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North American And Bermudan Insurers Continue To Step Up Their Enterprise Risk Management Efforts

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*(**Editor's Note:** This article was originally published on April 29, 2011. We are republishing with updated information in table 5.)*

Standard & Poor's Ratings Services has updated its enterprise risk management (ERM) opinions for all of its rated North American and Bermudan insurance companies. An insurer's ERM program is a system of processes and practices that aims to measure and manage risk. Our ERM opinion reflects our assessment of the strength of an insurer's ERM program. These latest ERM scores update previous scores (see "Enterprise Risk Management Continues To Show Its Value For North American And Bermudan Insurers," published Feb. 1, 2010).

Our findings include the following:

- We assigned a strong or excellent score for ERM culture to 29 of the 34 companies that went through ERM Level II reviews, which we perform for companies whose complexity requires an in-depth analysis. This indicates that senior management of companies with more complex risk profiles tends to recognize the importance of a robust ERM framework.
- Based on the results of our reviews, companies with more complex risk profiles have the most opportunity to strengthen their ERM programs in the areas of emerging and strategic risk management.
- Property/casualty (P/C) insurers appear to be more focused on emerging risk management than life/health insurers. Seventy-six percent of P/C companies with ERM Level II scores received strong or better ERM scores for emerging risk management, compared with only 31% of life insurance companies.
- During 2010, stock prices of companies with strong or better ERM scores continued to outperform those with lower scores. Although the improvement wasn't as pronounced for companies with excellent ERM scores as for those with strong scores, companies with weak ERM scores again had distinctly lower stock performance, on average, than companies with better scores.
- In 2010, as in 2009, the level of average stock price volatility of companies was observed to vary inversely with their ERM scores. Companies with excellent ERM scores demonstrated the lowest stock price volatility, while companies with weak ERM scores had the highest.

Updates To The ERM Opinion Analysis

We have updated our report to include our ERM opinions of 155 North American and Bermudan insurance companies, down from 165 insurers in last year's report, primarily because of withdrawn ratings (see table 5). We also have made three notable changes to our ERM opinion process. First, we expanded our analysis to include more granular information on the subset of 34 companies whose complexity requires an ERM Level II review. Second, we added aggregate information showing the distribution of component scores for companies that had ERM Level II reviews. Third, we provided separate breakdowns for life/health insurance companies and P/C companies.

Standard & Poor's ERM review consists of five components:

- Risk management culture: the degree to which risk and risk management are important considerations in all aspects of corporate decision-making.
- Risk controls: the processes and tools a company uses to manage risk exposures within its limits and losses within its tolerances.
- Emerging risk management: the process by which a company catalogs, prioritizes, and mitigates the possibility of unpredictable or unexpected events.
- Risk models: the tools a company uses to project and evaluate risk exposures under varying scenarios.
- Strategic risk management: the process by which a company evaluates, prioritizes, and optimizes strategic options.

The review results in a separate score for each ERM component. We then combine these scores to generate a composite ERM score. Each component's importance to the composite ERM score varies, depending on the company's specific risk profile. Factors such as the breadth and complexity of a company's products, geographic footprint, target markets, and competitive advantages determine the risk profile.

Classification Of Adequate ERM Scores

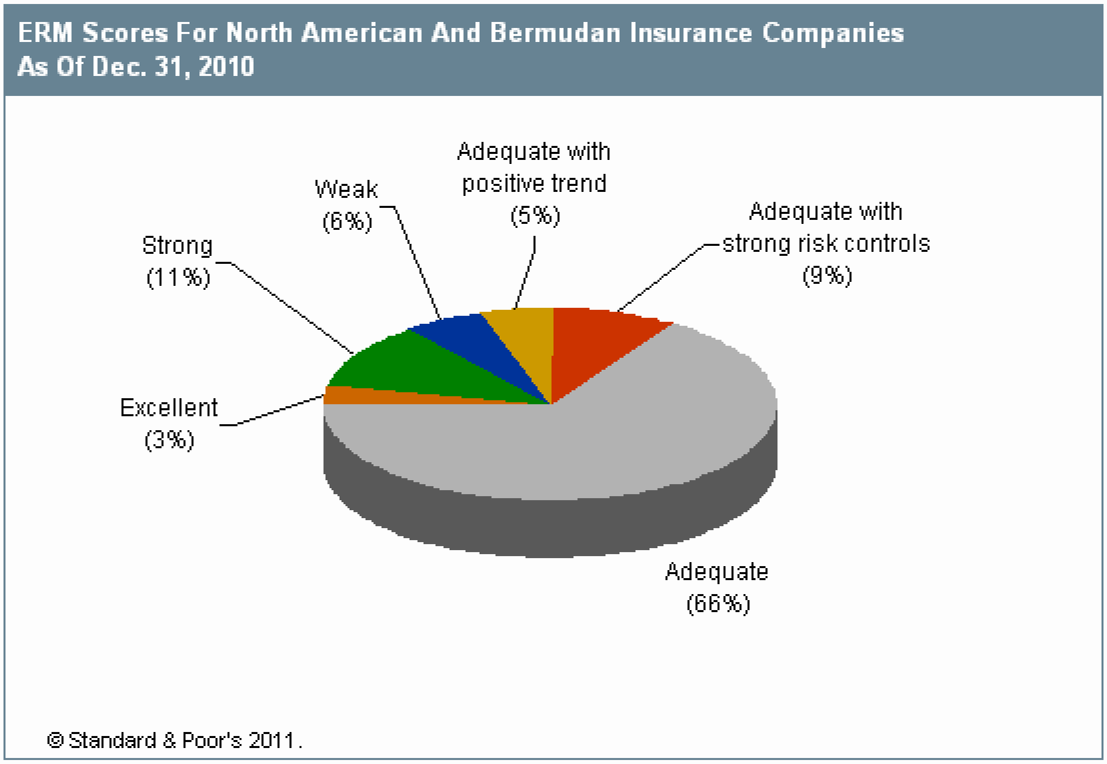
Before 2010, our ERM evaluations resulted in composite ERM scores of excellent, strong, adequate, or weak. In January 2010, we updated our criteria to expand and subdivide the definition of adequate ERM scores to adequate, adequate with strong risk controls, and adequate with positive trend. (For more information on our approach and a detailed definition of the ERM scores, see "Expanded Definition Of Adequate Classification In Enterprise Risk Management Scores," published Jan. 28, 2010.)

The following is an overview of our definitions of the three adequate ERM scores:

- A company with an ERM score of adequate has what we view as complete and reliable control processes in place for its major risks. This company typically won't experience outsized losses in an economy that is benign.
- A company with an ERM score of adequate with strong risk controls has, in our opinion, all of the characteristics of a company with an adequate ERM score plus strong controls over all of its material risks.
- A company with an ERM score of adequate with positive trend has, in our opinion, all of the characteristics of a company with an adequate with strong risk controls score, plus a strong or better score for risk management culture, the near-term potential for a strong or better score for strategic risk management, and the possibility of attaining an overall ERM assessment of strong within 24 months.

Of the companies we reviewed, 80% (124 insurers) are still in the adequate category (see chart 1). However, some of them have managed to differentiate themselves through nuances in their risk management frameworks: 14 had a score of adequate with strong risk controls and eight had a score of adequate with positive trend.

Chart 1



Overall ERM Scores

In 2010, the adequate ERM score category continued to include companies with scores in all three adequate classifications. Most of the movements in these scores during the past three years have resulted from companies, typically those with adequate scores, requesting that Standard & Poor's withdraw its ratings.

Table 1

ERM Score Distribution

	2008	2009	2010
Excellent	6	5	5
Strong	15	19	17
Adequate	122	126	124
Weak	9	15	9
Total	152	165	155

As the financial crisis continued to expose some less effective risk management practices, many insurance companies began strengthening their ERM frameworks. This resulted in ERM improvements for some of our rated insurers: Six of the 15 companies that scored weak in 2009 improved to adequate (see table 2). We also have observed that insurers are focusing more on ERM in the form of new or improved processes they have implemented to better control tail risks. We recognize the implementation of these processes in scoring risk management culture sooner than we do in risk controls, to give the new processes an opportunity to demonstrate their effectiveness.

Table 2

ERM Score Migration

	--2010 score--				
2009 score	Excellent	Strong	Adequate	Weak	Not rated
Excellent	5	0	0	0	0
Strong	0	15	3	0	1
Adequate	0	2	111	1	12
Weak	0	0	6	8	1
Not rated	0	0	4	0	0
Total	5	17	124	9	14

ERM Level II Reviews

In 2010, Standard & Poor's performed ERM Level II reviews on 34 insurance companies (see table 3). We consider these companies to have risk characteristics that are more complex than the overall group of insurance companies we rate. The ERM Level II reviews consist of more in-depth analyses of each element of a company's ERM framework.

Table 3

ERM Score Breakdown

	Overall	Risk management culture	Risk controls	Emerging risk management	Risk models	Strategic risk management
Excellent	5	6	4	5	0	5
Strong	10	23	24	13	17	11
Adequate	19	5	6	15	17	18
Weak	0	0	0	1	0	0

Note that we analyze multiple risk controls to arrive at an overall risk control score.

Larger insurers and those with complicated risk profiles generally emphasize risk discipline in their organizations because they recognize the importance of ERM. This is one of the reasons for the absence of weak scores in the ERM Level II evaluations and the predominance of strong scores for risk management culture. We note that the emerging and strategic risk management areas provide the greatest opportunities for those companies to improve their ERM processes.

We have included the distribution of ERM Level II scores by industry sector in this year's report, specifically the sector breakdowns for life/health and P/C insurers (see table 4). Note that we included multiline insurers in both categories. As a result, the sum of the number of life/health and P/C companies differs from the total number of companies that received ERM Level II reviews.

Table 4

Breakdown Of ERM Scores For Life/Health And P/C Insurers

Life/health insurers

	Overall	Risk management culture	Market risk control	Credit risk control	Life risk control	Asset-liability management	Operating risk control	Risk controls overall	Emerging risks	Risk models	Strategic risk management
Excellent	1	2	0	1	1	0	1	1	2	0	1
Strong	5	9	9	8	8	8	8	9	3	8	6

Table 4

Breakdown Of ERM Scores For Life/Health And P/C Insurers (cont.)

Adequate	10	5	7	7	7	8	7	6	10	8	9	
Weak	0	0	0	0	0	0	0	0	1	0	0	

P/C insurers

	Overall	Risk management culture	Market risk control	Credit risk control	Pricing risk control	Catastrophe risk control	Reserve risk control	Operating risk control	Risk controls overall	Emerging risks	Risk models	Strateg ris manageme
Excellent	5	5	1	0	9	8	5	2	4	5	0	
Strong	6	16	11	12	12	11	13	11	16	11	12	
Adequate	10	0	9	9	0	2	3	8	1	5	9	[illegible]
Weak	0	0	0	0	0	0	0	0	0	0	0	

Of the five companies with excellent ERM scores, three are reinsurers, one is a P/C direct writer, and one is a multiline company. A predominant number of reinsurers, particularly P/C reinsurers, have well-defined risk appetite statements that are consistent with their risk limits (exposures). They also have made significant investments in catastrophe risk management and economic capital modeling, demonstrating an enhanced understanding of their risk profiles.

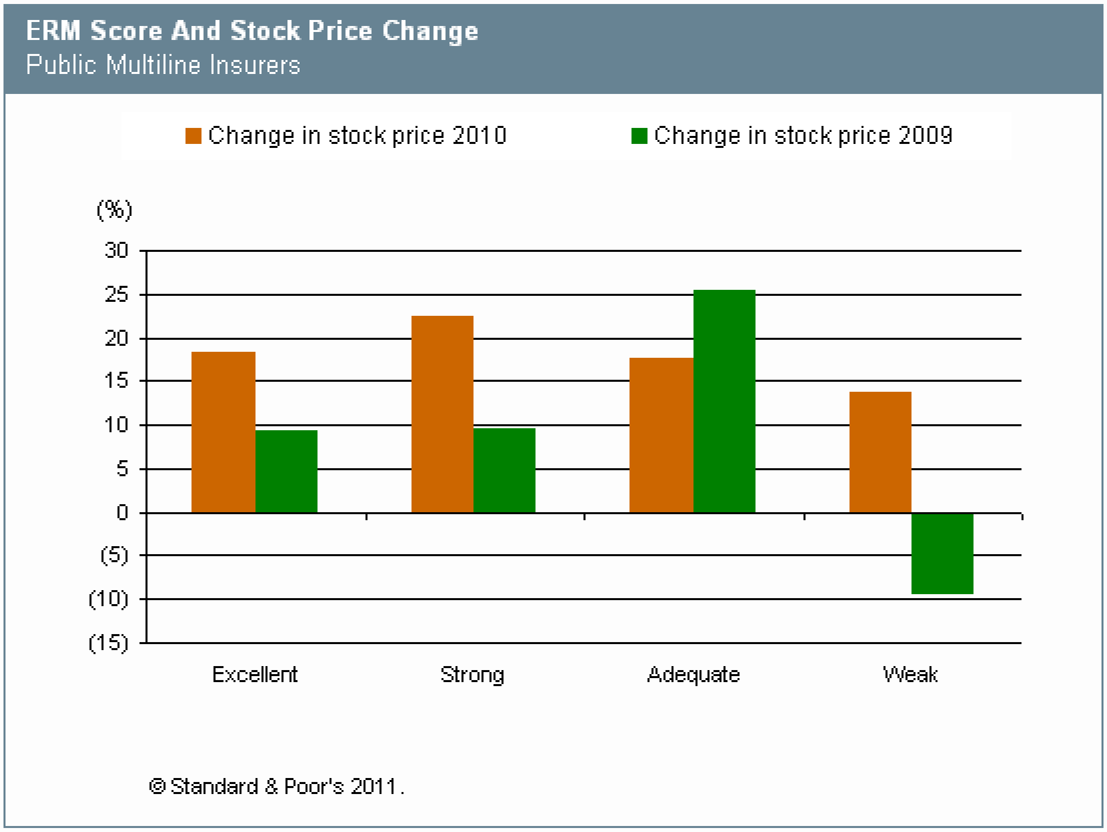
Stock Performance Relative To ERM Scores

Standard & Poor's believes that more robust ERM programs are the most valuable in times of more pronounced stress. In last year's report, we noted a correlation during 2008 and 2009 between ERM score and stock price, which we use as a proxy for company performance. Although average stock prices declined among all public insurers in 2008, companies with more robust ERM programs experienced smaller stock price reductions. This is consistent with our view that the true test of a company's ERM program comes during times of crisis.

In 2010, the S&P 500 Index gained 11% during the year as the equity markets improved. The stock market, as a whole, appreciated, and insurance companies, regardless of their ERM capabilities, witnessed positive movements in their stock prices, on average. We again noted a material difference in stock price performance of companies with weak ERM scores versus those with better ERM scores.

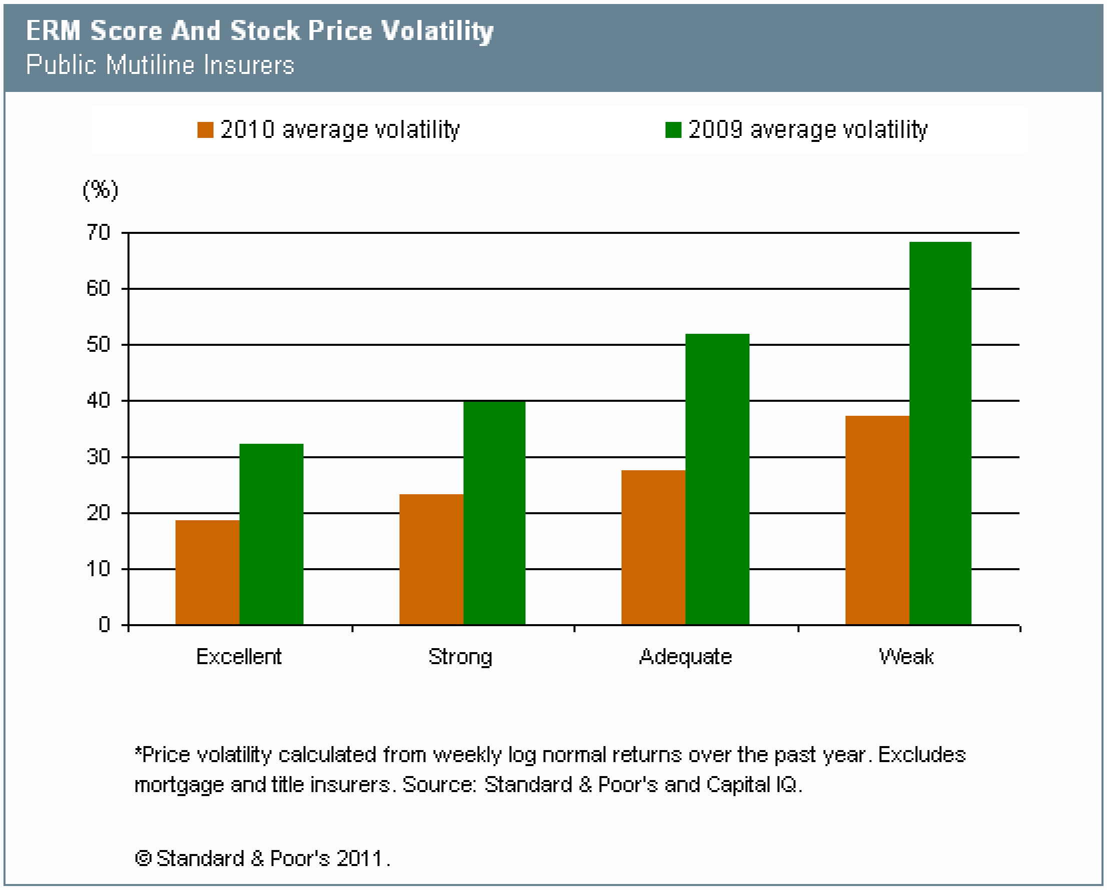
However, although the ERM scores relative to stock performance in 2009 and 2010 conformed to the general correlation we observed, they also revealed a somewhat different pattern (see chart 2). Stock prices for companies with strong ERM scores outperformed all the other categories, followed by stock prices for companies with excellent ERM scores.

Chart 2



We took a look at stock price volatility, which is a second-order measure of stock performance, and compared it with ERM scores (see chart 3). During 2010, the average daily level of stock price volatility displayed an inverse relationship with ERM score, as it did during the previous year. We expect that stronger ERM programs will result in more stable, predictable earnings. Companies with less robust ERM programs likely will be more susceptible to earnings swings.

Chart 3



Volatile market conditions and other factors have caused more insurance companies and their boards of directors to recognize the value of a robust ERM program. In 2010, many insurers responded by improving their ERM programs.

ERM shows its value most clearly in periods of significant stress, such as in the recent past. During less stressful economic conditions, such as the current macroeconomic environment, robust ERM continues to show its value by helping companies to better stabilize their performance. As such, we believe that prudent insurers will continue to recognize and reap the benefits of ERM as they strengthen their programs.

Table 5

ERM Scores For North American And Bermudan Insurers As Of Dec. 31, 2010
Excellent
Endurance Specialty Holdings Ltd.
PartnerRe Ltd.
RenaissanceRe Holdings Ltd.
Travelers Insurance Group
USAA Insurance Group
Strong
ACE Ltd.

Table 5

ERM Scores For North American And Bermudan Insurers As Of Dec. 31, 2010 (cont.)
Allianz Life Insurance Co. of North America
Arch Capital Group Ltd.
AXIS Capital Holdings Ltd.
Federal Insurance Group (Chubb Corp.)
Liberty Mutual Insurance Co.
Metropolitan Life Insurance Co.
Nationwide Mutual Insurance Co.
New York Life Insurance Co.
Northwestern Mutual Life Insurance Co.
Platinum Underwriters Holdings Ltd.
Principal Financial Group Inc.
Progressive Corp.
QBE Americas Division
Sun Life Financial Inc.
Tokio Millennium Re Ltd.
XL Group Ltd.
Adequate with positive trend
Allied World Assurance Holdings Ltd.
Allstate Corp.
Alterra Capital Holdings
Hanover Insurance Group Inc.
HCC Insurance Holdings Inc./ Houston Casualty Insurance Group
Industrial Alliance Insurance and Financial Services
Lincoln Financial Group
Montpelier Re Holdings Ltd.
Adequate with strong risk controls
ACUITY a Mutual Insurance Co.
Aetna Insurance Group
Attorneys' Liability Assurance Society (Bermuda) Ltd.
Berkley (W.R.) Corp.
Berkshire Hathaway Inc.
CNA Financial Corp.
Everest Re Group Ltd.
Prudential Financial Inc.
RLI Corp.
Selective Insurance Group
Transatlantic Reinsurance Holdings Inc.
UnitedHealth Group Inc.
Validus Holdings Ltd./Validus Re
White Mountains Re Group Ltd.

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Table 5

ERM Scores For North American And Bermudan Insurers As Of Dec. 31, 2010 (cont.)
Adequate
Aflac Inc.
American Equity Investment Life Insurance Co.
American Financial Group
American Steamship Owners Mutual P&I Assoc. Inc.
Americo Financial Life & Annuity Insurance Co.
Amerigroup Corp.
Ameriprise Financial
Argonaut Group Inc
Assurant Inc.
Blue Cross & Blue Shield of Rhode Island
Blue Cross & Blue Shield of Florida Inc.
BlueCross BlueShield of Tennessee Inc.
California Physicians' Service
CareMore Holdings Inc.
Centene Corp.
CIGNA Corp.
Cincinnati Financial
CMG Mortgage Insurance Co.
Cooperativa de Seguros Multiples de Puerto Rico
Co-operators Life Insurance Co.
Coventry Health Care Inc.
Delta Dental of New Jersey, Inc.
Excellus Health Plan Inc.
Fairfax Financial Holdings Ltd.
Fidelity Investments Life Insurance Co.
Fidelity National Financial Inc.
First American Title Insurance Co.
First Rehabilitation Life Insurance Co.
Forethought Financial Group
Fort Dearborn Life Insurance Co.
Genworth Financial / Genworth Life and Annuity Insurance Co.
Great-West Lifeco Inc.
Group Health Cooperative
Guarantee Co. of North America
Guardian Life Insurance Co.
Harleysville Group Inc.
Hartford Financial Services Group Inc.
Health Care Service Corp.
Health Net Inc.
HealthNow New York Inc.

Table 5

ERM Scores For North American And Bermudan Insurers As Of Dec. 31, 2010 (cont.)
HealthPartners Inc.
HealthSpring Inc.
Highmark Inc.
Hochheim Prairie Farm Mutual
Horace Mann P/C Group and Horace Mann Educators Corp.
Horizon Healthcare Services Inc. (d/b/a Horizon BCBS of New Jersey)
HSBC Insurance (Bermuda) Ltd.
Humana Inc. Group
Infinity Property and Casualty Group
Knights of Columbus
Louisiana Health Service & Indemnity Co. (d/b/a Blue Cross and Blue Shield of Louisiana)
Magna Carta Insurance Group
Manulife Financial Corp.
Massachusetts Mutual Life Insurance Co.
Medical Card System Inc.
Mercury General Corp.(unsolicited ratings)
Minnesota Life/Securian Financial
MTL Insurance Co.
Mutual of America Life Insurance Co.
Mutual of Omaha
National Life Insurance Co. (VT)
National Western Life Insurance Co.
Navigators Group Inc.
Noridian Mutual Insurance Co.
Ohio National
Oil Casualty Insurance Ltd.
Oil Insurance Ltd.
Old Republic International Corp.
OneAmerica Financial Partners
OneBeacon Insurance Group
Pacific Guardian Life
Pacific Life Insurance Co.
Penn Mutual Life Insurance Co.
Penn National Group
Phoenix Life Group
Primerica Life Insurance Co.
ProAssurance Corp.
Protective Life Group/Protective Life Corp.
Reinsurance Group of America Inc.
Sammons Financial Group
Security Benefit

Table 5

ERM Scores For North American And Bermudan Insurers As Of Dec. 31, 2010 (cont.)
Sedgwick CMS
StanCorp Financial Group Inc.
State Auto Group
State Farm Mutual Automobile Insurance Co.
Symetra Financial Corp.
Teachers Insurance & Annuity Assoc. of America
Texas Municipal League Intergovernmental Risk Pool
Torchmark Corp.
Transamerica Life Canada
Triple-S Inc.
UNIFI Group
Unitrin Inc.
Universal American Corp.
Universal Insurance Holdings Inc.
Unum Insurance Group
USAble Life Insurance Co.
WellCare Health Plans
Wellmark
Wellpoint Insurance Group
Western & Southern Financial Group
Zenith National Insurance Corp.
Weak
American International Group Inc.
American National Insurance Co.
CNO Financial Group
Delphi Financial Group
Health Insurance Plan of Greater New York
MGIC Investment Corp.(unsolicited ratings)
PMI Group
R.V.I. Guaranty Co. Ltd.
Radian Group Inc.

Related Criteria And Research

- A New Level Of Enterprise Risk Management Analysis: Methodology For Assessing Insurers' Economic Capital Models, Jan. 24, 2011
- Enterprise Risk Management Continues To Show Its Value For North American And Bermudan Insurers, Feb. 1, 2010
- Expanded Definition Of Adequate Classification In Enterprise Risk Management Scores, Jan. 28, 2010