RATING CRITERIA

Criteria for Rating Insurance Companies

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Related publications

General Rating Framework (14 August 2018)

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This criteria report updates and replaces the previous report dated 10 July 2017.

Changes compared to the previous version:

1. Individual Financial Strength Assessment (IFSA) renamed to Stand-Alone Assessment (SAA).
2. Incorporation of the concept of Insurer Financial Strength Rating (IFSR).
3. Incorporation of forecasted data for the Stand-Alone Assessment to include a forward-looking approach related to the assigned IFSR.
4. Definitions of the 7-scale opinions for qualitative factors.
5. Additional details on the Support Assessment (SA) and the application of notching and examples.

OVERVIEW

A key analytical highlight of Dagong Global's rating criteria is the overall emphasis on the long-term sustainability of a rated entity. A thorough understanding of the main drivers and factors that underpin a sustainable business strategy is fundamental in our view to assess the financial strength and therefore the credit profile of an entity. Our assessment includes a comprehensive understanding of the fundamentals of long-term business strategies, goals and plans to support the analysis that combines historic and forecast/projected data based on specific assumptions. This allows Dagong to include not only historic data but also to include performance assumptions for the short-medium term and provide a forward looking view of the credit profile of a rated entity.

I SCOPE

This criteria report describes the analytical framework used by Dagong for assigning ratings to insurance companies. It is applicable for life and non-life insurance companies, as well as reinsurance, other specialised insurance operations (health, mortgage, global credit and trade, marine etc.) and insurance companies with mixed business lines (life and non-life). Captive insurance companies can also be evaluated under this criteria, considering also the appropriate criteria applicable for their parent companies.

The criteria is used to assign new ratings and monitor existing ratings.

The analytical approach described in the criteria is implemented via Dagong's proprietary rating model.

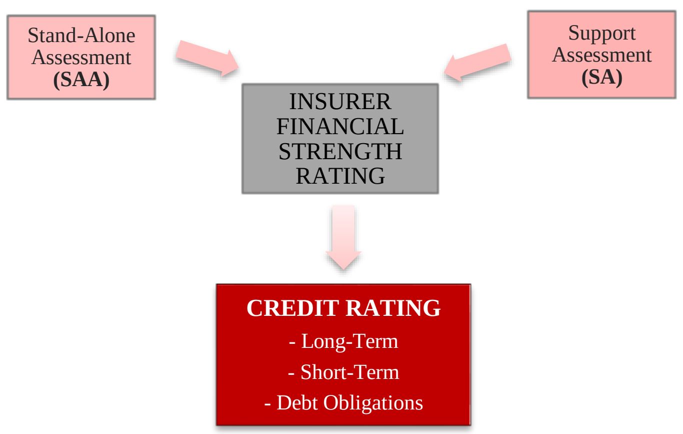
All Dagong's rating criteria and associated models are subject to regular validation and review in accordance with Dagong's internal procedures and regulatory requirements.

II SUMMARY

Dagong has developed a comprehensive analytical approach for rating insurance companies. The analysis follows a flow from macro to micro level based on specific characteristics that apply to any insurance company.

The criteria for insurance companies takes into account the peculiarities of the insurance industry, in terms of regulatory framework, financial performance, industry dynamics and competitiveness.

Exhibit 1: Components of Dagong's credit ratings for insurance companies



Source: Dagong

Stand-Alone Assessment ('SAA')

The SAA represents Dagong's opinion on the stand-alone and individual financial health of an insurance company. This opinion represents Dagong's analytical view on the financial strength based on financial profile fundamentals and business model. The SAA does not under any circumstance represent a credit rating, or a default indication of the debt issued by the company. Nevertheless, Dagong's SAA is helpful for direct comparisons between companies, and is the main driver of the credit rating. The SAA is used within all kinds of operating insurance companies and it is assigned at legal entity level.

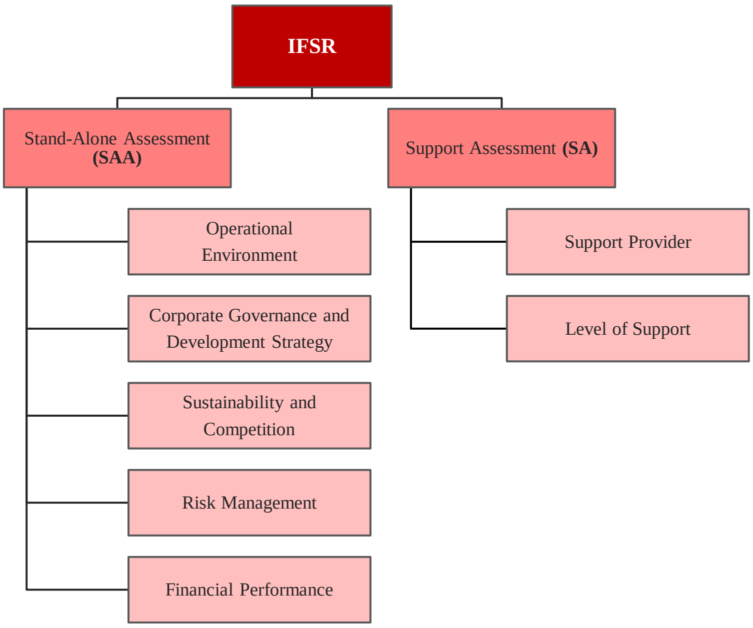
Support Assessment ('SA')

The SA represents Dagong's view on the likelihood of support (from a parent company, group or other possible support provider) that an insurance company could receive, to prevent default when in financial distress.

When insurance companies, in this case like most of the financial institutions, find themselves in depressed conditions - mainly when the ability to fulfil policyholders' obligations or debt obligations is deteriorating, or facing a significant reduction in capital or reserves that could weaken the financial profile - support is crucial in overcoming the financial stress or rebuilding market confidence. The opinion on support completes the overall analysis when assessing the likelihood of an insurance company's default, in order to assess the Insurer Financial Strength Rating (IFSR) and later the credit rating.

The sections that comprise the analytical framework applied by Dagong for assigning the SAA and SA for insurance companies are detailed in the chart below.

Exhibit 2: Insurer Financial Strength Rating (IFSR)



Source: Dagong

Insurer Financial Strength Rating (IFSR)

The IFSR is a rating assigned specifically to insurance companies. It measures the ability of the insurance company to fulfill its insurance claims and policyholders' obligations. IFSR is expressed in uppercase letters and the scale is the same as for credit ratings. IFSR typically does not differentiate between local and foreign currency due to the nature of the insurance business that could cover different geographic locations with insurance policies in different currencies. In particular cases in which Dagong believes it is necessary to specify a currency, the IFSR would be assigned indicating if it is a local currency or a foreign currency rating.

The IFSR can be assigned to a separate legal entity or to a group that consolidates different legal entities or to part of a group. The scope of entities covered under an assigned IFSR will be indicated in the rating publications. The IFSR does not include any assessment regarding the insurer's separated accounts (e.g. unit linked products or any other separated or segregated funds that carry investment risk for the policyholders).

Usually, the IFSR represents the strength of the insurance company in the medium to long-term, however, in cases in which Dagong perceives the need of assigning an IFSR for short-term policy obligations (less than 12 months), it will be indicated using the symbols of the short-term credit rating scale.

The IFSR represents the 'base rating' that Dagong will use to assign any other rating to the entity or group as part of the rating process, including issuer long-term and short-term credit ratings, as well as ratings to debt obligations.

The link between long-term credit rating (LTCR) and Insurer Financial Strength Rating (IFSR)

The LTCR is the comparable rating used by Dagong across sectors (financial institutions, insurance companies and non-financial corporates). It addresses the issuer's relative propensity to default. LTCR does not reflect a numerical forecasted default rate. Further, it does not include any opinion related to market risk or any risk other than credit risk.

For insurance companies, the IFSR is used as an anchor when deriving the LTCR. Typically, LTCR will be at the same level as the IFSR, unless Dagong observes that the insurance company's ability to meet its policyholder' obligations differs significantly from its ability to meet its financial liabilities to its creditors. For example, in cases in which the pool of assets is very small and barely allows to cover best estimates of policyholders' claims, the ability of the insurance company to cover other liabilities is limited, which would be reflected with a LTCR that is notched down from the IFSR. This will depend on the availability of balance sheet assets to cover other liabilities, not related to policyholders and the regulatory environment in which the entity operates, that could eventually have procedures for separation of accounts in case of failure to meet policyholder obligations or maintain solvency ratios.

The LTCR will be assigned to an insurance company whenever it has debt obligations of any type and not just in the form of issued bonds.

III STAND-ALONE ASSESSMENT (SAA)

The SAA reflects Dagong's evaluation of the stand-alone, intrinsic financial health of an insurance company based solely on its financial fundamentals, business model and operational environment. The SAA is directly comparable with other companies within the insurance industry since it does not include any adjustment related to support.

The composition of the SAA applied by Dagong to insurance companies varies between Life and Non-Life insurers. Decisions on applying the appropriate framework (Life or Non-life) for insurance companies with mixed business models (multiline insurers) will take into account the dominant segment. However, in cases of highly diversified and equally relevant business models, the combination of factors that represent each sector is used.

In addition, Dagong assesses whether the business nature of the insurance company is accurately represented by non-adjusted metrics. If this is not the case, adjustments are made to reflect the financial profile and risks that otherwise may not be identified (e.g. if off-balance sheet accounts are relevant for analytical purposes). It is worth noting that any adjustment, if necessary, is clearly highlighted and disclosed for analytical and benchmarking purposes.

The SAA is the first stage in Dagong's process of assigning an Insurer Financial Strength Rating. Note that the SAA does not, under any circumstance, represent an ultimate indication of default risk or severity of loss.

The SAA is presented in lowercase letters to distinguish it from the Insurer Financial Strength Rating and the credit rating, which are presented in uppercase letters. The SAA uses the scale detailed below; except for the SAA of 'aaa' and 'cc/c/d', each SAA can be modified by adding a plus or a minus, indicating a stronger (+) or weaker (-) SAA within each category.

When analysing operating insurance companies, Dagong usually uses consolidated financial statements. If an entity is part of a financial group, for analytical reasons Dagong assesses not only the financial profile of the entity on a stand-alone basis, but also the financial profile of the group. Dagong therefore uses the group's consolidated financial statements. For operating entities that are highly integrated within a financial group, Dagong could assign a SAA/SA, IFSR or a credit rating at consolidated level, and use it as the representation of the credit risk profile of that entity.

Exhibit 3: Definition of SAA

aaa	**'aaa'** denotes the highest score of the stand-alone assessment, with excellent indicators in all the factors that comprise the SAA. Represents insurance companies with solid and recognised successful business models supported by an excellent risk management framework. An excellent capital base to support organic growth and to face expected and any unexpected underwriting risk is also available. Companies are typically located in stable economic environments with highly efficient and predictable legal and regulatory frameworks.
aa	**'aa'** denotes very strong insurance companies, with a combination of excellent and sound indicators within the factors that compose the SAA. Represented by insurance companies with solid and recognised successful business models supported by a very strong underwriting risk framework. A very strong capital base to support organic growth and to face expected and unexpected underwriting risk is available. Companies in this category are typically located in stable economic environments with highly efficient and predictable legal and regulatory frameworks.
a	**'a'** denotes strong insurance companies with a mixed combination of good indicators within the factors that compose the SAA. It represents companies with stable business models supported by good underwriting risk frameworks. A strong capital base to support organic growth is available with a comfortable base to face expected and underwriting risk. Companies are typically located in stable economic environments with efficient and fairly predictable legal and regulatory frameworks.
bbb	**'bbb'** denotes satisfactory insurance companies with a combination of satisfactory performance indicators within the factors that compose the SAA. It represents companies with specific or stable business models supported by an adequate, but still requiring improvement, management of underwriting risk. An adequate capital base to support organic growth is available; strengthening of capital ratios and reserves is expected. Companies would be typically located in economic environments with some level of stability, however some deficiencies in the level of development of the legal and regulatory environment exist.
bb	**'bb'** denotes moderate insurance companies with a combination of moderate indicators within the factors that compose the SAA. Represents companies with business models that face tough competition and with underwriting risk models that require improvement. The capital base to support organic growth and to face expected and unexpected underwriting risks is highly sensible and should be strengthened to provide more stability. Companies are typically located in economic environments with deficiencies in the level of development of legal and regulatory frameworks.
b	**'b'** denotes weak insurance companies with a combination of weak performance indicators within the factors that compose the SAA. Represents companies with limited business models that face tough competition and with basic risk management frameworks that require material improvement. The capital base does not support organic growth and does not provide financial stability to face unexpected underwriting risks. Companies are typically located in economic environments with evident deficiencies in the level of development of legal and regulatory aspects and with unpredictable behavior patterns.
ccc/cc/c and **d**	**'ccc/cc/c/d'** denotes very weak insurance companies, with a combination of poor and very weak indicators within the factors that compose the SAA. Represented by companies with limited business models that face tough competition and with extremely deficient underwriting risk management. The capital base and reserves are weak and should be increased. Companies would be typically located in economic environments with evident deficiencies in the level of development of legal and regulatory aspects, and also with extremely unpredictable regulatory behavior driven by individual objectives.

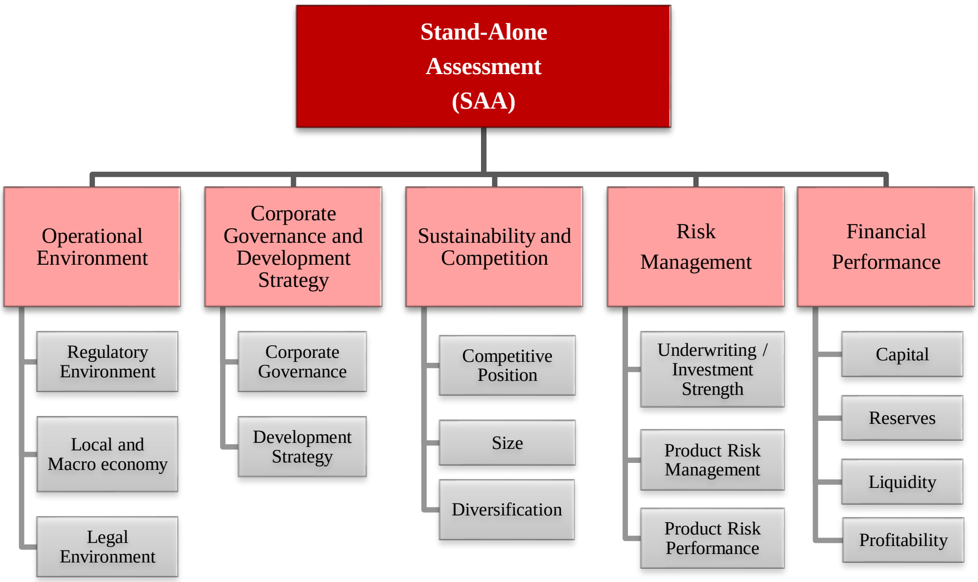
Source: Dagong

The SAA is the result of five key analytical components that Dagong believes represent the main drivers that determine an insurance company's individual financial profile.

The SAA is determined based on historic financial data for the purpose of obtaining a Historic SAA, as well as based on assumptions, projections and forecasts defined by the analyst in order to obtain a Forecast SAA. The assigned SAA will be the combination of the Historic SAA and the Forecast SAA. The Historic SAA is typically derived using annual financial data for the preceding 2 years together with current year-to-date data (if available), which allows to avoid cyclicality that could trigger a biased analytical conclusion. The forecast SAA is typically obtained over a 3-year time horizon. However, the time horizon could change depending on the nature and characteristics of the rated entity.

The five key factors include both qualitative and quantitative assessments. Factors and sub-factors are expressed following a seven-scale opinion: 'Excellent', 'Very Strong', 'Strong', 'Satisfactory', 'Moderate', 'Weak' and 'Very Weak'. This scale is then translated into rating equivalents and will then be used to calculate a weighted average rating equivalent. Quantitative factors are compared to a range of possible outcomes tested by Dagong over a specific period of time, based on publicly available information from reliable data sources.

Exhibit 4: SAA – Sub-Factors



Source: Dagong

III.1 Operational Environment

The analysis of an insurance company starts with the assessment of the operational environment. The international and domestic macroeconomic climate is crucial to the financial performance of individual entities, setting the starting point for any fundamental analysis and credit risk evaluation.

Dagong includes three sub-factors within the 'Operational Environment' which group the key elements that determine the economic, legal and regulatory environment where an insurance company sets and develops its business model.

If feasible, in case of geographically diversified businesses, the sub-factors Regulatory Environment and Legal Environment are assessed considering the most relevant countries in which the entity has operations.

III.1.1 Regulatory Environment

The regulatory environment provides the base in which an insurance company develops and sets its business practices. A sound and transparent regulatory environment, with a framework set by a fully independent and credible regulator that shows evidence of empowerment and has control over companies with best practices, promotes a healthy industry environment with adequate incentives.

The regulatory environment ranges from multilateral agreements (e.g. Solvency II) to customised regulations based on country specifications (mainly concerning capital adequacy levels, minimum reserve requirements or specific reporting standards). For Dagong, it is expected that the main objective of the regulator is to promote a healthy insurance industry framework. Following on from this, Dagong expects that the regulatory framework should be aligned with the best interests of market participants. Advances in terms of promoting best practices and anticipating upcoming regulations from different regulatory authorities is highly valued and assessed accordingly.

It is worth noting that regulatory homogeneity in the insurance industry in terms of reporting is also addressed and analysed. The different levels of information disclosure required by country-specific regulators, represents a challenge for comparison purposes and therefore should be addressed carefully.

For insurance companies that have operations in more than one country with a relevant size (primarily in terms of gross premiums, net premiums written or, depending on disclosure earnings contribution or assets), the analysis includes an assessment of the secondary country's regulatory framework as well. The Regulatory Environment is determined following the seven-point scale qualitative opinions detailed below:

Regulatory Environment Assessment	Definition
Excellent	Applies only to entities regulated at a global level (Globally Systemically Important Insurers - GSII). Fully developed and highly transparent regulatory framework with long track-record of consistent, predictable and independent decisions. Regulation is standardised with no exceptions in its application.
Very Strong	Developed and transparent regulatory framework, with long track-record of consistent, predictable and independent decisions. Regulation is standardised with no exceptions in its application.
Strong	Well-developed framework with above average transparency, reliability and predictability; track-record of consistent, predictable and independent decisions. Some exceptions in the application of the regulatory framework are applied, mostly following the framework applied by national authorities in the best interest of the characteristics of the domestic market to migrate to a standardised approach in the medium term.
Satisfactory	Regulatory framework that is moving to a consistent application of industry best practices, with average level of transparency, reliability and predictability. Track-record of consistent and independent decisions. Exceptions in the application of the regulatory framework are in place applied by national authorities in the interest of the characteristics of the domestic market.
Moderate	Regulatory framework that is in the process to apply industry best practices and promotes stricter self-regulation for entities. However shows evidence of some inconsistency or lack of track-record or transparency.
Weak	Regulatory framework that applies a flexible approach towards industry best practices with a high degree of inconsistency or significant lack of transparency. Exceptions to the application of the regulatory framework are easy to be identified.
Very Weak	Undefined or unclear regulatory framework with strong political interference and track-record of inconsistent and hostile decisions.

III.1.2 Local and Macro Economy

The importance of local and macroeconomic conditions is highly correlated to the performance of the insurance industry. Due to the nature of the industry, the state of the local and macro economy has direct effects on the demand for insurance services and thus the ability of market players to generate earnings. Since insurance products are very diverse in origin, the demand for more specific and sophisticated products is highly dependent on the country's development stage and the penetration level of insurance products within its population. For example, it is known that in more mature markets, the offer of very specific and more specialised insurance products is larger, e.g. specific health insurance, income insurance, earthquake insurance, etc. On the other hand, economies highly exposed to natural disasters (e.g. floods, earthquakes, hurricanes etc.) are very specific and regulated in terms of the minimum insurance coverage required. In those cases, the analysis of the local and macro economy and the level and development of supply and demand of insurance products is analysed. Hence, the analysis and assessment of a country's economic growth trend is a key driver to understand its demand for insurance services and further, to assess an insurance company's expected performance.

If feasible, for insurance companies that develop global business models, the local and macro economy analysis is done through a weighted average of the most relevant countries in which the company keeps businesses.

To evaluate the stage of the local and macro economy, Dagong analyses the following macro indicators:

Local and Macro Economy Factors	Definition and data used
GDP per capita	Based on IMF data, last full year; Data represents the absolute market attractiveness in terms of economic wealth and potential for growth, using a weighted average if there is presence of business operations in different countries.
Unemployment rate	Based on IMF data, last full year or most recent data related to analysed results; Data indicates the prospective economic strength in terms of potential purchasing power and size of the population with real disposable income.

Industry development on the other hand, represents Dagong's assessment of the risks and opportunities faced by any insurance company, according to the development stage of the insurance industry in a specific country. Dagong focuses the industry development analysis amongst others on the following drivers: 'growth potential of insurance products', 'supply and demand equilibrium of insurance products', 'barriers to entry and exit for insurance companies' and 'penetration of insurance products into the population'. The Industry Development is determined following the seven-point scale opinions detailed below:

Industry Development Assessment	**Definition**
Excellent	Stable and mature growth for insurance products, excellent equilibrium for demand and supply of insurance products, well established framework for entry , excellent penetration and density of insurance products into the population and markets.
Very Strong	Stable and mature growth for insurance products, very strong equilibrium for demand and supply of insurance products, well established framework for entry , very strong penetration and density of insurance products into the population and markets.
Strong	Strong equilibrium for demand and supply of insurance products, strong penetration and density of insurance products into the population and markets.
Satisfactory	Balanced growth potential for insurance products, satisfactory equilibrium for demand and supply of insurance products, some barriers to entry for insurance companies exist, satisfactory penetration and density of insurance products into the population and markets.
Moderate	Moderate equilibrium for demand and supply of insurance products, some barriers to entry for insurance companies exist, moderate penetration and density of insurance products into the population and markets.
Weak	Weak equilibrium for demand and supply of insurance products, low barriers to entry for insurance companies, weak penetration and density of insurance products into the population and markets.
Very Weak	Very weak equilibrium for demand and supply of insurance products, very low barriers to entry for insurance companies and underdeveloped framework for entry to new insurance companies, very weak penetration and density of insurance products into the population and markets.

We assess sovereign risks within the local and macro economy analysis. However, sovereign caps are not automatically applied, neither are the driver of the operational environment assessment.

III.1.3 Legal Environment

The Legal Environment is an important factor in setting the operational framework of insurance companies. A well-established and proven legal framework, with clear legal claim procedures as well as the ability to enforce reinsurance contracts is vital to provide a smooth operational environment. In addition, situations when a country's legal framework requires high minimum insurance coverage for specific products (mostly health insurance and P&C) and when the base costs and the ability to manage underwriting expenditures is less flexible in terms of accounting standards, are viewed by Dagong as strengths.

Dagong evaluates and compares the strengths and weaknesses of each country's legal framework with the aforementioned characteristics in terms of minimum product standards for the industry development and therefore, for the operational environment.

The Legal Environment is determined following the seven-point scale opinions detailed below:

Legal Environment Assessment	Definition
Excellent	Excellent established and proven legal framework, with clear, objective and transparent legal claim procedures and very fast ability to enforce reinsurance contracts. Degree of predictability of regulatory measures is very high.
Very Strong	Very strong established and proven legal framework, with clear, objective and transparent legal claim procedures and fast ability to enforce reinsurance contracts. Degree of predictability of regulatory measures is high.
Strong	Strong established and proven legal framework, with clear, objective and transparent legal claim procedures and fast ability to enforce reinsurance contracts. Degree of predictability of regulatory measures is high.
Satisfactory	Satisfactory established and proven legal framework, with clear, objective and transparent legal claim procedures and satisfactory ability to enforce reinsurance contracts. Degree of predictability of regulatory measures is satisfactory.
Moderate	Moderate established legal framework, with moderate transparency moderate speed for legal claim procedures, as well as moderate ability to enforce reinsurance contracts. Degree of predictability of regulatory measures is moderate.
Weak	Weak and under-development legal framework, with lack of clarity and low speed for legal claim procedures, as well as weak ability to enforce reinsurance contracts. Degree of predictability of regulatory measures is low.
Very Weak	Very weak and under-development legal framework, with opac and very low legal claim procedures, as well as very weak ability to enforce reinsurance contracts. Degree of predictability of regulatory measures is very low.

III.2 Corporate Governance and Development Strategy

III.2.1 Corporate Governance

The assessment of an insurance company‘s corporate governance framework is an important factor in determining the quality of management, the fulfilment and predictability of the strategic plan and long-term performance. It therefore affects the long-term financial stability and sustainability of any insurance company. Since the approach to corporate governance can be very different depending on the ownership structure of a company, the qualitative judgment made by Dagong takes into account also the complexity of the ownership structure.

Our assessment includes an opinion on how the insurance company manages its relationship with all stakeholders including shareholders, financial markets, regulatory companies, employees, policyholders and any other relevant parties. A review of the company’s vision, mission, definition, procedures, internal policies and business practices is crucial in our view to understand and identify potential risks from lack of governance or management weaknesses.

Dagong’s opinion on corporate governance is defined as a qualitative opinion that is ‘Neutral’, ‘Weak’ or ‘Very Weak’. The rationale behind this is based on the fact that corporate governance should be a minimum standard of best practices in every company. Dagong gives no credit to strong corporate governance frameworks, since it should represent a standard level of professionalism and responsibility. However, there is a negative stance for those frameworks that in Dagong’s opinion do not comply with minimum industry standards or best practices; therefore, represent a flaw that could lead to potential governance risks. A comprehensive list of questions and topics that are usually discussed when evaluating corporate governance are:

- Composition of the board of directors/supervisory board, background and independency.
- Concentration of power of decision making processes.
- Are strategy and objectives communicated within the organisation and how aligned are they within the organisational structure?
- Is risk tolerance appetite clearly determined and communicated?
- How is the risk management function structured and managed?

- How experienced is the senior management?
- Are internal procedures and practices clearly defined, communicated and applied?
- What has been the outcome of the last inspection made by the regulator?
- Is there any evidence of complexity of the ownership structure?
- Structure of the management compensation packages. Are the incentives for management compensation aligned with a sustainable long-term perspective of the institution?
- Is there any evidence of moral hazard risk?
- Quality of reporting, controls and monitoring of the board to management level.
- Evidence of any legal or regulatory dispute that can affect the reputation of the entity.
- Any compliance breach, exception, or fine from a regulatory institution
- Other relevant aspects.

As part of the Corporate Governance assessment, Dagong also highlights the importance of financial reporting in terms of quality, transparency and timing. The disclosure of financial information of poor quality that lacks transparency, or is published late, is considered weak corporate governance by Dagong.

Dagong applies a '-1 notch' adjustment for a 'Weak' corporate governance framework and '-3 notches' adjustment for a 'Very Weak' framework to the SAA. As mentioned above, a 'Neutral' assessment does not alter the SAA.

III.2.2 Development Strategy

The assessment of the development strategy of any insurance company ranges from a basic review of the organisational structure to a more in depth analysis of the management skills and competitiveness to fulfill the strategic plan and focus on the long-term sustainability of the business model without jeopardizing the financial profile.

In any business model, the business philosophy and strategy plays key roles in determining the long-term objectives and risks that the management is willing to undertake for achieving its strategic goals. It is important that the management's philosophy and actions provide realistic strategies that reflect the real competitive advantages and disadvantages of the company. Unrealistic expansionary strategies, relaxing underwriting standards, aggressive pricing strategies, and increasing commissions to intermediaries to gain market share all unnecessarily increase the company's overall risk appetite and misalign the real performance from approved policies. On the other hand, an overly conservative management strategy may result in missed business opportunities and reduced competitive advantages in the long-term. A comprehensive analysis of the management's ability to implement the business strategy and its competency in achieving the strategic goals is fundamental to Dagong's analysis. As a key tool to analyse the implementation of the strategy, Dagong requests access to a company's management reporting system and reports to evaluate the soundness of the information and data shared for decision-making purposes and consequently the successful execution.

The analysis of the development strategy also includes an analysis of any merger and acquisition (M&A) process in place. It is known that M&A involve risks that are sometimes difficult to identify. The success and value creation through M&A depends heavily on an adequate strategic fit among the merging companies.

Management's business decisions and plans for poorly performing business units or those that no longer make strategic sense represent another relevant area for analysis. Objective appraisals of business units and disciplined approaches in dealing with under-performers (divestiture, restructuring, discontinuation etc.) are also reviewed.

The Development Strategy is determined following the seven-point opinions detailed below:

Development Strategy Assessment	Definition
Excellent	Thoroughly defined business strategy and goals, fully aligned with core competencies and market developments; excellent track-record of exceeding strategic goals and targets; successful and constant organic growth utilising market opportunities and mitigating risks.
Very Strong	Very well-defined business strategy and goals very aligned with core competencies and market developments; very strong track-record of consistently fulfilling strategic goals and targets; successful organic growth utilising market opportunities and mitigating risks.
Strong	Strong business strategy and goals aligned with core competencies and market developments; strategic goals and targets met; organic growth strategy outperforming industry averages and balanced in terms of opportunities and risks.
Satisfactory	Adequate business strategy and goals aligned with core competencies and market developments; strategic goals and targets mostly met; organic growth strategy aligned to industry averages and balanced in terms of opportunities and risks.
Moderate	Business strategy and goals relatively aligned with core competencies and market developments; strategic goals and targets generally met; organic growth strategy balancing opportunities and risks.
Weak	Business strategy and goals not thoroughly defined, overly ambitious or not aligned with company or market developments; some underperformance against targets in the past; high risk appetite for organic growth and M&A.
Very Weak	Poorly defined or unrealistic business strategy and goals not aligned with company or market developments; track-record of consistent underperformance against targets; aggressive organic growth and M&A with significant uncertainties and risks involved.

III.3 Sustainability and Competition

Sustainability and Competition factors are strengths that any insurance company should consider to develop a successful position within its competitive environment and implement a sustainable business strategy. The ability of an insurance company to scale its operation with a healthy growth to gain a stable market share provides a basis for long-term earnings, competitiveness and therefore financial sustainability.

For Sustainability and Competition, Dagong analyses the following sub-factors:

III.3.1 Competitive Position

The ability of an insurance company to develop a competitive advantage provides a basis to generate stable profits and long-term returns. In that context, an insurance company should carefully manage and monitor the competitive environment to foresee the effects that any competitive change would have on its business model and eventually, competitive position. Since the insurance industry is very sensitive to changes in pricing and underwriting policies that respond to a higher risk appetite, the ability of a company to compete and offer differentiated products with adequate risk pricing without jeopardising the short-term profitability is carefully analysed by Dagong. In the case of insurance companies, competitive advantages can be a result of an internal strength or an external factor that allows the company to offer a distinctive product, or to be successful in a niche market. Thus, insurance companies develop competitive advantages through mastering specific market knowledge on certain segments or focusing on business lines where they are able to maintain above-average underwriting performance.

A strong competitive position can also be the result of higher control over distribution channels, adequate agreements with insurance intermediaries (brokers), efficient underwriting cost structure and easy access to target or captive markets. These strengths represent a key for an insurance company to consolidate its competitive position. Market dominance in terms of market share is important; however, it is analysed not only in gross terms but detailed by market, product, underwriting ability, loss-rate track record and ability to absorb unexpected risks or actuarial changes.

The assessment on Competitive Position is determined following the seven-point scale opinions on each of the following measures:

Competitive Position Assessment	Insurance sector	Definition
Competitive Position	Life and Non-life	**Excellent:** Excellent market position and leading market share per market and product; Excellent client recognition and brand name; Excellent niche market position. **Very Strong:** Very strong market position and leading market share in almost all markets and products; Very strong client recognition and brand name; Very strong niche market position. **Strong:** Strong market position and leading market share in several markets and products; Strong client recognition and brand name; Strong niche market position. **Satisfactory:** Satisfactory market position and among the top 5 leaders in market share per market and product; Satisfactory client recognition and brand name; Satisfactory niche market position. **Moderate:** Moderate market position and moderate market share per market and product; Moderate client recognition and brand name; Moderate niche market position. **Weak:** Weak market position and weak market share per market and product; Weak client recognition and brand name; Weak niche market position. **Very Weak:** Very weak market position and very weak market share per market and product; very weak client recognition and brand name; Very weak niche position.
Distribution Channels	Life	**Excellent:** Material number of distribution channels, excellent productivity and excellent dominance of the company to keep control over any distribution channel. **Very Strong:** Very large number of distribution channels, very strong productivity and very dominance of the company to keep control over any distribution channel. **Strong:** Large number of distribution channels, strong productivity and strong dominance of the company to keep control over any distribution channel. **Satisfactory:** Satisfactory number of distribution channels, satisfactory productivity and satisfactory dominance of the company to keep control over any distribution channel. **Moderate:** Moderate number of distribution channels, moderate productivity and moderate dominance of the company to keep control over any distribution channel. **Weak:** Limited number of distribution channels, weak productivity and marginal dominance of the company to control any distribution channel. **Very Weak:** Very limited number of distribution channels, very weak productivity and very weak dominance of the company to control any distribution channel.
Distribution Channels	Non-life	**Excellent:** Excellent level of underwriting expenses over net premiums, demonstrates excellent dominance, productivity and ability to keep control over any distribution channel. **Very Strong:** Very strong level of underwriting expenses over net premiums, demonstrates very strong dominance, productivity and ability to keep control over any distribution channel. **Strong:** Strong level of underwriting expenses over net premiums, demonstrates strong dominance, productivity and ability to keep control over any distribution channel. **Satisfactory:** Satisfactory level of underwriting expenses over net premiums, demonstrates satisfactory dominance, productivity and ability to keep control over any distribution channel. **Moderate:** Moderate level of underwriting expenses over net premiums, demonstrates moderate dominance, productivity and ability to keep control over any distribution channel. **Weak:** High level of underwriting expenses over net premiums, demonstrates weak dominance, productivity and ability to keep control over any distribution channel. **Very Weak:** Very high level of underwriting expenses over net premiums, demonstrates very weak dominance, productivity and ability to keep control over any distribution channel.

III.3.2 Size

Dagong believes small insurance companies (in terms of asset size or gross premiums) can enjoy a significant competitive advantage when they build defendable market positions in niche segments through specific market knowledge, in terms of underwriting risks, pricing and management of loss ratios. However, small or modest size is considered to be an adverse factor when it is not supported by a proven market specialisation in niche segments or business lines (e.g. P&C focused on catastrophic risks, agriculture insurance etc.). Small companies with no market specialisation tend to be more concentrated geographically and also less diversified in terms of product, supplier and customer base; thus, more likely to expose themselves to adverse financial performance if unexpected catastrophic events occur or health risks arise.

Although our measure to assess size is 'Total Assets', additional attention is given to revenues and size relative to the industry, as it determines market position, extent of diversification and financial flexibility.

III.3.3 Diversification

Diversification is an important factor in the analysis of any insurance company. In the case of both Life and Non-Life companies, geographic and product diversification can help to spread the concentration of underwriting risks and reduce the exposure of the balance sheet to unexpected losses as a consequence of specific events (natural disasters, country economic recession, actuarial changes in annuities, etc.). In addition, the diversification effect can help insurance companies to develop a more resilient business model with reduced dependence on premiums generated by fewer business lines, target segments or any other risk concentration.

That said, diversification helps insurance companies to spread the risks they underwrite and reduce the effects on the balance sheet from the occurrence of a single risk event.

Developing business segments that are not of the company's expertise, or that are in markets where broader knowledge of risk occurrence or large business intelligence is required to be successful, could be viewed as a potential weakness instead of a business opportunity. In that context, insurance companies that claim to enter a market or to develop a business line only for diversification purposes with no previous expertise in that field, is carefully analysed to determine the potential benefits in terms of underwriting capabilities.

The level of business diversification is also influenced by the degree of risks the company is willing to accept, both in terms of business mix and underwriting risk. One of the key factors to improve diversification in insurance companies is the geographical spread of underwriting risks. Premium volume or market share alone does not represent diversification for business purposes. For Non-Life insurance, mostly P&C and credit-trade insurance, the geographic location of their business can have a material impact on its financial profile if unexpected catastrophic events take place, such as natural disasters, terrorist attacks, sovereign crises, etc.

In addition, business lines concentrated in market-sensitive products in terms of regulatory pressures (e.g. healthcare) are also evaluated carefully to identify their diversification benefits if combined with other business lines. Since a sound underwriting expertise is extremely important in terms of the business diversification strategy developed by any insurance company, a complement to the analysis on 'Diversification' is done through the analysis of the 'Underwriting Strength' that is detailed under the 'Risk Management' section.

To analyse diversification, Dagong separates it into **'Product Line Diversification'** and **'Geographic Diversification'**:

Product Line Diversification Assessment	**Definition**
Excellent	Excellent mix of products, no concentration of products on market-sensitive sectors, all adding excellent diversification benefit.
Very Strong	Very strong mix of products, no significant concentration of products on market-sensitive sectors, all adding very strong diversification benefit.
Strong	Strong mix of products, no significant concentration of products on market-sensitive sectors, all adding strong diversification benefit.

Satisfactory	Satisfactory mix of products, some evidence of concentration of products on market-sensitive sectors but that does not generate losses, adding a satisfactory level of diversification benefit.
Moderate	Moderate mix of products, evidence of concentration of products on market-sensitive sectors but that does not generate losses, adding a moderate level of diversification benefit.
Weak	Weak mix of products, evidence of large concentration of products on market-sensitive sectors that does generate losses, adding a weak level of diversification benefit.
Very Weak	Very weak mix of products, evidence of very large concentration of products on market-sensitive sectors that does generate large losses, not adding diversification benefit.

Geographic Diversification Assessment	**Definition**
Excellent	Excellent geographic diversification, with large presence in major global regions and a balanced combination of developed and non-developed countries that add diversification benefit.
Very Strong	Very strong geographic diversification, with presence in major global regions and a combination of developed and non-developed countries that add diversification benefit.
Strong	Strong geographic diversification, with presence in major global regions/countries and a combination of developed countries that add diversification benefit.
Satisfactory	Satisfactory geographic diversification, with presence in one major global region/country and a satisfactory combination of developed countries/regions that reduces volatility.
Moderate	Moderate geographic diversification, with presence in one global region/country and a moderate combination of countries/regions that could add volatility.
Weak	Weak geographic diversification, with presence in one region/country and a weak combination of countries/regions with evidence of large volatility.
Very Weak	Very weak geographic diversification, with presence in one region/country and a very weak combination of countries/regions with evidence of very large volatility.

III.4 Risk Management

For Dagong, insurance companies with a proven ability and expertise to successfully manage underwriting and investment risks are likely to maintain their long-term financial sustainability. An insurance company's ability to generate operating profits under a solid risk management framework in terms of underwriting policies, investment strategy and product risk management is analysed and challenged, based on the operational environment and diversification strategy. The business model developed by insurance companies that carry underwriting, product and investment risks needs to be managed well to provide long-term profitability. This profitability is in turn, the result of an appropriate pricing structure that identifies and fairly estimates the underwriting risks acquired. Since the overall profitability that insurance companies achieve is highly determined by the level of risks accepted and rejected, the management of underwriting and investment risk should be economically profitable in the long-term.

The analysis of the risk management framework to determine price, monitor and control risks is assessed in the business context of each insurance company. The coherence of the risk management framework with the business model is the starting point for our assessment. In this context, Dagong assesses risk components managed by insurance companies separately: Underwriting and Investment Strength, Product Risk Management and Product Risk Performance.

III.4.1 Underwriting and Investment Strength

Our analysis is based on the company's risk appetite in terms of underwriting policies for Non-Life insurance companies and investment strategies for Life insurance; the identification of business incentives to accept risks; and the review of the practical application of risk appetite are also important factors for assessing the underwriting and investment strength.

For Non-Life insurance, Dagong evaluates the 'Underwriting Strength' in terms of underwriting policies, risk acceptance, pricing and reinsurance policies to determine the level of overall product risk and ability to manage catastrophic events in the long-term. The analysis of reinsurance policies also includes a view on the reinsurance record from past responses and current disputes that can affect the ability of an insurance company to transfer risks and eventually to cover policyholders. Depending on the risk appetite of an insurance company, the policies and level of reinsurance are tools to spread risk concentration and protect against any risk the company is unwilling to manage and accept.

In the case of Life insurance, the analysis focuses on the 'Investment Strategy'. Quality and diversification of the investment portfolio are taken into account when analysing the ability to manage reserves and to keep an adequate asset buffer to provide a minimum yield to policyholders. This is more critical in the cases of guaranteed products, in which the volatility of the underlying investment portfolio could substantially affect the ability of an insurance company to pay to policyholders in the long-term.

It is worth noting that the investment strategy is also important for Non-Life insurance companies, since in the cases in which the technical result from insurance operations is weak, most of the net profit will then come from the proceeds of the investment portfolio. For Non-Life insurance companies with combined ratios near 100%, the core of the non-insurance profits comes from the return on the investment portfolio and therefore is key to keep an adequate investment strategy in the long-term.

Tthe investment portfolio is evaluated and analysed in detail to identify the overall risk and assets default history. A broader diversification in terms of asset classes, geography and maturity, with high asset quality and high liquidity will mitigate any uncertainty in terms of reserves sufficiency to absorb losses if forced asset sales are needed to back policyholders' obligations. Hence, Dagong is keen in understanding the company's investment strategy, guidelines and how those are applied to support the company's operating cash flow needs and strategy.

Dagong analyses in detail the largest investment exposures or single investments that exceed a material portion of the total capital. In that case, in addition to a qualitative judgment on investment strategy, Dagong monitors and evaluates (if possible) the reinvestment rate and any other relevant yield indicator, to understand the rationale and application of the investment strategy and their long-term effects on policyholders' liabilities and other debt obligations.

Dagong's opinion on underwriting and investment strength for Non-Life and Life insurers, respectively, is determined following the seven-point scale opinions:

Underwriting and investment strength assessment	Insurance sector	Definition
Underwriting strength	Non-life	**Excellent:** Excellent underwriting expertise and capacity, excellent ability to price risk through the cycle evidenced with excellent underwriting results and profitability. **Very Strong:** Very strong underwriting expertise and capacity, very strong ability to price risk through the cycle evidenced with very strong underwriting results and profitability. **Strong:** Strong underwriting expertise and capacity, strong ability to price risk through the cycle evidenced with strong underwriting results and profitability. **Satisfactory:** Satisfactory underwriting expertise and capacity, satisfactory ability to price risk through the cycle evidenced with satisfactory underwriting results and profitability. **Moderate:** Moderate underwriting expertise and capacity, moderate ability to price risk through the cycle evidenced with moderate underwriting results and profitability. **Weak:** Weak underwriting expertise and capacity, weak ability to price risk through the cycle evidenced with weak underwriting results and profitability. **Very Weak:** Very weak underwriting expertise and capacity, very weak ability to price risk through the cycle evidenced with very weak underwriting results and profitability.

Investment strength	Life	**Excellent:** Excellent investment strength, with credit risk, market risk, interest risk and liquidity risk managed under best practices; no evidence of large concentrations of risks, excellent and consistent returns and immaterial losses from investments over the cycle; assets-liabilities mismatch immaterial. **Very Strong:** Very strong investment strength, with credit risk, market risk, interest risk and liquidity risk managed under best practices; no evidence of large concentrations of risks, very strong and consistent returns and immaterial losses from investments over the cycle; assets-liabilities mismatch immaterial. **Strong:** Strong investment strength, with credit risk, market risk, interest risk and liquidity risk managed above industry standards; no evidence of large concentrations of risks, strong and consistent returns and immaterial losses from investments over the cycle; assets-liabilities mismatch managed. **Satisfactory:** Satisfactory investment strength, with credit risk, market risk, interest risk and liquidity risk managed under industry standards; some evidence of concentrations of risks, satisfactory returns and relatively low losses from investments over the cycle; assets-liabilities mismatch satisfactorily managed. **Moderate:** Moderate investment strength, with credit risk, market risk, interest risk and liquidity risk managed below industry standards; Evidence of concentrations of risks, moderate returns and moderate losses from investments over the cycle; assets-liabilities mismatch moderately managed. **Weak:** Weak investment strength, with credit risk, market risk, interest risk and liquidity risk managed below industry standards; large evidence of concentrations of risks, weak returns and high losses from investments over the cycle; assets-liabilities mismatch weakly managed. **Very Weak:** Very weak investment strength, with credit risk, market risk, interest risk and liquidity risk managed with significant flaws; large evidence of concentrations of risks, very returns and very high losses from investments over the cycle; assets-liabilities mismatch very weakly managed.

III.4.2 Product Risk Management

The product mix chosen by an insurance company gives an indication of the overall risk appetite, acceptance, and ultimately risk absorption capacity. The underwriting risk of a product is sometimes not entirely known and modelled when it is created and commercialised. Therefore, the real risk of insurance products arises only during or after their lifetime. If any specific product risk is not identified, well-chosen and well-managed, it can have material effects on the operating profitability, firstly with higher than expected loss ratios and secondly, by affecting the level of reserves and deteriorating capital ratios. In that context, Dagong evaluates the ability of an insurance company to manage its product risk mix in terms of granularity, loss ratio volatility, reserve requirements and product underwriting policies and limits.

Product Risk Management is determined following the seven-point scale opinions detailed below:

Product Risk Management Assessment	Definition
Excellent	Excellent product risk mix and underwriting controls, excellent ability to transfer risk through reinsurance policies and excellent performance, excellent capacity to face changes in the industry/market to re-shape its product risk mix.
Very Strong	Very strong product risk mix and underwriting controls, very strong ability to transfer risk through reinsurance policies and very strong performance, very strong capacity to face changes in the industry/market to re-shape its product risk mix.
Strong	Strong product risk mix and underwriting controls, strong ability to transfer risk through reinsurance policies and strong performance, strong capacity to face changes in the industry/market to re-shape its product risk mix.
Satisfactory	Satisfactory product risk mix and underwriting controls, satisfactory ability to transfer risk through reinsurance policies and satisfactory performance, satisfactory capacity to face changes in the industry/market to re-shape its product risk mix.

Moderate	Moderate product risk mix and underwriting controls, or evidence of complex products that can add underwriting risk, moderate ability to transfer risk through reinsurance policies and moderate performance, moderate capacity to face changes in the industry/market to re-shape its product risk mix.
Weak	Weak product risk mix and underwriting controls, or complex products that show underwriting risk, weak ability to transfer risk through reinsurance policies and weak performance, weak capacity to face changes in the industry/market to re-shape its product risk mix.
Very Weak	Very weak product risk mix and underwriting controls, or large portion of complex products that show very large underwriting risk, very weak ability to transfer risk through reinsurance policies and very weak performance, very weak capacity to face changes in the industry/market to re-shape its product risk mix.

III.4.3 Product Risk Performance

To complement the analysis of ‘Product Risk Management’, Dagong applies more detailed qualitative factors to analyse the specific framework in terms of product risk performance of the mix chosen by the insurance company.

Dagong realises that data disclosure and data quality is not necessarily consistent across companies and markets. For this reason, in addition to the qualitative judgment on ‘Product Risk Management’ in the case of Life insurance, Dagong evaluates the performance of the company in terms of product risk, including products on the assets side and liabilities side of the balance sheet. For example, special attention is given to the composition of the investment portfolio in terms of high risk investments (highly volatile equity, high-yield debt obligations etc.) as a proportion of the total policyholders’ equity or over the total investment portfolio. Since this information is subject to each company’s disclosure, due to lack of standardisation on minimum requirements for data disclosure, in some cases this information is not easy to compare across companies and therefore difficult to be used on a comparable basis. This is the main motivation for Dagong to analyse the ‘Product Risk Performance’ separately from the ‘Product Risk Management’.

In the case of Non-Life insurance, the analysis of ‘Product Risk Performance’ includes a thorough understanding of the reinsurance policies and its dependence to determine the overall level of risk underwritten and the ability to manage undesirable risks or catastrophic events. The ‘Loss Ratio’ is also analysed, which evidences the ability of an insurance company to manage and absorb underwriting losses in the past. High volatility in the ‘Loss Ratio’ due to changes in underwriting policies or pricing is evaluated carefully, since it could generate further technical losses in the future that are not promptly recognised but later affect the profitability and reserves. On the other hand, losses due to unexpected events that were modelled or where pricing was not properly designed can affect substantially the company’s ability to manage product risks in the long-term.

The analysis of reinsurance policies and performance also includes a view on the past response of reinsurance counterparties and the stage of current disputes that can have a material effect on the company’s ability to fulfil its obligations with policyholders. Although reinsurance can help to diversify the underwriting risk in the case of small insurance companies, it can also significantly increase the dispute risk and expose the insurance company to counterparty risks that are difficult to manage. In addition, if there is concentration in few reinsurance counterparties, any solvency issue in a reinsurance company can have a domino effect on the insurance company and therefore jeopardize its ability to pay its policyholders.

Product diversification, sound reinsurance counterparties (in terms of credit quality and record in response to claims), prudent reinsurance policies and reasonable risk pricing are important factors of ‘Product Risk Performance’. For companies that have little economics of scale and no further loss absorption, the need to align their reinsurance strategy with their business strategy is fundamental to provide enough policyholders’ protection on those risks that the company itself cannot absorb with its own cash generation. More detailed information in terms of reinsurance policies is requested for the cases of P&C in business lines with catastrophic protection and credit and trade insurance.

The measures that Dagong uses to assess ‘Product Risk Performance’ are:

Product Risk Performance Assessment	Insurance sector	Definition
Product Risk Performance	Life	**Excellent:** Excellent product risk performance, excellent pricing ability and diversification factor; very low level of liabilities with guarantees or excellent ability to share risk with policyholders. **Very Strong:** Very strong product risk performance, very strong pricing ability and diversification factor; low level of liabilities with guarantees or very strong ability to share risk with policyholders. **Strong:** Strong product risk performance, strong pricing ability and diversification factor; relatively low level of liabilities with guarantees or strong ability to share risk with policyholders. **Satisfactory:** Satisfactory product risk performance, satisfactory pricing ability and diversification factor; satisfactory level of liabilities with guarantees or satisfactory ability to share risk with policyholders. **Moderate:** Moderate product risk performance, moderate pricing ability and diversification factor; moderate level of liabilities with guarantees or moderate ability to share risk with policyholders. **Weak:** Weak product risk performance, weak pricing ability and diversification factor; high level of liabilities with guarantees or weak ability to share risk with policyholders. **Very Weak:** Very weak product risk performance, very weak pricing ability and diversification factor; very high level of liabilities with guarantees or very weak ability to share risk with policyholders.
Net loss ratio:	Non-life	Measures the amount of claims relative to a unit of premium. It shows the level of underwriting prudence and effectiveness of reinsurance; Data used is most recent full year or year-to-date; The numerator includes ‘net claims paid’ and changes in ‘net loss reserves’ during the period and the denominator is ‘net premiums earned’. If ‘net premiums earned’ are not available, ‘met premiums written’ could be used instead.
Reinsurance recoverables:	Non-life	Reinsurance recoverables to total shareholder’s equity; Is used to evaluate the risk and size of uncertain value assets – reinsurance debt, recoverables and receivables, relative to total shareholders’ equity; Data used is most recent full year or year-to-date data; Calculation is done including ‘total shareholder’s equity’ (‘shareholder’s equity’ + ‘minority interests’). This ratio is also assessed in the context of composition and credit quality of related reinsurers.

III.5 Financial Performance

The last component of the SAA is focused solely on the financial profile, and for the case of insurance companies includes a detailed view on capital, reserves, liquidity and profitability. This analysis provides a set of ratios to assess the financial soundness of insurance companies, both Life and Non-Life, which is then used also for peer comparison.

A sound financial profile that can withstand peak of insurance losses and also economic cycles of lower demand for insurance products are the basis for a healthy and sustainable company’s financial sustainability. The assessment of technical or operating performance, balance sheet strengths and weaknesses, capital and reserves positions represent key drivers for long-term solvency prospects. Thus, Dagong has divided the analysis into four sections: Capital, Reserves, Liquidity and Profitability.

III.5.1 Capital

Capital is fundamental to the financial stability of any insurance company. It is the most certain source of funds to absorb potential and unexpected losses caused by the normal operation of risk underwriting and any unexpected weakening of operational earnings, due to reduction in premiums written, increase in operational expenses related to changes in distribution channels or unexpected losses from the investment portfolio. Capital is also the sole source of funding that is completely reliable to support any organic growth expansion if needed.

To maintain a reasonable level of protection to policyholders, insurance companies are normally required by regulators to keep higher capital levels than those obtained from internal models, to offset potential operational losses. In that context, the capital analysis also includes an understanding of the minimum regulatory requirements and its comparability across countries and with the entity's internal model.

Dagong reviews the composition of the company's capital base, the tools the management has in place to control the capital needs, and any internal limit and minimum capital levels that are defined by the management for the daily operation or to face business cycles. Dagong focuses its attention on a company's minimum internal capital adequacy as an important indication of risk tolerance and ability to manage operational losses under tight financial scenarios.

The internal capital adequacy level is compared with any regulatory capital requirement if it exists. Since regulatory requirements in terms of capital adequacy may change within countries, the comparability is also calculated based on the surplus over regulatory requirements as a portion of total capital. However, for comparison reasons, this ratio is used only to understand the capital flexibility and to compare with other countries, rather than used strictly as a key benchmark ratio. In addition to capital ratios, the analysis includes the financial leverage to compare the indebtedness capacity of the company to assess its financial flexibility through the cycle.

A prudent management of capital and financial leverage can prevent an insurance company from being exposed excessively to financial difficulties generated by unexpected losses, catastrophe risks, and adverse changes in underwriting. If the financial leverage is significant, the effects of a volatile or weak operational performance could ultimately affect the company's capacity to pay policyholders' commitments and further its financial debt. In addition, for Life insurance, the effect of poor investment performance or eventual investment portfolio losses could be mitigated by a stronger capital position that easily absorbs downturn economic and market conditions. The capital analysis emphasizes standard ratios, providing a high level of comparability between companies with different business models and geographic location.

Dagong uses the following ratios to assess 'Capital':

Capital Factors	Definition and data used
Capital adequacy ratio	Total Equity to Total Assets; It is used to assess the level of capital relative to risks underwritten by an insurance company. It provides good comparability across the industry and sectors. However it is a broad measure and does not reflect the exact economic risks of the company; the data used is the most recent full year or year-to-date. The numerator includes 'total shareholders' equity (calculated by adding 'shareholders equity' and 'minority interest') and the denominator is 'total assets'. 'Total assets are calculated by taking 'total assets' as reported and deducting separated accounts if available and deemed necessary.
Financial leverage ratio	Financial Liabilities to Total Equity; It is used to assess the amount of debt used to finance the company. The numerator consists of bank debt, financial debt and subordinated debt; the data used is the most recent full year or year-to-date.It excludes operating debt of the rated entity and non-insurance subsidiaries. The denominator consists of 'total shareholder's equity' (that includes 'shareholders equity' and 'minority interests').

III.5.2 Reserves

The analysis of available loss reserves (or technical reserves) as well as a proven ability of loss reserves management is an important part of the financial performance. Track record of historic loss ratios, reserves adequacy volatility and reserve management techniques are assessed in line with the underwriting strategy. Poor reserve management techniques can impact negatively both the operational profitability and the capital levels, often with a certain time-lag, after products with underestimated risk profiles have been sold.

Dagong recognises that the quality of data available to analyse reserves adequacy is limited and also confidential - used for internal models only. In addition, reserves adequacy can be subject to volatility due to underlying changes in business mix, underwriting policies, actuarial changes or other causes. Those factors are crucial for Dagong in order to understand the fundamentals of the reserves management, together with the specific ratios applied to evaluate and compare across companies.

The reserves' position and adjustments are evaluated to understand the insurance company's ability to anticipate or manage eventual losses coming from underwriting policy changes, incorporation of new products, changes in reinsurance policies or finally actuarial changes. The reserve adequacy level and growth observed in the past is key to understand the underwriting risks added to the balance sheet, and how the company build buffers to absorb them. For P&C, this will also help to identify trends in the industry in terms of changes in risk appetite and its alignment with the growth on premiums underwritten. This is also a tool to identify companies that have historically been under-reserved and take momentum opportunities and those that present a stronger reserve position in the long-term. The reserve adequacy also complemented with the opinion provided by internal actuaries who work on proprietary reserve management models of the entity.

The measures that Dagong uses to assess 'Reserves' are:

Reserves Assessment	Insurance sector	Definition and data used
Reserve adequacy ratio	Non-life	It is used to assess the volatility of reserves relative to total shareholders' equity; data used is the last year change in Reserves to Equity (3 year average); The numerator includes the last annual change in 'net technical reserves' and the denominator includes the three year average of 'total shareholders' equity' (shareholders' equity plus minority interest).
Reserves ratio	Non-life	It is used to assess the scale of reserves relative to total liabilities net of 'total shareholders' equity'. Policy Liabilities or Technical Reserves / Total Liabilities) most recent full year or year-to-date The numerator includes 'net technical reserves' and the denominator includes total liabilities net of 'total shareholders' equity' ('shareholders equity' + 'minority interest').
Reserve Management	Life	**Excellent:** Excellent track record on reserves management, excellent ability to keep excellent reserves following market developments, no evidence of unjustified 'one-off' reserves releases. **Very Strong:** Very strong track record on reserves management, very strong ability to keep very strong reserves following market developments, no evidence of unjustified 'one-off' reserves releases. **Strong:** Strong track record on reserves management, strong ability to keep strong reserves following market developments, no relevant evidence of unjustified 'one-off' reserves releases. **Satisfactory:** Satisfactory track record on reserves management, satisfactory ability to keep satisfactory reserves following market developments, limited evidence of unjustified 'one-off' reserves releases. **Moderate:** Moderate track record on reserves management, moderate ability to keep adequate reserves following market developments, evidence of unjustified 'one-off' reserves releases. **Weak:** Weak track record on reserves management, weak ability to keep adequate reserves following market developments, evidence of historic unjustified 'one-off' reserves releases. **Very Weak:** Very weak track record on reserves management, very weak ability to keep adequate reserves following market developments, evidence of historic unjustified large 'one-off' reserves releases.

III.5.3 Liquidity

The liquidity position in insurance companies in general is more related to the anticipation of cash needs to cover policyholders' claims and debt creditors' requirements. Liquidity should not only be focused on cash availability or significant free cash flow generation, but also assess the investment strategy that allows an easy-to-liquidate investment portfolio. Dagong gives special attention to liquidity management tools, including a qualitative analysis of liquidity plans (under contingency and normal scenarios) and a thorough understanding of the historical liquidity dynamics that the company has faced during economic cycles with higher-than-expected policyholders' claims.

For Life insurance, a sound asset and liability management framework is utterly important, since certain business and product characteristics might require high investment leverage with ready liquidity. Internal tools to achieve better cash flow that matches long-term liabilities are also reviewed. For Non-Life insurance instead, the availability of liquidity buffers to match claim expenses is important, when the level of operating cash flow is not large enough and therefore exposes the company to the risk of forced sales.

The definition of the company's cash holding is subject to the information disclosed and the availability of detailed marketable securities portfolio – Dagong would consider securities like e.g. government bonds (with the highest credit quality) as easy-to-liquidate securities in specific cases. Since the liquidation of this type of securities would typically not cause any market loss, the total amount would eventually be added to the definition of cash.

The ratios that Dagong uses to assess liquidity are:

Liquidity Assessment	**Insurance sector**	**Definition and data used**
Cash over net policy holder liabilities	Life	Used to assess the investment portfolio liquidity relative to life insurance liabilities on a very conservative basis. Although life business usually has good liquidity due to its long tail nature and low current liquidity needs, in cases of high lapses, surrenders or other negative factors, liquidity requirements could significantly increase. In the calculation of cash, we include cash, bank deposits, cash equivalents, and other high credit quality and easy to liquidate securities (e.g highly rated government bonds). In the calculation of net policy holder liabilities, we deduct the 'reinsurance share of policyholder liabilities' if available. The data used is the most recent full year or year-to-date.
Cash over net technical reserves	Non-life	Used to assess the investment portfolio liquidity relative to non-life 'net technical reserves' on a very conservative basis. In the calculation of cash, we include cash, bank deposits, cash equivalents, and other high credit quality and easy to liquidate securities (e.g. highly rated government bonds). In the calculation of net technical reserves, we deduct the 'reinsurance share of technical reserves' if available. The data used is the most recent full year or year-to-date

III.5.4 Profitability

The ability of an insurance company to generate and maintain strong, sustainable and stable operating earnings is essential for business continuity and long-term solvency. A detailed analysis of profitability, including key products, sources and composition, allows to identify the stability and predictability of earnings. Core earnings are identified and analysed depending on the business model. A business model that lacks stable core earnings is more exposed to product demand volatilities and therefore, compares poorly with peers that generate more stable core earnings with well positioned products.

A deviation from the defined business model to obtain 'one-off' earnings (e.g. earnings contribution from sales of investments following market momentum, accounting changes in treatment of investments or unjustified actuarial changes) is not considered positive and thus, is treated as extraordinary earning or non-core profit. In fact, Dagong on a case-by-case basis may adjust net income for extra-ordinary items, adjustment that will be clearly identified within the analysis. In order to evaluate a company's recurring profitability, items that are unusual in nature and infrequent may be deducted to net income for that purpose.

For the cases on Non-Life insurance, the Combined Ratio is used to complete the overall profitability for determining the operating and technical profitability. As per common market standards, a combined ratio of less than 100% fairly represents minimum underwriting profits.

The ratios that Dagong uses to assess 'Profitability' are:

Profitability Assessment	**Insurance sector**	**Definition and data used**
Net combined ratio	Non-life	Used to assess technical non-life profitability. It is the sum of 'Net Loss Ratio' and 'Net Expense Ratio'. Net loss ratio is calculated as 'net claims paid' and changes in 'net loss reserves' during a year over 'net premiums earned'. The 'Net Expense

		ratio' is calculated as a sum of 'administrative costs', 'acquisition costs', 'reinsurance expense' net of 'reinsurance commissions', and 'other underwriting expense' net of 'other underwriting income', over 'gross premiums earned'. If 'net premiums earned' are not available, 'net premiums written' could be used instead; Data used is a 3 year average of net combined ratio.
Return on total assets	Life and Non-Life	Used to assess overall profitability relative to the company's related assets. It also enables cross sector and industry comparison. The numerator includes 'net income' and the denominator includes average 'total assets'; Data used is a 3 year average. Total Assets are as reported and could be deducted with separated accounts if available and deemed necessary.

Exhibit 5: Summary of Dagong's SAA Framework for Life Insurance

Level 1 Indicators	Weight	Level 2 Indicators	Weight	Level 3 Indicators
I. Operational Environment	10%	I.1. Regulatory Environment	10%	Regulatory Environment
		I.2. Local and Macro Economy	65%	GDP per capita
				Industry development
				Unemployment Rate
		I.3. Legal Environment	25%	Legal Environment
II. Corporate Governance and Development Strategy	5%	II.1. Corporate Governance	Notching Adjustment	Corporate Governance
		II.2. Development Strategy	100%	Development Strategy
III. Sustainability and Competition	20%	III.1. Competitive Position	50%	Competitive Position
				Distribution
		III.2. Size	25%	Total Assets
		III.3. Diversification	25%	Product Line
				Geographic Diversification
IV. Risk Management	25%	IV.1. Investment Strength	30%	Investment Strength
		IV.2. Product Risk Management	30%	Product Risk Management
		IV.3. Product Risk Performance	40%	Product Risk Performance
V. Financial Performance	40%	V.1. Capital	25%	Capital Adequacy Ratio
				Financial Leverage
		V.2. Reserves	25%	Reserves Management
		V.3. Liquidity	25%	Cash over Net Policyholder Liabilities
		V.4. Profitability	25%	Return on Total Assets

Source: Dagong

Exhibit 6: Summary of Dagong's SAA Framework for Non-Life Insurance

Level 1 Indicators	Weight	Level 2 Indicators	Weight	Level 3 Indicators
I. Operational Environment	10%	I.1. Regulatory Environment	10%	Regulatory Environment
		I.2. Local and Macro Economy	65%	GDP per capita
				Industry development
				Unemployment Rate
		I.3. Legal Environment	25%	Legal Environment
II. Corporate Governance and Development Strategy	5%	II.1. Corporate Governance	Notching adjustment	Corporate Governance
		II.2. Development Strategy	100%	Development Strategy
III. Sustainability and Competition	20%	III.1. Competitive Position	50%	Competitive Position
				Distribution
		III.2. Size	25%	Total Assets
		III.3. Diversification	25%	Product Line
				Geographic Diversification
IV. Risk Management	25%	IV.1. Underwriting Strength	30%	Underwriting Strength
		IV.2. Product Risk Management	30%	Product Risk Management
		IV.3. Product Risk Performance	40%	Net Loss Ratio
				Reinsurance Recoverables to Total Shareholder's Equity
V. Financial Performance	40%	V.1. Capital	25%	Capital Adequacy Ratio
				Financial Leverage
		V.2. Reserves	25%	Reserves Adequacy Ratio
				Reserves Ratio
		V.3. Liquidity	25%	Cash over Net Technical Reserves
		V.4. Profitability	25%	Return on Total Assets
				Net Combined Ratio

Source: Dagong

IV STRESS-TESTING AND SCENARIO ANALYSIS FOR THE SAA

In order to evaluate the resilience of any insurance company to difficult macroeconomic scenarios or market shocks, Dagong applies specific stress tests which can be represented either by a change in a single factor (sensitivity analysis) or by a change in multiple factors simultaneously (scenario analysis).

Typically, the SAA incorporates the resilience of the solvency ratio of an analysed entity under a Dagong standard scenario, in which assets and liabilities are stressed based on volatilities in line with general market expectations and, under an adverse scenario, in which volatilities are at the levels of previous crisis and historic peaks. In cases where Dagong expects a fair likelihood of a more severe scenario in the medium term, the SAA incorporates the effects of this severe scenario.

The obtained scenario outcomes help to analyse the level of resilience of each company to face financial distress. Therefore, they are used in conjunction with the SAA and SA. The clear rationale and fundamentals of any IFSR is disclosed. In the case of an analysed entity that shows evidence of a weaker financial position after applying the stress test, the IFSR will reflect it accordingly.

V SUPPORT ASSESSMENT (SA)

The SA is the analysis of the likelihood of support from an identified ‘Support Provider’. The Support Assessment (SA) is combined with the SAA to determine the IFSR and the final credit rating. The support providers identified and used by Dagong in the case of insurance companies are:

1. Parent / Holding Company / Groups
2. Government

After the identification of the ‘Support Provider’, Dagong assesses the ‘Level of Support’. Dagong applies a set of criteria to determine the potential level of support through a scoring system in which four levels of support could be obtained:

1. Low
2. Moderate
3. High
4. Very High

In certain cases more than one support provider can be identified. Given the parallel assessment of support, this typically does not result in an addition of support. As such, the credit rating is based only on the most suitable ‘Support Provider’ in combination with one of the four levels of support assessed. Based on that analysis, the SAA may or may not receive a notching up. Please note that the notching up is not automatic but subject to the decision of Dagong’ rating committee. The final combination of the ‘Support Provider’ and the ‘Level of Support’ is disclosed in Dagong’s rating-related publications.

Exhibit 6: Level of Support

Low	Moderate	High	Very High
Unlikely to receive notching uplift.	Notching uplift could be at maximum to the middle point between the credit strength of the support provider and the SAA of the rated entity.	Notching uplift could be in between the middle point from the SAA and the credit strength of the support provider and to a level close to the credit strength of the support provider but not at the same level.	Notching uplift could reach the same level of the credit strength of the support provider.

Source: Dagong

For each ‘Support Provider’, Dagong sets a specific list of conditions that are evaluated and if existing, will add or reduce the potential of support from the identified support provider.

Example:

SAA	bbb
Support provider financial strength	AA+
Level of Support	Moderate
Support Provider	Parent
Maximum potential IFSR	**A+**
uplift in notches	**4**

Source: Dagong

V.1 Parent / Holding Company and Groups

Dagong uses the following definitions:

1. '**Parent Company**' or '**Holding Company**': Means the company having ultimate power of management, coordination and control on controlled companies, subsidiaries and affiliates;
2. '**Group**': Means jointly the Parent Company/Holding Company and the companies controlled by or with participation from or affiliated to the Parent Company/Holding Company. Groups may operate across different geographical jurisdictions, with complex control and ownership structures. Consequently Dagong uses analytical judgment to define the scope of a group and therefore, the extent of the group identified by Dagong for analytical purposes could differ from the official and/or legal group structure.

To evaluate the level of support on a subsidiary, for the cases where the company is part of a 'Group' (as defined by Dagong), with a Parent Company or Holding Company (as defined above), Dagong evaluates various factors, primarily the following:

1. Existence of any form of guarantee or legal obligation to support the subsidiary by the Parent Company/Holding Company. In that case, due to the obligation to support, the notching up of the company's credit rating could be increased up to the level of the Parent company/Holding company. Even though the Parent company may not have any formal or explicit commitment to support the operations of a subsidiary, Dagong evaluates the strategic importance of the subsidiary and the effects on the Parent's reputation and market confidence if a potential default affects the operation. In that context, Dagong uses the concept of 'strategic importance' and considers giving uplift to the subsidiary's SAA based on the financial strength of the Parent Company/Holding Company/Group. Although Dagong evaluates the eventual support from the Parent Company/Holding Company/Group, the track record and previous examples of support highlighted during past crisis is considered a key element.
2. Dagong also evaluates the structure and organisation of a Group, the legal ownership, organisational structures, direct and indirect control mechanisms and intragroup relationships to assess the financial strength of the Group to evaluate the external support when there is no guarantee or legal obligation to provide support from an existing Parent/Holding Company/ Group.

The descriptive set of criteria applied to assess the Parent/Holding Company/ Group support are as follows:

Factor	Adds support or subtracts support
Support or bailout history	Existing?
Financial strength of the Parent Company/Holding Company/Group	Above investment grade?
Direct ownership structure	Subsidiary?
Guarantees	1. Implicit?
	2. Explicit?
Strategic importance	1. Brand sharing?
	2. Profits?
	3. Assets?
	4. Region?
Operational integration	Existing?
Reputational risk	Existing?
Operational environment differences	Existing?

In special cases where the subsidiary has a stronger SAA than the parent (Parent Company/Holding Company/Group), Dagong evaluates the degree of connection and dependence of both companies, namely the direct relation of both credit ratings.

V.2 Government

Support from government to insurance companies has been historically proven in isolated cases. However, Dagong includes the analysis of eventual support from the government in case the entity is owned (in part or fully) by the government or viewed as systemically important. When the stability of the domestic financial system is at risk, governments would be willing to support insurance companies if needed. However, a government may be more willing to support those companies in which it has direct investment, through mechanisms such as direct cash and capital injections, liquidity facilities, long-term debt, subordinated debt provisions, guaranteed debt programs etc.

For systemically important insurance companies, the incentive for the government to provide support is driven by the catastrophic consequences of a company facing a scenario of insolvency, with a direct effect on investors' confidence, possible contagion to the financial system and the real economy. In those cases, the support to systemically important insurance companies comes from a desire to avoid any further damage to capital markets and therefore macroeconomic and social stability. It is worth mentioning that in those cases where Dagong considers the government does not have a sound financial profile or enough financial resources to provide support, the level of support expected is adjusted accordingly.

In that context, Dagong identifies those insurance companies that, in extreme scenarios are likely to receive Government support in case of financial distress. The following criteria are used to assess Government support:

Factor	Adds support or subtracts support
Insurance industry importance	High?
Bailout history	Existing?
Legal capacity	Existing?
Public sentiment	Favorable?
Insurance industry regulatory/legal framework, development	Weak?
Geographic diversification	High?
One off support due to:	1. Capital shortfall from regulatory requirements
	2. Fraud or similar
	3. Extra-national problems
Guarantee	Existing?
State ownership	Existing?

It is worth mentioning that Dagong's opinion on the national systemic importance could differ from the definition of systemic importance that a country or supranational entities agree for insurance companies. In that context, Dagong's opinion will be used and explained accordingly.

VI OTHER CONSIDERATIONS FOR INSURANCE COMPANIES' CREDIT RATINGS

VI.1 Reporting and Information Risk

Dagong's analysis and ratings rely on a wide range of information sources including audited historical financial reports and legal documentation of credit facilities. In addition to this, management information such as preliminary financial data, projections, scenario analyses, liquidity and cash flow figures are also evaluated. Dagong uses a company's internal and external data -- the latter provided by valid publicly available sources of information, to complement and verify validity, consistency and the rationale of the information provided by the company.

Dagong always relies on audited financial statements and does not implement any further audit or verification of audited financial accounts. Dagong understands the importance of the information risk as it significantly influences decisions on credit rating - including assignment, maintenance, monitoring or withdrawal. In cases where the information risk is so significant that it prevents a meaningful analysis, Dagong will decline to assign a credit rating, or when a credit rating is already assigned, will withdraw it.

Transparency and thorough reporting standards are fundamental to Dagong's credit analysis. Dagong recognises that lengthy reporting delays, material restatements, inconsistencies and related investigations indicate poor quality of reporting. Close attention is given to any adverse developments such as regulatory challenges, lawsuits, and challenges in the capital markets or frequent auditor change. Management's approach to the resolution of these matters is also a pivotal part of the analysis.

VI.2 Separated Accounts

For analytical purposes, in the case of Life and Non-Life companies, to isolate separated accounts related to 'unit-linked' assets/liabilities and 'reinsurance assets', Dagong analysts could adjust balance sheet and income statement accounts to exclude items related to separated accounts that are evaluated as items with risks carried by policy holders/reinsurers.

The adjustments will be properly disclosed and explained in relation to each account affected and will be based on the availability of information.

VI.3 Insurance Holding Companies

In the cases of pure holding companies within an insurance group, for which cash flows are represented mainly by dividends received from the operating subsidiary (a rated insurance company), Dagong analyses the holding either on a non-operating or operating basis.

In the case of a non-operating holding, the SAA is anchored at the level of the operating insurance company and then notched down to reflect the lack of independency on earnings generation and high dependency on dividends as the only income source. Further notching down might apply, depending on the level of leverage and lack of financial flexibility of the holding company.

In the case of operating holding, it could have a SAA/IFSR at the same level as the operating subsidiary, if it has additional proven sources of earnings or cash e.g.:

– Significant investment assets (real estate, marketable securities) that can be easily liquidated and transformed into an immediate source of cash.
– Other important and significant earning generating businesses that contribute to stable cash flows and helps the holding company to keep a very flexible and healthy financial position without over-dependency on one subsidiary only.

VI.4 Subsidiaries, International Operations or Companies in Run-Off

Large insurance companies sometimes keep small operations in non-core countries for special purposes such as alternative business units, specific insurance coverage or other reasons. In those cases, the subsidiary (vehicle, or branch) is highly integrated with the parent, sharing IT, funding, risk management operations and all the other core services. This makes the IFSR or credit rating of the subsidiary (or branch) highly dependent on the IFSR of the parent company or group. Therefore, the IFSR of the subsidiary is most likely to be at a similar level to that of the parent company or group, considering that these subsidiaries have a limited independence and that decision-making processes and operations are concentrated at the parent level.

The IFSR can be instead, different from that of the parent when the subsidiary (or branch) is located in countries where the jurisdiction differs substantially from that of the parent. Therefore, the subsidiary is subject to legal limitations or regulatory restrictions that could affect its financial profile individually.

It is worth noting that Dagong assesses these subsidiaries on a case by case basis in order to clearly identify the potential risks or weaknesses that debt-holders could face within those specific jurisdictions.

In cases when an Insurance company enters a 'Run-Off' stage, the operational characteristics change substantially. Thus, previous performance in terms of development strategy, sustainability and competition, as well as specific parts of the financial analysis such as past operating losses and reserves adequacy become less relevant for analytical purposes.

An insurance company is declared under a 'Run-Off' stage when it officially closes its operations to new business. In those circumstances, the IFSR, and therefore the final credit rating is limited only to the analysis of those sections that are actively managed by the insurance company during that stage.

VI.5 Foreign Currency and Local Currency Ratings

Dagong assigns 'Foreign Currency' ratings in cases where the insurance company issues debt instruments in a currency different from the local currency. These ratings are not independent and are obtained through the 'Local Currency' rating. The debt obligations that an issuer committed in a 'Foreign Currency' are subject to notching adjustments (up or down) based on the rated company's access to the specific foreign currency. Dagong defines notching as 'the practice of assigning different ratings to different sets of liabilities included within a company's financial statement.' The adjustment also takes into account the specific features of the foreign currency issuance and any other factor that Dagong would consider as constrains to foreign currency access and reduce the company's ability to fulfil its obligation accordingly.

In addition, a ceiling on 'Foreign Currency' would be applied if Dagong believes that the company's access to that currency is considerably restricted within its operating country or if there is a government restriction on foreign currency access in events of financial distress. In those cases, the 'Foreign Currency' rating would mostly follow the external restrictions; therefore would not be in alignment with the 'Local Currency' rating. The difference in notching is analysed on a case by case basis, depending on the rated company's strength and ability to ring-fence the specific 'Foreign Currency' debt obligation.

VI.6 Debt Obligations (senior and subordinated)

Dagong Global can also assign ratings to debt issued by an insurer or insurance holding entity. In assigning ratings to debt obligations we consider the company or group organizational structure, the SAA and SA, IFSR and LTCR. The ratings of debt obligations are notched from the LTCR. The notching applied depends on the different features of the debt instrument (including senior and subordinated debt, secured and unsecured, or issued by an operating company or holding).

VI.6.1 Long-Term Debt Ratings

Senior Debt obligations:
Ratings assigned to senior debt are either equal to or notched above or below the LTCR depending on the level of expected recoveries (for example, recoveries could come from guarantees, credit enhancement and/or other sources). In jurisdictions where policyholder claims rank above senior and subordinated debt, we would usually deduct one notch. However, in certain cases a debt rating is not notched down when the LTCR is high and the issuer's financial characteristics are very strong. Dagong also will take into consideration any additional collateralisation or guarantees to senior debt obligations. In cases of speculative grade (BB+ and below) issuers, with weak financial characteristics, the notching down could be wider. For insurance companies where asset encumbrance elevates the credit risk of subordinated or senior unsecured debt, Dagong applies further notching down.

Subordinated debt obligations:
Ratings assigned to subordinated debt obligations are also notched down from the LTCR. Dagong believes that given the on-going promotion of the overall burden sharing in case of distress by policy makers and regulators, subordinated debt instruments should be evaluated carefully on individual basis. However, our general approach is to incorporate a two notches haircut from the LTCR.

The notching differential for subordinated debt obligations is based on a more specific assessment of the characteristics of the debt instrument, according to the following items:

- Subordination level in the capital structure.
- Coupon skip and loss absorption mechanisms.
- Interest coverage and leverage.

- Additional revenue sources and other financial strengths (or weaknesses) for holding entities.

The generic indication on insurance operating entity's debt ratings (final notching could differ depending on individual characteristics of the company/group and the debt issuance):

- Senior debt rating = Operating entity's LTCR minus one notch.
- Subordinate debt rating = Operating entity's LTCR minus two notches.
- Preferred shares rating = Operating entity's LTCR minus three notches.

The debt ratings issued by insurance operating holding entities typically have different notching to reflect the relative priority ranking and different recovery expectations. The generic indication on insurance operating holding entity's debt ratings **(**final notching could differ depending on individual characteristics of the company/group and the debt issuance):

- Senior unsecured debt rating = Operating holding's LTCR
- Subordinate debt rating = Operating holding's LTCR minus one notch
- Preferred shares rating = Operating holding's LTCR minus two notches

In assessing the debt rating of the operating holding entity, we also consider additional factors including:

- The rating level of the operating entity and holding, if in speculative grade (BB+ and below) the notching difference could be wider indicating increasing credit risk.
- Management structure of the group, regulatory and legal aspects.
- Diversity and historic track record of income sources.
- Stand-alone holding company's investment portfolio, liquidity and additional liquidity sources relative to capital, debt servicing costs.
- Consolidated financial leverage and double leverage.

As an example:

Entities & Instruments	**General approach for investment grade rated entities**	**General approach for speculative grade rated entities**
Main operating entity of the group		
LTCR	**A**	**BB+**
Senior unsecured debt	A-	BB
Subordinated debt	BBB+	BB-/B+
Preferred stock & junior subordinated debt	BBB	B+/B
Holding entity		
LTCR	BBB+	BB-/B+
Senior unsecured debt	BBB+	BB-/B+
Subordinated debt	BBB	B+/B-
Preferred stock & junior subordinated debt	BBB-	B-/CCC

VI.7 Hybrid Securities

To evaluate the scope of debt or equity like characteristics of any hybrid issuance, Dagong focuses on the maturity, cumulative versus non-cumulative character of coupon suspension, structural ranking of the hybrid security, various capital features and triggers. Dagong assesses and recognises the proportion of equity versus debt content in an issuer's capital structure on a case-by-case basis, depending on the structure of the specific security.

In general, a high equity proportion is recognised on deeply subordinated hybrid securities that usually are represented in the most junior instrument in the issuer's capital structure. These are characterised by strongly protective and non-cumulative coupon suspension conditions, 'can't default' or cross default, with long maturity or at perpetuity. Hybrid securities with weak loss absorption features, higher priority of claim in liquidation or short maturity (generally less than 20 years) would be treated as debt-like instruments with low or no equity proportion. Nevertheless, we assess also the regulatory rules and requirements for hybrid eligibility.

Usually, hybrid securities do not represent a significant proportion of overall debt and their treatment has marginal impact on an issuer’s capital structure and credit rating. However, Dagong considers hybrid equity as a weaker form of capital. It could be also limited to a threshold for the calculation of equity content in cases where other forms of capital, different from shareholders equity represents also a high proportion of overall capital. Therefore, credit ratings for any hybrid security are assessed on case-by-case basis and in general, notched down from the credit rating. Securities with high equity proportion tend to be subject to higher notching difference, compared to debt-like cases.

VI.8 Short-Term Debt Ratings

Commercial Paper debt or programs are defined as an unsecured, short-term debt instrument. Dagong uses the short-term rating scale to assign ratings to Commercial Papers. In general, these ratings are assigned based on the mapping between short-term and long-term credit ratings published in our rating definitions. In cases in which the insurance company presents evidence of a stronger/weaker liquidity profile determined by the liquidity analysis, the rating could differ from the published mapping.

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