Corporate Scorecard

Ratings Methodology – Insurance Rating Criteria

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Table of Contents

1 OVERVIEW

This document provides an overview of Corporate Scorecard's (Corporate Scorecard) criteria for assessing the creditworthiness of insurance companies. The document outlines the process, principles and methodology applied in Corporate Scorecard's engagements.

2 SCOPE

Corporate Scorecard's insurance rating methodology is an analytical framework for assigning the different type of credit ratings (credit and issue) which reflect an Insurer's capacity and willingness to honour its financial commitments in a timely manner.

Corporate Scorecard's top-down approach is supplemented by rigorous, bottom-up, evidence-based analysis. Inputs to Corporate Scorecard's rating methodology include a variety of financial and non-financial data from diverse sources.

Corporate Scorecard's rating incorporates an Insurer's standalone financial risk profile and the likelihood that it may receive external support from a parent group and/or extraordinary support from the sovereign. Corporate Scorecard assesses both the ability and propensity of the potential support provider to extend such support in a timely manner. This document also details the steps to arrive at the Financial Strength Rating (FSR) once we have arrived at the Insurer's credit rating (ICR).

3 KEY RATING TERMINOLOGIES

Type of Rating Assignments

Financial Strength Rating (FSR) is a forward-looking opinion about the financial strength of an Insurer, with respect to its ability to pay all claims under its insurance policies. The FSR denotes the financial strength of an Insurer only with respect to claims of its policy holders, and not to meet its non-policy obligations (e.g.: bank borrowings or bonds or subordinated debt etc.). The FSR differentiates the Insurer's credit worthiness from the perspective of a policy holder and that of a non-policy holder.

Insurer's Credit Rating is a forward-looking opinion about the Insurer's capacity to discharge all liabilities incurred in the ordinary course of the business on an ongoing basis and in a timely manner.

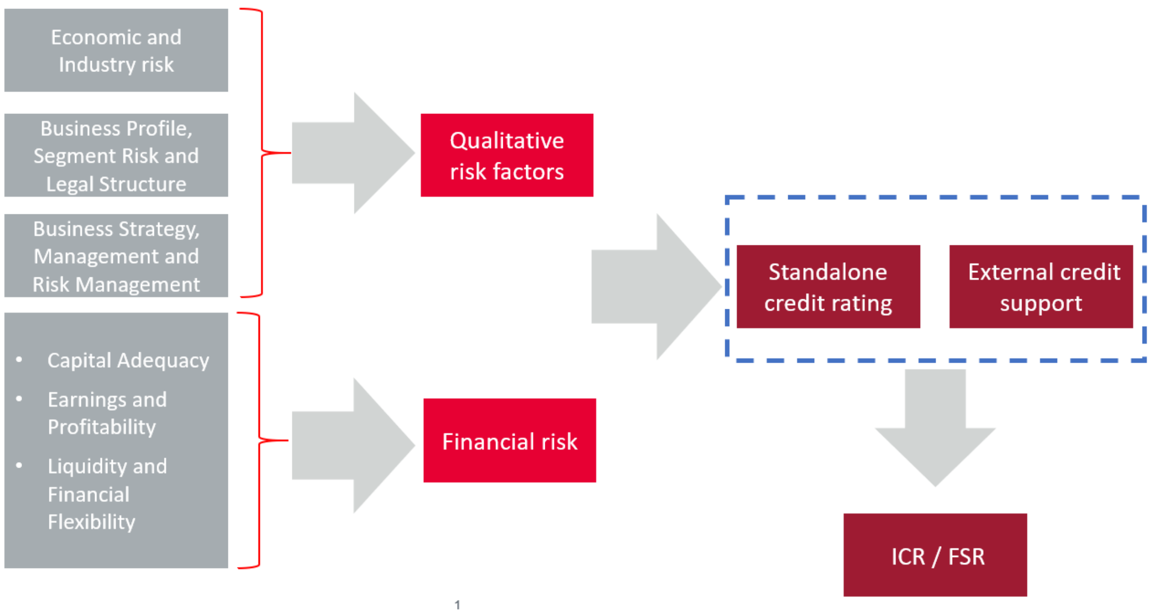
For all other key rating terminologies including definitions, qualifications and outlook refer to the ratings service guide hosted on the Corporate Scorecard's website.

4 RATING METHODOLOGY

Corporate Scorecard's assigned credit ratings are arrived at by analysing the stand-alone and combined impact of key drivers of systemic (industry fundamentals) and non-systemic risks (an Insurer's business risk and financial risk profile). Corporate Scorecard evaluates an Insurer's exposure to systemic and non-systemic risks on both, gross and net basis – taking any mitigating factors into account, to assess the impact of these risks on an Insurer's credit rating or Financial Strength Rating.

The below figure summarises Corporate Scorecard's framework for arriving at credit ratings.

Figure 1: Overview of the Rating Process



* External Credit Support refers to parent support and/ or Soveriegn support.

Corporate Scorecard's rating process starts with an assessment of an Insurer's exposure to industry risk factors (top-down approach). Corporate Scorecard determines an Insurer's exposure to non-systemic risk factors by analysing financial and non-financial risks (bottom-up approach). While evaluating an Insurer's financial risk profile, Corporate Scorecard analyses both the historical and projected financial position and the outlook for business.

Corporate Scorecard combines the results of its top-down and bottom up approaches to arrive at the standalone credit rating. Since, the claim of an Insurer's debt holders and external liabilities is weaker than that of its policyholders, hence, an FSR is generally stronger than (or sometimes same as) its ICR. Corporate Scorecard adjusts the credit rating to reflect this subordination to assign an FSR for

an Insurer. Corporate Scorecard lays additional emphasis on the following factors to determine the extent of notching between the FSR and credit rating. These factors are grouped under the same headings as they appear in the Insurance Rating Methodology.
Lastly, the standalone rating is modified for availability of any external support.

The table below summarises various factors and sub-factors which may be evaluated to determine impact of key risk drivers:

Risk	Factors	Sub – Factor
Economic and Industry Risks	Sovereign Risks, Legal and Regulatory Framework	• Legislations and regulations
		• Effectiveness of regulatory bodies
		• Financial market development
	Economic Performance, Growth and Stability	• Economic growth
		• Size and diversity of the economy
		• Volatility
		• Geopolitical risks
	Level of Competition and Market Structure	• Size of the market
		• Market penetration
		• Entry barriers
Business Profile, Segment Risk and Legal Structure	Business Profile	• Market share and scale
		• Brand and reputation
		• Diversity of operations
	Segment Risk	• Type – indemnity or guarantee
		• Segment specific risks
	Structure	• Transparency
		• Complexity
		• Limitations
Business Strategy, Management and Risk Management	Business Strategy and Management	• Management track record
		• Adaptive framework
	Corporate Governance	• Financial reporting and audit quality
		• Remuneration structure
		• Related party transactions
	Risk Management	• Monitoring of limits
		• Operational controls
		• Portfolio diversification and security

	Risk Appetite, Underwriting Policies and Reinsurance Quality	• Delegated approval authorities
Financial Risk	Capitalisation and Leverage	• Regulatory capital requirements • Ability to raise capital • Quality of capital
	Profitability	• Quality of earnings • Efficiency
	Liquidity and Financial Flexibility	• Adequacy of cash reserves • Composition of asset portfolio • Diversification of funding sources
External Credit Support	Parent Subsidiary Linkage (PSL) Framework	• Legal linkage • Operation linkage • Strategic linkage • Financial linkage • Strength of the parent
	Sovereign Support	• Systemic importance of the Insurer • Ability and willingness of the Sovereign

The following sections summarise the credit rating process. The arrangement of the following paragraphs is only to facilitate cohesion and does not necessarily reflect the actual rating process.

4.1 Economic and Industry Risks

Corporate Scorecard identifies key risks associated with the economy and the industry, which the Insurer operates in. Economic Risk is the risk associated with macroeconomic conditions such as geo political risks, foreign currency exchange rates, interest rates, GDP growth, employment indicators, government regulation, political stability, financial market development, etc, and is a key determinant of the cap or floor to an Insurer's credit rating. Industry Risk relates to the threat of a loss in revenue or market share due to regulatory changes, structural changes to the industry landscape (e.g. disruptive business models, technological or product advancements), a change in the competitive landscape and market dynamics, or any other factors.

Some factors contributing to Economic Risk and Industry Risk assessment include:

4.1.1 Sovereign Risks, Legal and Regulatory Framework

Typically, the economic prospects of the country/sovereign directly influence the stability of its insurance sector. Corporate Scorecard analyses the extent of geopolitical risks in the country of the Insurer's operations. This includes analysis of the political climate, the sovereign's relations with its neighbouring economies, the economic interdependencies and relations with key partners.

A developed legislative and regulatory framework, an effective regulatory body, sound accounting and corporate governance standards, and appropriate regulations for reasonable protection to creditors are essential for a stable operating environment. A large financial sector with developed institutional investors market supports the financial institutions and an Insurer's access to capital, funding and liquidity.

Insurance is a highly regulated sector in most countries, resulting in a moderate to high barriers to entry. Corporate Scorecard analyses and evaluates the regulations including capital requirements, degree of supervision and oversight. Corporate Scorecard also views the enforcement track record of the regulator, the pricing freedom, licensing requirements, investment guidelines in our assessments.

4.1.2 Economic Performance, Growth and Stability

Healthy economic growth, its sustainability and low volatility in variables such as interest rates, exchange rates and asset prices are viewed favourably for an operating environment assessment. Corporate Scorecard also reviews other indicators of macro-economic performance such as the current position of the economy in the credit cycle, system lending growth and its mix; consumer confidence; household borrowing levels; terms of trade and asset prices (commodity prices, house prices, equity prices, bond yields). Prolonged weakness in the general economy, asset bubbles, wide fluctuations in capital flows, a negative trend in lending practices are some of the drivers of increased risk to the financial sector. The health and rate of growth of the economy can also serve as a reference point to assess if Insurer is following an aggressive growth strategy relative to the system growth.

A large, well-diversified domestic economy generally results in lower macro-economic volatility, in comparison to a small economy dependent on few sectors, particularly if the sectors are highly cyclical. Corporate Scorecard's analysis of the cyclicality, size and diversification of an economy, and the sensitivity of an economy to market risks helps it ascertain the relative stability of an Insurer's operations and earnings.

4.1.3 Level of Competition and Market Structure

Corporate Scorecard evaluates the market's maturity, including penetration of insurance products, product differentiation, the efficacy of existing actuarial practises for reserving, use of enterprise risk management systems etc.

Industry concentration is mainly a function of entry barriers and the size of the market. Typically, a tightly regulated, small market with few large operators will tend to exhibit higher concentration and stability of earnings, than a less regulated and fragmented market. The market-share concentration in an industry typically determines the strength and stability of a typical operator's margins. Corporate Scorecard reviews the trend and composition of margins and their consistency with the market structure.

4.2 Business Profile, Segment Risk and Structure

4.2.1 Business Profile

Corporate Scorecard assesses an Insurer's business profile to determine its competitive position using, among other factors, its market share and scale, brand and reputation, diversity of operations and segment mix.

Market Share and Scale: An Insurer's market share and scale is usually reflective of its competitive position within the industry. Market share could be ascertained from the proportion of an economy's total demand for insurance products met by the Insurer. Scale of operations is generally reflective of market share and pricing power, while product/technological leadership and breadth of service offering may be a key driver of the same. Larger insurers generally have a higher capacity to absorb system related (undiversifiable) losses, making them more resilient to financial crises. In addition, Corporate Scorecard also reviews an Insurer's distribution network which includes the use of brokers, branches or any other distribution networks.

Brand and Reputation: An Insurer's product leadership, pricing power, scale of operations and track record of robust earnings contribute positively to its brand and reputation. Adverse public opinion of an Insurer's business practices, evidence of financial misconduct and deficient risk management and compliance procedures may negatively impact the brand and reputation, consequently impacting market share and earnings.

Diversity of Operations: Diversity of operations across products, customers and geographic segments may provide strong, intrinsic resilience to earnings. Global players with international foot-print rate well in this category. In addition, strong product level and geographic diversification can also act as a key competitive advantage over local players and drive high client retention.

4.2.2 Segment Risk

The risk factors relevant to an Insurer may differ, based on its product offering. Corporate Scorecard categorises insurers into two broad subsegments - property and casualty insurance (P&C), and life and annuity insurance (L&A).

L&A insurance typically involves a contract of assurance or a contract to pay a certain sum of money in the event of a death or upon maturity. Generally, life insurance comprises long term contracts, wherein there is absolute certainty with respect to occurrence of the event but high uncertainty pertaining to its timing.

P&C insurance contracts are contracts of indemnity. The scope of P&C insurance includes all forms of insurance other than life and annuity, such as motor insurance, health insurance, trade credit insurance, travel insurance, catastrophe insurance, theft insurance etc. The coverage for a P&C insurance is generally for a short duration, usually one year.

4.2.3 Structure

Legal structure and its complexity may also impact the assessment of an Insurer's business risk. Corporate Scorecard examines the legal structure, the restrictions on an Insurer, and its suitability to the business objectives. Structures that limit scalability and/or impose restrictions on access to capital and liquidity, among other factors, may typically constrain a rating.

Structural complexity may limit transparency to asset ownership, sources of cash generation, tax liability, contingent liabilities and legal recourse. Lack of transparency may emanate from layers of intermediate entities, cross ownerships, structure unsuitable for scale and complexity of operations, and may influence a rating outcome.

Corporate Scorecard also considers legal form of an Insurer and its potential impact to a rating. For instance, a mutual may benefit from a lack of return on capital objective, but its ability to source additional equity funding may be limited and may necessitate a higher buffer to regulatory capital requirements, than what may be considered sufficient for a corporate.

4.3 Business Strategy, Management and Risk Management

Corporate Scorecard evaluates the effectiveness of the strategy of the Insurer. A clear and realistic strategy reflects on the management quality. which can either increase or reduce the Insurer's exposure to non-systemic risks. Some of the factors which impact the quality of management include management strategy, corporate governance, underwriting standards and risk controls.

4.3.1 Business Strategy and Management

Management qualifications, track record, diversity, size and participation directly and indirectly impact execution of an Insurer's business strategy. High attrition/turnover may adversely impact smooth business operations and execution of medium to long-term business objectives. An Insurer's clearly articulated strategic vision and evidence of a management team that is in alignment with that strategy, supports the business risk profile. Corporate Scorecard analyses the flexibility of an Insurer's strategy and its ability to respond to changes in its external environment.

4.3.2 Corporate Governance

Corporate Scorecard considers if the Insurer's corporate governance practices are considered adequate to minimise agency risk – a risk that management actions are not in the interest of the Insurer's creditors, depositors or any other stakeholders. The quality of financial reporting, external and internal audit processes, management's and directors' remuneration structure and other policies are also considered. The presence of multiple and/or material related party transactions, linkage of management compensation to only short-term business objectives are some instances which may adversely impact an Insurer's performance on the corporate governance parameter and may also necessitate a further analysis.

4.3.3 Risk Management

An Insurer requires strong and effective risk management tools to adhere to its stated risk appetite and underwriting standards. These controls include; the reporting and monitoring of limits pertaining to product or credit concentrations, geography, market risks; policies for escalating breaches to controls; and operational controls (e.g. separation of duties and consistency in the alignment of employee incentive structures). Corporate Scorecard also looks at the portfolio risk management practices of the Insurer including monitoring, control and review of limits. Risk controls may also include custom scorecards, internal ratings or third-party data sources such as national credit bureaus. In addition, Corporate Scorecard also assesses if the Insurer has put in place sufficient risk controls to manage reputational, litigation and cyber risks.

4.3.4 Risk Appetite, Underwriting Policies and Reinsurance Quality

Well-defined risk tolerance and risk appetite statements, and underwriting policy, and their alignment with business operations, are key factors supporting an Insurer's long-term solvency. The underwriting policy should set limits for maximum concentration to customers, events or sectors, along with a guideline for limits beyond which excess risks shall be covered through reinsurance. Expansion or contraction in operations is compared against underlying economic scenario, peers, sector and industry averages to assess the adherence of an Insurer's operations to its risk appetite and the build-up of any potential risks.

Risk policies should also cover the type and structure of re-insurance arrangement an Insurer can deploy. A proportional reinsurance treaty means the reinsurer accepts a certain – predefined - proportion of risk underwritten by the Insurer. A surplus risk reinsurance means the reinsurer indemnifies the Insurer from losses that reduce its capital surplus to a given threshold. This protects the Insurer's policy holders by supporting its capital base. The credit rating or profile of the re-insurer may also influence the Insurer's credit rating. Re-insurance also serves to increase an Insurer's underwriting capacity — by freeing capital.

Risk policies should include guideline for the Insurer to invest policyholder funds in market securities and/or other investments. The risk and return on the permissible investments should be commensurate with the Insurer's operating activities. Stable investment portfolio returns augment an Insurer's loss absorption capacity. A history of stable investment returns through several business cycles is an indicator of sound asset management practice. In examining an insurers investment asset, key elements reviewed include composition and mix; the liquidity; suitability with respect to the types of underwriting risks retained on balance sheet; and valuation assumptions.

4.4 Financial Risk

Corporate Scorecard uses quantitative measures to benchmark and measure the financial risk profile of an Insurer. These measures are grouped into four main categories - Capital Adequacy, Earnings and Profitability, Liquidity and Financial Flexibility.

4.4.1 Capital Adequacy

A healthy capitalisation provides the Insurer the ability to absorb any operational and/or impairment losses. In some jurisdictions, the regulator sets out the minimum risk-based capital thresholds to be maintained by an Insurer at all times (also called as Regulatory Capital Ratio or RCR). Corporate Scorecard also assesses the use of external borrowings and impact of financial leverage on the Insurer's credit profile. Some of the indicators of the strength of an Insurer's capital in our view:

Ratio	Calculation
Regulatory Capital Ratio	As Prescribed by the Regulator
Solvency Margin	Net Assets/Net Premium Written
Operating Leverage	Insurance Liabilities/Equity Capital

Debt to EBITDA	Debt/EBITDA
Risk Retention	Net Premiums Written/Gross Premiums Written
Gearing	Total Liabilities/Total Assets
Solvency	(Total Assets-Total Liabilities)/Net Premiums Written

While analysing Capital Adequacy, Corporate Scorecard emphasises on understanding the Capital structure of the Insurer to determine the extent of notching between FSR and credit rating. It is important to evaluate the leverage or the extent of external liabilities as a percentage of policyholder's claims to understand the capital structure of an Insurer. For an Insurer with a high leverage, the credit rating could be lower than the FSR.

4.4.2 Earnings and Profitability

Healthy and sustained profitability, combined with consistent retention of earnings, supports an Insurer's capacity to service external debt and withstand adverse asset related shocks through generation of internally accrued capital. Corporate Scorecard also evaluates the nature and quality of an Insurer's earnings – recurring earnings like underwriting profitability are considered more favourably than earnings from one-off items such as the profit on sale of assets or releases from reserves. The level of profitability should be commensurate with the risk appetite of the Insurer. Some indicators useful in measuring Earnings and Profitability are:

Ratio	Calculation
Return on Equity	Net Income/Equity Capital
Loss Ratio	Incurred Losses for the Calendar Year/Net Premiums Earned
Expense Ratio	Underwriting and Acquisition Expenses Incurred/ Net Premiums Earned
Combined Ratio	Sum of Loss Ratio and Expense Ratio
Underwriting Profitability	1-Combined Ratio
Net Profit Ratio	Net Profit after Tax/Net Premiums Written
Non-Premium Income	(Operating Profit -Underwriting Profit)/Net Premiums Written
Return on Assets (ROA)	Net Profit after Tax / Average Assets
Premium Receivable Days	(Premiums Due from Policy Holders) *365/Gross Premiums Written

4.4.3 Liquidity and Financial Flexibility:

Liquidity assessment encompasses the analysis of an Insurer's cash reserves, and their adequacy to meet its short-term obligations, and the Insurer's ability or inability to access external capital and liquidity with ease. Regular cash flows from premiums and investment portfolio support an Insurer's liquidity. It is important to analyse the quality, mix and composition of the asset portfolio. Although, these investments can increase diversification, and can support Insurer's returns, they also expose the Insurer's income to higher volatility.

The degree of sovereign exposure also can be an important factor to consider for liquidity, especially in case of insurers which operate in developing countries. Further, L&A insurers may need to maintain a higher liquidity than P&C insurers, since the latter generate a higher degree of recurring cash flows from policy premiums.

An Insurer's access to equity capital markets or wholesale borrowing may further support its ability to meet policyholder or external obligations in a timely manner. Insurers with diversified funding sources and a well laddered debt maturity profile generally enjoy superior financial flexibility over their peers. Also crucial to the analysis of liquidity is the asset liability management of the Insurer including the interest rate risk and matching of the duration of assets and liabilities. Some of the indicators considered for Corporate Scorecard's analysis of liquidity and financial flexibility are:

Ratio	Calculation
Liquidity Ratio	Liquid Assets/Total Assets
Cash to Policy Holder Liabilities	Cash and Cash Equivalents/Policyholder Liabilities
Claims Ratio	(Claims Paid-Reinsurance Inwards)/Net Premiums Written
Net Technical Reserves	Unearned Premiums + Claims Liability - Reinsurance Receivable - Deferred Acquisition Costs - Deferred Reinsurance Premiums

4.5 Arriving at the Rating

Corporate Scorecard consolidates its findings of drivers of economic and industry risk, business risk, management and strategy, and financial risk to arrive at the stand-alone credit strength of an Insurer.

While finalising the credit rating, Corporate Scorecard relies on internally developed financial models that are informed by the evaluation of the above risk factors combined with the inputs and forecast estimates provided by the Insurer. These estimates are stressed or modified, as required, to reflect prevailing industry trends and Corporate Scorecard's view of various risk factors which may undermine the Insurer's credit rating. The above exercise also helps to identity the probable trajectory of the Insurer's credit rating along with the associated triggers and the drivers of any likely ratings migration.

The claims of policyholders rank superior to that of all other debt holders, therefore, the FSR is generally higher (or at least equal to) than the Insurer's credit rating. While analysing the subordination risks, Corporate Scorecard evaluates the repayment capability of the borrower to ascertain the difference between an FSR and the Insurer's credit rating.

A final step before arriving at the rating is adjusting for any extraordinary sovereign support and/or any external support, implicitly or explicitly provided by the Insurer's parent group. (refer to Section 4.5.1)

4.5.1 Sovereign Support

Governments, globally, have demonstrated their willingness to intervene and support industries and entities that are viewed as essential to the functioning of the economy. A high level of systemic importance indicates a higher probability of government intervention in the event an Insurer lacks internal resources to meet its financial obligations. We do note however following the Global Financial Crisis that this willingness has decreased as has (in many cases) the Government's ability to support. These factors are also considered when assessing the likelihood of Sovereign support.

Corporate Scorecard determines the probability of an extraordinary sovereign support and adjusts the Insurer's credit rating to reflect the same. If the Insurer is owned by the government, its credit rating will be closely tied to the government's credit rating. In other cases, Corporate Scorecard ascertains the extent of support depending on the relative importance of the Insurer to the economy, implications for the financial sector if the Insurer were to default, and the ability and propensity of the government to provide timely support.

Additionally, while factoring extraordinary support from the government, it is important to understand the perceived difference in the sovereign's willingness to support the policyholder liabilities as compared to other external liabilities. There is a high likelihood that the sovereign would step in to support claims by policyholders as opposed to other debt obligations of an Insurer. Corporate Scorecard also considers the relative importance of the Insurer within the economy while determining the extent of notching.

4.5.2 Parent Support

The standalone rating of the Insurer is adjusted to reflect the credit profile of the parent. This adjustment depends on degree of operational, strategic, financial and legal linkage between the Insurer and the parent group, and the strength of the parent's credit profile. Refer to Annexure 6.1 detailing Corporate Scorecard's Parent Subsidiary Linkage methodology.

4.5.3 Final Rating of the Insurer

If the parent's rating is stronger and the linkages between a parent and the Insurer are assessed to be strong or moderate, the final rating of the Insurer may benefit and be higher than its standalone rating. On the contrary, if the linkages are weak, there may be limited, or no adjustments made to the Insurer's rating.

5 ISSUE RATINGS

An Insurer's credit rating after adjustments for any external support and extraordinary sovereign support serves as a starting point to compute issue ratings.

Corporate Scorecard's issue rating is closely linked to credit ratings of the Insurer but may differ from the credit rating either due to seniority of the issue (subordination risks) or the collateral available (recovery prospects).

5.1 Subordination Risks

Corporate Scorecard evaluates the explicit and implicit subordination risks. The explicit subordination risk stems from the position in the capital structure, covenants, credit enhancements and bankruptcy laws. Implicit subordination arises from the group structure where risk is increased due to structural subordination.

The position of an issue in the capital structure, covenants of an issue, credit enhancement measures and bankruptcy laws of the region are evaluated to derive the seniority of the issue relative to all existing and potential future liabilities of the Entity.

After determining the explicit risks, Corporate Scorecard evaluates the implicit subordination risks through an assessment of the corporate structure and identifying any structural subordination which may arise from the position of the entity within a group, or as a result of specific capital controls identified in the broader group.

5.2 Recovery Prospects

Availability of collateral can partly offset the loss to an issue subscriber in the event of a default. The expected loss to an issue subscriber is a product of the loss given default (exposure at default less collateral's recovery value) and probability of default (determined by the Insurer's credit rating). The reduction in expected loss to an issue subscriber due to the availability of collateral may put upward pressure on the issue rating.

Salvage Value

The salvage value is computed by grouping assets into categories derived along the lines of tangibility, liquidity and type. A distressed sale discount is applied to the prevailing market values of each of the categories and the sum of these discounted market values is the estimated salvage value expected to be realised.

The realisable value of a collateral is a function of its nature, marketability and condition, and the primary determinant of recovery prospects. Collateral may be a specifically identifiable asset or an asset class.

After forming an opinion on the subordination risks and recovery prospects, the issue rating may be notched higher or lower to reflect the reduced or additional credit risks associated with the issue.

6 ANNEXURES

6.1 Parent Subsidiary Linkage (PSL) Framework

Purpose

The PSL Framework provides an overview of Corporate Scorecard's methodology for assessing the impact on the Insurer's credit rating, from any potential support from its ultimate parent.

Scope

The PSL Framework facilitates determination of any potential uplift on an Insurer's standalone credit rating as a result of support from its parent. Generally, the PSL Framework applies when the credit profile of the parent is stronger than the stand-alone credit profile of the Insurer.

The Framework should be read in conjunction with Corporate Scorecard's Insurance Rating Methodology.

The extent of uplift to the Insurer's standalone credit rating would depend on the strength of linkage between the Insurer and the parent. Linkage is likely to be material if the parent is the dominant shareholder, asserts economic control or is able to otherwise influence the key strategic decisions of the Insurer.

Framework

The first step in the PSL Framework is the assessment of the standalone credit rating of an Insurer and the parent, using the relevant Credit Rating Criteria.

Corporate Scorecard then proceeds to assess the strength of linkage between parent and the Insurer. The legal, strategic, financial and operational ties between the parent and the Insurer are analysed to determine the strength of the linkage. The stronger the linkage, the higher the parent's propensity to extend support.

Assessment of Linkage

Corporate Scorecard analyses the legal, strategic, financial and operational linkage between the Insurer and the parent, by assessing the below-mentioned factors.

Legal Linkage

Extent of shareholding, legally enforceable provisions, corporate status of the parent

Full ownership or majority shareholding by the parent is a key contributor to a strong legal linkage. The other instances of a strong legal linkage include the presence of a deed of cross guarantee between the parent and an Insurer, presence of any legally enforceable provisions, such as guarantees, or standby letter of credit provided by the parent to the Insurer's debt instruments.

If the parent is a listed entity, then default by the Insurer could result in adverse impact to the parent's reputation. Such default could also trigger cross default clauses on ISDAs and other facilities, and hence, may adversely affect the parent's ability to raise funds.

Geographical barriers and regulatory constraints may weaken the legal linkage. For instance, if the parent and the Insurer are domiciled in different countries, it may limit the parent's ability to gain control over the Insurer's funds due to tax and capital transfer barriers.

Strategic Linkage

Relative importance of the Insurer to the parent, shared name

Strategic linkage is measured by the Insurer's deemed importance to the parent, which is prima facie measured by the Insurer's contribution to the parent's revenue, assets, profitability or cash flows. In some cases, the strategic linkage may be strong despite the small scale of the Insurer's operations. For instance, the parent's focus on improvement in the Insurer's market competitive position through regular capital investment, or the parent's strategy to expand operations in the Insurer's domicile country may indicate a strong strategic linkage.

Strategic linkage is also deemed strong when the Insurer and the parent use a common name/ brand/ logo. Such commonality also indicates a greater intent on the parent's part to associate itself with the Insurer. Under these circumstances, the Insurer's failure to meet its financial obligations may also adversely impact the parent's reputation, thereby meaning there is a higher likelihood of financial support.

Financial Linkage

Demonstrated track record of support, economic incentive to the parent

A demonstrated track record of financial support in the form of equity infusion, extension of related party loans or standby letter of credit/ letter of comfort for availing financing facilities, are all indicative of a strong financial linkage. Financial linkage is also deemed strong, when there is evidence of the parent extending regular and timely funding support, leading to the Insurer's low dependence on external borrowings.

While determining financial linkage, it is also necessary to ascertain the economic incentive (or disincentive) to the parent, from extending or refraining to extend financial support to the Insurer. If the Insurer is not profitable and is a drain on financial resources of the parent on a persistent basis, there is a greater likelihood that the parent company may stop extending financial support beyond a point.

Operational Linkage

Extent of management control, control over operations, centralised treasury function

Operational linkage may be considered strong if the parent and the Insurer have common Board of Directors, or where the parent appoints majority of the directors on the Insurer's Board. Corporate Scorecard also assesses the control exerted by the parent, over the Insurer's day to day operations and the Insurer's access to the parent's proprietary technology/resources. Operational linkage is also deemed strong, when the parent manages treasury operations centrally and maintains and controls common funding facilities. Further, the greater the similarity in operations and/or interdependence for product, technology, R&D, access to target markets, brand(s) etc., the stronger the operational linkage is likely to be.