

Enterprise Risk Management Continues To Show Its Value For North American And Bermudan Insurers

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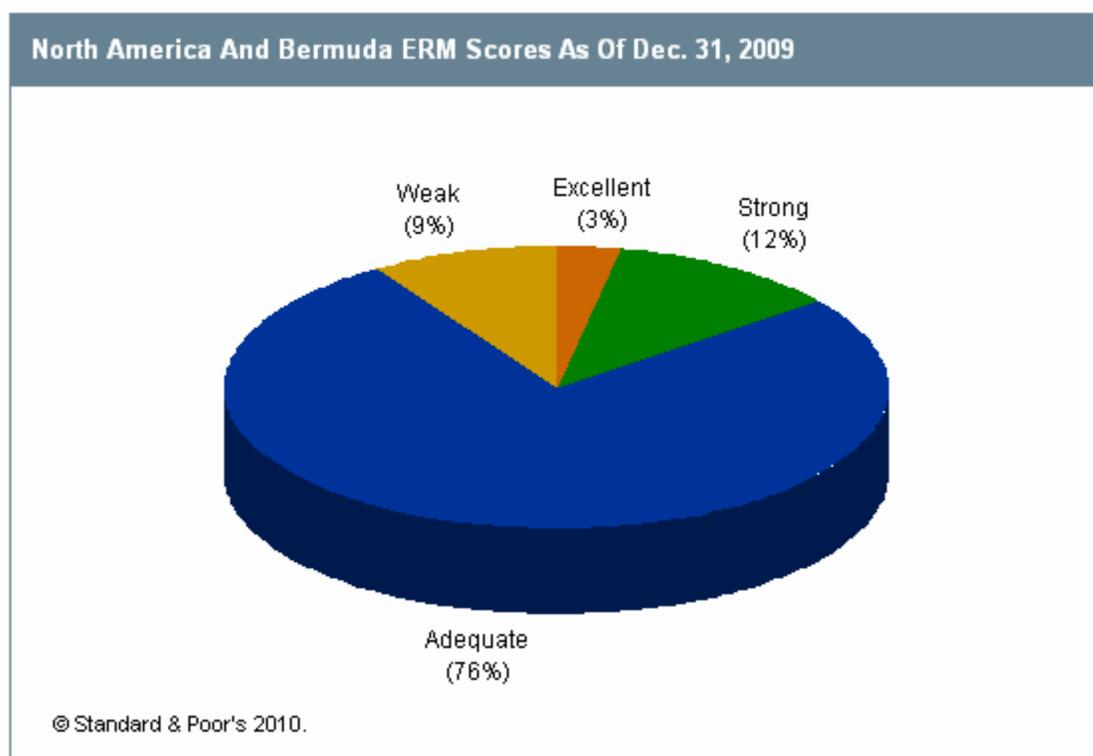
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Standard & Poor's Ratings Services has published its opinion on the enterprise risk management (ERM) programs of all of its rated insurance companies. We have updated many of these opinions through multiple review cycles. The scores reflected in this article update those we published in the article titled "Enterprise Risk Management Is Improving In North American And Bermudan Insurers," on May 28, 2008, on RatingsDirect. Our findings this year indicate that while the financial crisis uncovered weaknesses in risk management practices of some companies, company performance seemed to reflect the perceived overall strength of their ERM programs.

Chart 1



This update includes our scores on 165 North American and Bermudan insurance companies, a 15% increase from last year's count. In addition to an analysis similar to the one we did in 2008, this year's report includes a distribution of scores from ERM Level II reviews, which produced more granular information on a subset of companies whose complexity requires an additional, more in-depth review of ERM. This subset consists of 33 companies. This year we also included information about stock performance for companies with varying ERM scores. Standard & Poor's believes that this analysis is very telling with respect to the importance of ERM. This analysis covers multiline insurers other than mortgage and title insurers.

Standard & Poor's ERM reviews have five components:

- Risk Culture: the degree to which risk and risk management are important considerations in all aspects of corporate decision-making.
- Risk Controls: the processes and tools a company uses to maintain risk exposure within its risk tolerances.
- Strategic Risk Management: the approach a company takes toward evaluating, prioritizing, and optimizing strategic options.
- Emerging Risk Management: the approach a company takes toward cataloguing and mitigating the possibility of future unpredictable or unexpected events.
- Risk Models: the tools a company uses to project and/or evaluate risk exposure.

During our review, we scored each component separately and then used those scores to create a composite total ERM score for each company. The importance of any one component to the composite ERM score depends on the company's specific risk profile: the breadth and complexity of its products, its geographic footprint, target markets, competitive advantages, etc.

Overall ERM Scores

The share of "Strong" and "Excellent" insurers stayed roughly constant near 15% between our last review on April 30, 2008, and Dec. 31, 2009. Gains in the "Strong" category more than offset the loss of one "Excellent" (see table 1).

Table 1

ERM Score Distribution		
	2008	2009
Excellent	6	5
Strong	15	19
Adequate	122	126
Weak	9	15
TOTAL	152	165

Although, in general, we observed some improvement in companies' ERM practices, Standard & Poor's noted that some elements of companies' ERM practices didn't perform as well as we or the companies expected when they were exposed to the pressures of the financial crisis. Consequently, the "Weak" category grew to 9% from 6% of total scores. This is especially notable because nearly half of the companies identified as "Weak" in 2008 subsequently withdrew their ratings. There has been some score migration, both positive and negative, since our last insurance ERM scorecard (see table 2).

Table 2

ERM Score Migration					
2009 Score					
2008 Score	Excellent	Strong	Adequate	Weak	Not rated
Excellent	4	1	1	0	0
Strong	1	13	1	0	0
Adequate	0	3	96	7	16
Weak	0	0	2	3	4
Not rated	0	2	26	5	0

ERM Level II Reviews

Standard & Poor's performs ERM Level II reviews on a subset of 33 companies that we consider to have risk characteristics that are more complex than the general group. The ERM Level II review consists of a more in-depth analysis of each of the five ERM elements described above. This year we are showing the results of the more detailed ERM reviews we performed on this subset of companies (see table 3). Depending on the complexity of the organization and its risk preferences, we reviewed more risk controls of some companies than others.

Table 3

ERM Score Breakdown									
	Overall ERM	Risk management culture	Market risk control	Credit risk control	Life risk control	Pricing risk control	Emerging risks	Risk models	Strategic risk management
Excellent	4	4	0	2	0	6	3	0	5
Strong	13	25	10	12	2	13	15	20	12
Adequate	16	4	13	9	1	1	15	13	16
Weak	0	0	0	0	0	0	0	0	0

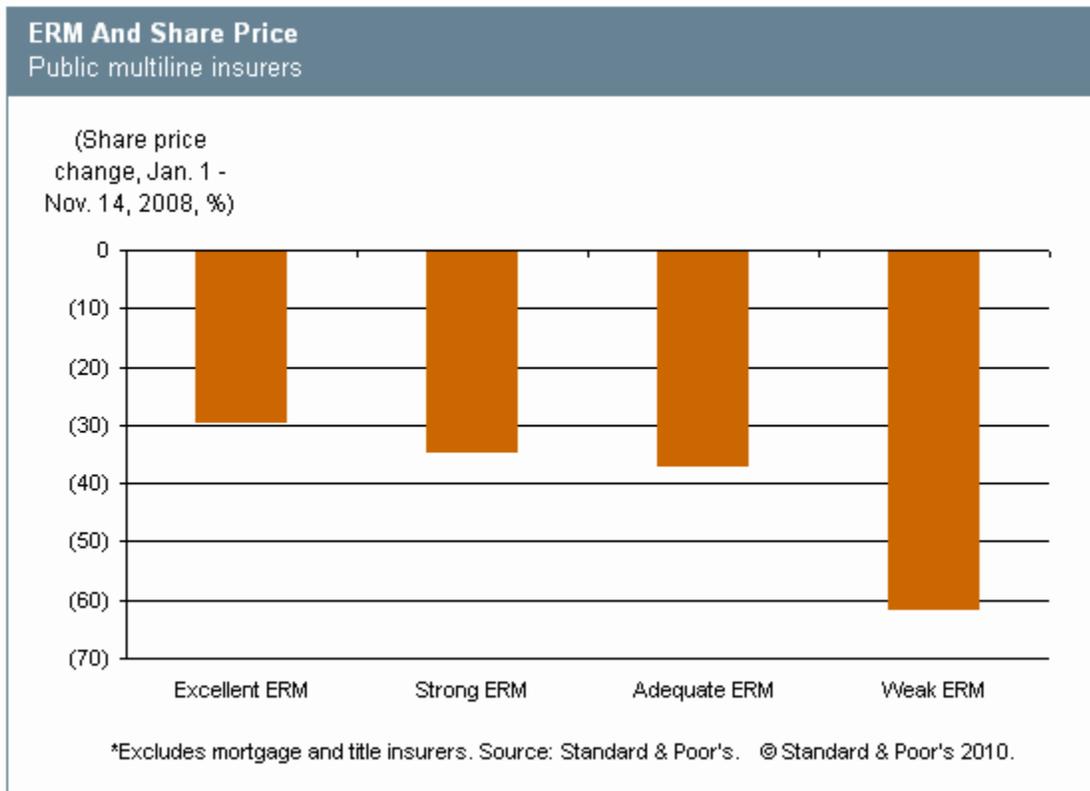
Adequate ERM

A composite ERM score of "Adequate" means that, in our opinion, the company has complete and reliable control processes in place for its major risks; overall, 76% of the companies we reviewed fell into that category. A company with Adequate ERM should experience no outsized losses in an economic environment that is not unusually adverse. However, because so many companies' ERM scores have fallen into this category in the past, we divided the definition of Adequate into three subcategories: Adequate, Adequate With Strong Risk Controls, and Adequate With Positive Trend. Additional information on the subcategories of an Adequate ERM score can be found in the article, "Expanded Definition Of Adequate Classification In Enterprise Risk Management Scores," published on RatingsDirect on Jan. 28, 2010.

Stock Performance Relative To ERM Scores

As we noted in our article "For North American Insurers, Strong Risk Management And Capital Adequacy Are Key Defenses Against Recession," published on RatingsDirect on Dec. 12, 2008, the performance of insurance companies was stressed in 2008. Many weaknesses in companies' ERM programs and implementation were also exposed. Standard & Poor's has found that ERM scores correlate with companies' stock performance (see chart 2). Although average stock prices declined among all public multiline insurers in 2008, companies with more advanced ERM programs experienced smaller stock price reductions.

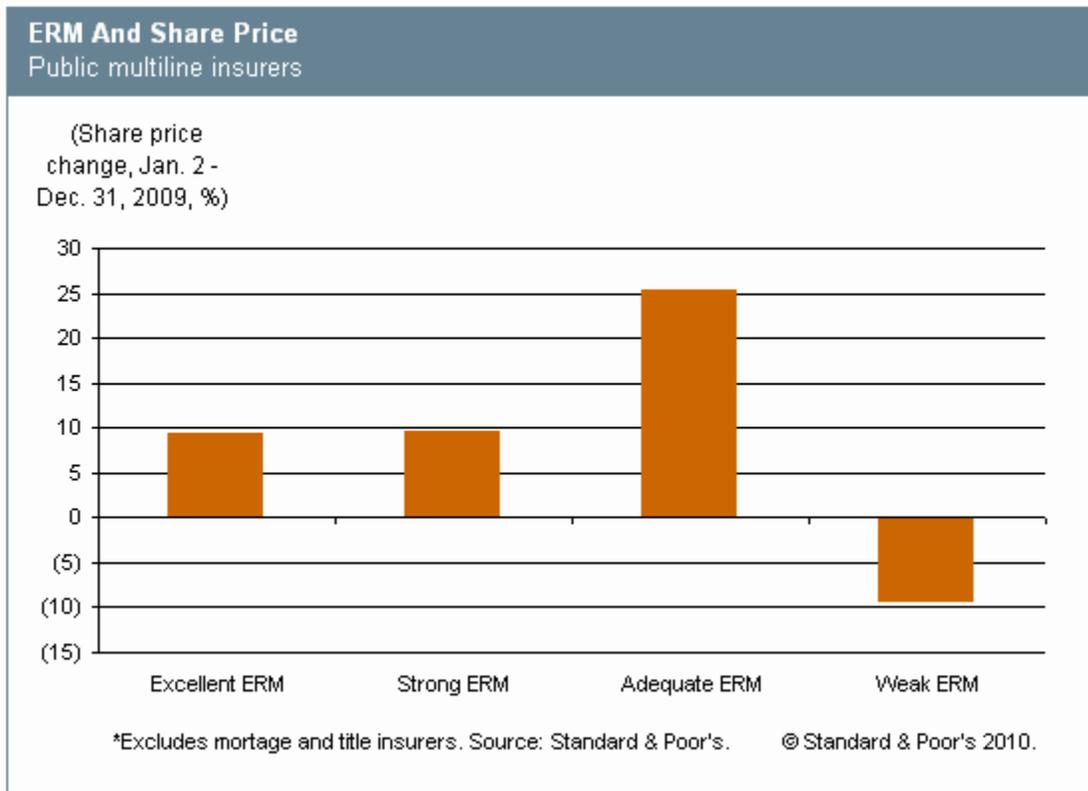
Chart 2



Those companies whose stock performance was better (i.e. those whose price declines were smaller) had received higher ERM scores. On the other hand, those companies whose stock prices had larger declines had lower ERM scores. This is consistent with Standard & Poor's view that more robust ERM programs are the most valuable in times of more pronounced stress.

Looking at ERM scores relative to stock performance in 2009 reveals a different pattern (see chart 3).

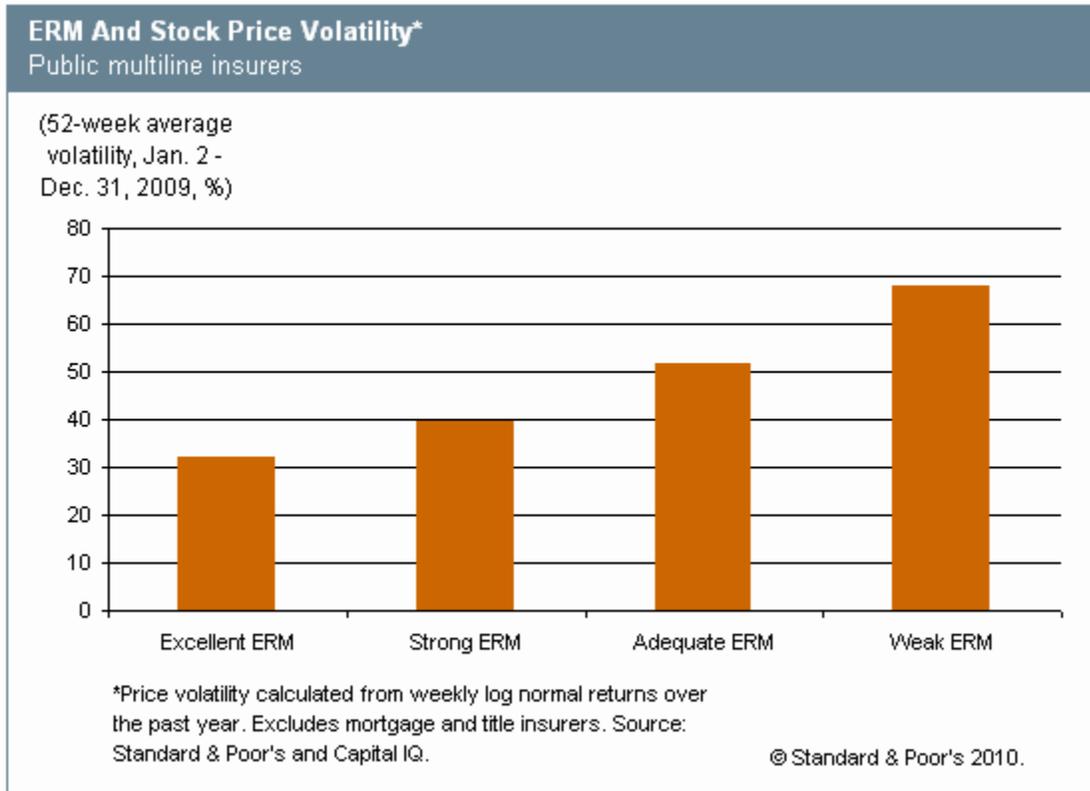
Chart 3



Companies with Excellent and Strong ERM scores--companies whose stock prices performed better during the more stressful 2008--still improved during 2009, but didn't need to perform as well as companies with lower ERM scores to return to their pre-2008 levels of performance. Companies with Adequate ERM scores showed significant improvement in their stock price performance and realized higher returns than companies in either the Strong or Excellent categories. Meanwhile, companies in the Weak category experienced further stock performance declines in 2009. Standard & Poor's attributes this to a belief that while companies whose ERM programs were scored at least Adequate derived material benefits from those programs, companies whose ERM score was Weak derived little or no benefit from their enterprise risk management practices.

A second-order look at stock performance, price volatility, during 2009 yields even more interesting results. ERM is made up of a family of processes and practices whose purposes are to measure and manage risk, thereby limiting volatility of results. We expect stronger ERM programs to result in more stable, predictable earnings while companies with less robust programs likely will be more susceptible to earnings swings. Assuming that share price volatility is a fair indicator of performance, companies with stronger ERM programs performed better during 2009 (see chart 4). As ERM scores worsen, share price volatility increased in 2009.

Chart 4



Standard & Poor's believes there are two clear takeaways from this information about stock performance relative to ERM scores:

- ERM shows its value most clearly in periods of significant stress, and
- ERM shows its value in less-stressful environments by helping companies better stabilize their performance through the prudent management of risks.

Table 4

Insurer ERM Scores	
Group/Company Name	
Excellent	
Endurance Specialty Holdings Ltd.	
PartnerRe Ltd.	
Renaissance Re Holdings Ltd.	
Travelers Insurance Group	
USAA Insurance Group	
Strong	
ACE Ltd.	
Aetna Insurance Group	
Allianz Life Insurance Co of North America	
Arch Capital Group Ltd.	

Table 4

Insurer ERM Scores (cont.)
AXIS Capital Holding Ltd.
Berkshire Hathaway Inc.
Federal Insurance Group/Chubb Corp.
Liberty Mutual Insurance Co.
Manulife Financial Corp.
Max Capital Group Ltd.
Metropolitan Life Insurance Co.
Nationwide Mutual Insurance Co.
New York Life Insurance Co. (NYLIAC)
Northwestern Mutual Life Ins Co.
Platinum Underwriters Holdings Ltd.
Principal Financial Group Inc.
Progressive Corp.
QBE Americas Division
Sun Life Financial Inc.
Adequate
ACUITY a Mutual Insurance Co.
AFLAC Inc. Insurance Group
Allied World Assurance Holdings Ltd.
Allstate Corp.
American Family Mutual
American Financial Group
American National Insurance Co.
American Steamship Owners Mutual P&I Association
Americo Life Financial Life & Annuity Insurance Co.
Amerigroup Corp
Ameriprise Financial
Argonaut Group Inc
Assurant Inc.
Attorney's Liability Assurance Society (Bermuda) Ltd.
Berkley (W.R.) Corp.
Blue Cross & Blue Shield of Rhode Island
Blue Cross Blue Shield Florida
Blue Cross Blue Shield of Tennessee
C.N.A. Financial Corp
CAHLIF
California Physician Service
CareMore Holdings Inc.
Centene Corp
CIGNA Corp
Cincinnati Financial
Combined Insurance Co. of America

Table 4

Insurer ERM Scores (cont.)
Commerce Group
Cooperativa de Seguros Multiples of PR
Co-operators Life Insurance Co.
Delta Dental NJ
Electric Insurance Co.
Everest Re Group Ltd.
Excellus Health Plan Inc.
Fairfax Financial Holdings Ltd.
Fidelity Investments Life Insurance Co.
Fidelity National Financial Inc.
First American Title Insurance Co.
First Rehabilitation Life Insurance Co.
Fort Dearborn Life Insurance Co.
Genworth Financial / Genworth Life and Annuity Insurance Co.
Greater New York Group
Great-West Lifeco Inc.
Group Health Cooperative
Guarantee Co. of North America
Guardian Life Insurance Co.
Hanover Insurance Group Inc.
Harbor Point Re Ltd.
Harleysville Group Inc.
Hartford Financial Services Group Inc. (The)
HCC Insurance Holdings Inc./ Houston Casualty Insurance Group
Health Care Service Corporation
Health Net Inc.
HealthMarkets
HealthNow New York Inc.
HealthPartners Inc.
HealthSpring Inc.
Highmark Inc.
Hoccheim Prairie Farm Mutual
Horizon Healthcare Services Inc. (d/b/a Horizon BCBS of New Jersey)
HSBC Insurance (Bermuda) Ltd.
Humana Inc Group
Industrial Alliance Insurance and Financial Services
Infinity Property\Casualty Corp.
IPCR Holdings Ltd.
Kansas City Life Insurance Co.
Knights of Columbus
Lincoln Financial Group
Louisiana Health Service & Indemnity Co. (d/b/a/ Blue Cross Blue Shield of Louisiana)

Table 4

Insurer ERM Scores (cont.)
Magna Carta Insurance Group
Massachusetts Mutual Life Insurance Co.
Mercury General Corp.
Minnesota Life/Securian Financial
Montpelier Re Holdings Ltd.
Mutual of America Life Insurance Co.
Mutual of Omaha
National Life Insurance Co. (VT)
National Western Life Insurance Co.
Navigators Group Inc.
Noridian Mutual Insurance Co.
Odyssey Re
Ohio National
Oil Casualty Insurance Ltd.
Oil Insurance Ltd.
Old Republic International Corp.
OneAmerica Financial Partners
OneBeacon Insurance Group
Pacific Guardian Life
Pacific Life Insurance Co.
Penn Mutual Life Insurance Co.
Penn National Group
Phoenix Life Group
Primerica Life Insurance Co.
ProAssurance Corp.
Professionals Direct Insurance Co.
Protective Life Group/Protective Life Corp.
Prudential Financial Inc.
Reinsurance Group of America Inc.
RLI Corp.
Sammons Financial Group
Security Benefit
Sedgewick CMS
Selective Insurance Group
StanCorp Financial Group Inc.
State Auto Group
State Farm Mutual Automobile Insurance Co.
Symetra Financial Corp.
Teachers Insurance & Annuity Assoc. of America
Texas Municipal League Intergovernmental Risk Pool
Tokio Millenium Re Ltd.
Torchmark Corp.

Table 4

Insurer ERM Scores (cont.)
Transatlantic Reinsurance Holdings Inc.
Triple-S Inc.
UNIFI Group
UnitedHealth Group Inc.
Unitrin Inc.
Universal American Corp.
Universal Insurance Co of PR
Unum Insurance Group
USABLE Life Insurance Co.
Validus Holdings Ltd./Validus Re
Wellmark
Wellpoint Insurance Group
Western & Southern Financial Group
White Mountains Re Group Ltd.
XL Capital Ltd.
Zenith National Insurance Corp.
Weak
American Equity Investments Life Insurance Co.
American International Group Inc.
CMG Mortgage Insurance Co
Conseco Inc.
Delphi Financial Group
Health Insurance Plan of Greater New York (HIP)
Horace Mann PC Group and Horace Mann Educators Corp.
Kingsway Financial Services Inc.
MGIC Investment Corp.
MTL Insurance Co.
PMI Group
R.V.I. Guaranty Co. Ltd.
Radian Group Inc.
Transamerica Life Canada
WellCare Health Plans

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