain insurers and business lines, and to appreciate how the industry was affected by stressed conditions in the past.

Macro-economic and sector issues

- Investment cycles: stock, property and credit market levels and their 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 inflation and cultural changes in litigation
- Non-life reserving issues: redundancy or deficiency; asbestosis & environmental liabilities

- Competitive factors: market fragmentation; penetration levels in emerging vs. 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: double leverage in financial conglomerates, capital requirements of non-insurance businesses, EU Insurance Groups Directive (IGD)
- Degree of comfort from quality of supervision
- Exercises*: historic and prospective impact of the operating environment on life and non-life insurers and reinsurers; Double Leverage and weak group structures.

FINANCIAL FUNDAMENTALS

Section aims: to identify and benchmark key performance indicators in order to identify strong and weak performers and early warning signals of credit deterioration.

Statement logic

- Review of key items in financial statements
- Key accounting issues: regulatory returns, IFRS Phase I and II; GAAP and embedded value reporting
- Items subject to management discretion: write-downs, IFRS Fair Value hierarchy, temporary and permanent impairments, reserving for IBNR claims (non-life) and for investment guarantees (life).

Business risk

- Investment risk: quality and liquidity of the investment portfolio, asset and liability matching, cost of investment guarantees, use of derivatives for hedging, concentration risks
- 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, calendar year vs. accident year analysis, survival ratios etc.
- Catastrophe and reinsurance risk: utilisation policy; adequacy of reinsurance cover, credit and dispute risk
- Control of operating expenses, fixed and variable costs
- Case study*: assessing investment and underwriting risk and performance for a composite insurance company.

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, 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, total commitments including off-balance sheet
- *Exercise*: key financial indicators for strong and weak life companies
- *Case study*: assessing liquidity, leverage and solvency for a composite insurance company.

Early warning signals

- Recognising financial and non-financial indicators of distress
- Accounting discrepancies: areas to check and questions to ask.
- *Case study*: a strongly-rated insurer which failed. Quantitative and qualitative signs of weakness.

MANAGEMENT AND FRANCHISE

This section will focus on the implications of various ownership structures and provide a structured approach to assessing management and franchise.

- Framework for assessing management, strategy and operational risk
- Significance of franchise and ownership: mutuals, public, state and private companies.

STRUCTURE

Section aims: to review the funding needs of insurance companies; how these might be met and the potential risk mitigants for counterparties.

- Funding needs of insurance companies
- 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 vs. policyholder rights and the impact of ranking and structure
- *Case study*: maximum hybrid issuance to obtain rating agency equity credit
- *Exercise*: recovery prospects for different issues and issuers.

Learning Paths



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