



## Rating Criteria for General Insurance Companies

### **Executive Summary:**

General insurance refers to non-life insurance policies, which provide coverage for things like health, property, auto, travel, and liability. However, there are several common parameters that insurance companies typically assess when evaluating applications for general insurance. Brickwork Ratings' (BWR's) criteria for rating these instruments is discussed in this document.

The sectoral cap for Foreign Direct Investment (FDI) in the insurance sector has undergone several revisions. Initially, the cap was set at 49%, but it was later increased to 74% under the automatic route. As part of the Union Budget 2025, the government has announced a further increase in this cap, raising it from 74% to 100%. However, this enhanced 100% FDI limit will be applicable only to insurance companies that commit to investing the entire premium amount in India. This move is expected to strengthen the sector by encouraging more foreign investments, boosting insurance penetration, and fostering competition in the market.

### **Scope of Criteria:**

To arrive at the Counterparty Credit Risk (CCR) rating of GICs, BWR assesses the standalone credit profile, as well as the support expected from the parent entity or group to which it belongs. BWR considers several criteria to arrive at the rating, including the analysis of the company's policies, practices, performance of management, projected business plans and financial analysis, industry and business risks analysis, risk management systems, investment management, use of technology, marketing and distribution channels, and parental and recapitalisation support in the case of new companies.

### **Risk Assessment and Methodology:**

BWR's rating focuses on critical aspects for the insurance business under the Indian regulatory framework. The insurer's ability to meet its obligations to the policy holders is assessed on the basis of the following key parameters:

## A. Business Risk:

Business growth in GIC depends a lot on its competitive positioning in the market vis-à-vis its peers. BWR analyses the insurer's source of competitive advantage, as well as its overall microeconomic business profile with the aim of evaluating its long-term revenue-generating capability while maintaining its risk profile. Key points considered are as follows:

| Competitive positioning of the entity | Enterprise Risk Management capabilities           |
|---------------------------------------|---|
| Market position of the entity         | Diversity of operations of the entity             |
| Diversity of products offered         | Risk management policies and systems              |
| Nature of products offered            | Reinsurance – risk retained in high-risk products |
| Net retention ratio                   | Reinsurer risk                                    |
|                                       | Regulatory risk                                   |

- **Competitive positioning of the entity**

Market position of the entity: An entity's position in the market can significantly influence its exposure to certain types of risk, its financial stability, and the complexity of its operations. BWR assesses as per the key factors mentioned below:

- Company's competitive strengths and weaknesses
- Quality and spread of distribution channels
- Diversification of business mix – by geography, sector, line of business, distribution source
- Growth rates of premiums – in total and by line of business - on both net and gross bases, generally over five years
- Market shares overall and by major lines of business
- Related non-insurance activities, if any
- Net retention of customers every year

In addition to the factors mentioned above, BWR also evaluates the adoption of technology for product distribution and business diversification. With more consumers purchasing insurance products online, it is crucial for insurance companies to leverage advanced technology. This adoption not only facilitates product comparison, reducing reliance on expensive manpower, but also enables seamless customer onboarding and retention through digital channels, catering to the expectations of tech-savvy customers who demand frictionless transactions.

### 1. Nature and Diversity of products offered:

Policies including health, auto, property, and liability insurance are among the types of goods that general insurance companies offer. Risks associated with each product include the frequency of claims, difficulties with underwriting, and possible vulnerability to outside variables like natural catastrophes, all of which can have an effect on financial stability and profitability. The diversity of products is an important factor not only for the insurer to be the preferred choice for customers, but also for assessing their relative risk profile, given that each product has a different risk profile.

While analysing the entities, BWR focuses on the prudential guidelines to assess the risk of products/business segments. The Insurance Regulatory and Development Authority of

India (IRDAI) establishes variables for every business segment according to their risk levels.

| Business Segment | Risk Category  |
|------------------|----------------|
| Fire             | Medium         |
| Engineering      | Medium         |
| Rural Insurance  | Medium         |
| Marine-hull      | Medium         |
| Marine-Cargo     | Medium to High |
| Health           | Medium to High |
| Liability        | Medium to High |
| Crop             | High           |
| Motor            | High           |
| Aviation         | High           |

**2. Net retention ratio:**

GIC's net retention ratio indicates how much risk it retains after transferring some of it to reinsurers. It's the portion of premiums that the business retains, and it shows how much risk it can bear on its own. A greater ratio indicates that the business is taking more risk, whilst a smaller ratio indicates that it is depending more on reinsurance.

**3. Enterprise Risk Management capabilities:**

BWR would analyse the insurer's efforts to align the risk strategy with the business strategy. All ERM (Enterprise Risk Management) practices will be assessed relative to the realistic levels of risk at the company and relative to peers with similar risks. BWR evaluates ERM quality in the following areas:

**4. Diversity of operations of the entity:**

Diversity in locations, customers and products constitutes the means through which the insurer manages its risk.

**5. Risk management policies and systems:**

In general insurance, risk management policies and systems are frameworks and practices designed to identify, assess, and effectively manage risks. By staying within the entity's risk appetite, these policies ensure that the insurer has strategies to minimize potential losses, comply with legal regulations, and maintain financial stability.

**6. Reinsurance – risk retained in high-risk products:**

In high-risk products, the insurer retains a portion of the risk, which can increase short-term profits but also exposes the business to potentially larger future losses. To manage this, the company must have robust risk management strategies and sufficient capital reserves to prevent financial instability. In order to assess the internal portfolio risk controls, BWR assesses how the insurer manages its risk through reinsurance taken for its high-risk products.

**7. Reinsurer risk:**

The risk that a reinsurer may fail to pay its share of claims, resulting in the insurance company assuming greater financial responsibility. This risk is mitigated by selecting reliable reinsurers and securing agreements with additional safeguards, such as collateral.

**8. Regulatory risk:**

Regulatory risk refers to the potential impact on an insurer's operations or profitability due to changes in laws or regulations. This can lead to higher compliance costs, operational challenges, or the need for adjustments in corporate practices. BWR assesses the regulatory compliances followed by the insurer.

## B. Financial Risk:

The key factors that BWR considers when evaluating a general insurance entity's financial position in terms of financial risk are as follows:

### 1. Capitalization of entity:

Capitalisation of an entity is the process of evaluating the financial health of an insurer by looking at its capital structure, which includes debt, equity, and resources that can be used to pay down debt and fund expansion. It entails assessing important indicators for a General Insurance Company, such as the capitalisation ratio, solvency ratio, growth and infusion plans and financial flexibility.

#### Capitalisation Ratio:

The capitalisation ratio (net premium written to net-worth) is considered to assess the risk undertaken by the insurer against the capital cushion it carries. Broadly, the assessment covers the following areas: Capital cushion available to support policy holders' obligations and other liabilities

Balance sheet strength Solvency profile of the insurer Insurer's potential need for additional capital in the future, and the sources that may be available to meet this requirement

|                      |                                |
|----------------------|--------------------------------|
| Capitalisation Ratio | Net Worth /Net Premium Written |
|----------------------|--------------------------------|

#### Solvency Ratio:

Solvency is the most important measure of an insurer's ability to continue to service its policy holders and debt holders and continue to grow. Solvency is ensured through the adequate infusion of funds to maintain the capital in the entity. IRDAI requires insurers to maintain a solvency ratio (available solvency margin / required solvency margin) of 1.5.

#### Growth and infusion plans:

This involves evaluating the insurer's strategy for expansion, including increasing market share, launching new products, or expanding into new regions. Growth plans should be sustainable and backed by solid financial foundations to prevent overextension. Infusion plans ensure that the insurer has the necessary funds to support its operations, particularly in times of rapid growth or when facing unforeseen losses.

#### Financial flexibility:

This refers to the insurer's capacity to adjust and access its financial resources to meet evolving needs and circumstances. It includes the ability to raise extra capital or liquidity, when necessary, through methods such as debt, equity, or other financial instruments.

## 2. Underwriting Performance:

Strong underwriting policies and practices are essential for the long-term success of insurance companies. Although insurers earn significant income from investments, their primary profitability should come from an underwriting surplus. This surplus depends on effective underwriting practices, such as selecting customers with appropriate risk levels and pricing high-risk customers correctly. BWR assesses how effectively an insurance company prices the risk transferred from policyholders. It is important to weigh the risk vs premium charged to the policyholders (higher premium for higher risk and lower premium for lower risk). Additionally, BWR also assesses quality of premium in terms of payment continuity and granularity of policyholders.

- **Claims Ratio:** Indicating if the insurer's premiums are adequate to cover anticipated claims, the Claims Ratio compares the cost of claims to the premiums earned.
- **Expense Ratio:** A metric that illustrates how well an insurer controls its operational costs by comparing operating expenses to premiums.
- **Combined Ratio:** An overall evaluation of the insurer's underwriting performance and profitability is provided by the Combined Ratio, which is the sum of the claims ratio and expenditure ratio.
- **Operating Profit:** The total profit from investment income and underwriting, which represents the insurer's financial performance.
- **Trend for profitability:** The examination of how profitability measurements change over time in order to comprehend the insurer's long-term financial health is known as the trend of profitability. While assessing the profitability of insurance company the long-term trend of return ratios like PAT, ROE and ROI are observed.

|                  |  |
|------------------|--|
| Net Claims Ratio | Net Claims Incurred / Net Premium Earned           |
| Expense Ratio    | Operating Expenses / Premium                       |
| Combined Ratio   | Net Claim Ratio + Expense Ratio + Commission Ratio |
| Operating Profit | Profit After Tax / Total Operating Income          |

## 3. Asset Liability and Liquidity:

Asset liability is assessed to ensure that the entity has sufficient liquidity/cash flows to meet any asset liability mismatch. Since the insurance company can have short- and long-term liabilities, hence evaluation of its asset liability management (ALM) through liquidity coverage becomes a critical part of analysis.

Liquidity risk for general insurance companies arises from potential mismatches between incoming and outgoing cash flows. To cover claims and operating costs, businesses require a significant amount of liquid assets. If not adequately managed, high or unexpected claims, particularly during catastrophic events, can put a pressure on liquidity. The timing discrepancy between assets and obligations also poses liquidity problems. To guarantee that assets are available when obligations are due, investment portfolios need to be managed. By altering asset valuations and availability, outside variables such as market volatility and economic downturns can further affect liquidity. Meeting commitments, preventing interruptions, and preserving policyholder trust all depend on efficient liquidity management.

To analyse this critical parameter, BWR performs the following:

- Interest rate risk and asset-liability duration gap analysis.
- Liquidity coverage is measured through cash balances and liquid investments.
- Asset allocation strategies, asset credit quality and asset diversification (by asset class, sector, maturity, issuer)
- Portfolio liquidity, to maintain the portfolio level liquidity, the entities should maintain healthy cashflow, liquid investment and treasury portfolio to meet policy holders demand at all times. It is important to assess that the insurer is maintaining portfolio diversification and no risk concentrations.

#### **4. Investment Portfolio:**

BWR reviews the investment policy and portfolio of the insurer. A detailed analysis is done to understand the processes followed by the company to manage market risk, credit risk, and so on, in its investments. The diversification in the investment portfolio into different industries, single name concentration limits and distribution across rating grades is studied.

### **C. Management Risk:**

The quality and credibility of an insurer's management team is a key determinant of the company's success. BWR would meet the senior management to understand the risk appetite for the future growth strategy and implementation plan. Therefore, BWR considers the following parameters to determine management risk:

#### **1. Management Strategies:**

It outlines the comprehensive plan and strategy developed by the insurance company's leadership to achieve its long-term goals, maximize profits, and manage risks. This involves setting clear objectives, allocating resources efficiently, and making informed decisions to adapt to evolving market conditions.

#### **2. Risk Appetite:**

The level of risk an insurance company is willing to take on to achieve its objectives. It determines the boundaries of acceptable risk by balancing potential rewards with the company's capacity to absorb losses without compromising financial stability.

#### **3. Competence and Integrity:**

BWR assesses the skills, expertise, and ethical standards of the management. BWR considers the management team's ability to effectively execute business strategies and ensure sound decision-making, while maintaining transparency and ethical practices. It is also assessed that the entity is in line with regulatory aspects and aligned with market standards in terms of products, technological advancements, treating customers fairly and maintaining trust in financial dealings.

#### **Additional factors in assessing credit risk**

These criteria outline the methodology to arrive at the standalone rating of a GIC. The rating further considers any support that the GIC can get from its parent or group. Public sector GICs are also assessed for the support they enjoy from the government. Parent support is especially key in the initial years of growth of GICs, where profitability will not be sufficient to support growth in business. In such cases, the standalone rating of the GIC gets notched-up, and the extent of the notch-up is driven by BWR's criteria for notching-up the standalone ratings of entities based on parent/group/government support, which can be found on the BWR website.

In addition to the risks mentioned above, BWR also believes Environmental, Social and Corporate

governance (ESG) risks and opportunities can increasingly have an impact on the operations and sustainability of business of an issuer. Hence, BWR while assessing the credit profile also assesses the ESG profile of the issuer based on data availability. It may be noted that the impact of the ESG profile of the issuer, both in terms of its strengths and weaknesses, are incorporated in the various management risk related parameters while assessing the credit risk associated with the issuer entity.

### **Conclusions:**

General insurance companies typically cover a wide range of risks, such as property, casualty, health, and liability, making the management of underwriting, claims, and regulatory compliance particularly critical. The criteria for general insurance companies focus on financial stability, risk management, operational efficiency, and customer service. Companies that meet these criteria are better positioned to weather economic fluctuations, manage claims effectively, and maintain profitability in a competitive market. By balancing underwriting performance, investment returns, and claims management, general insurers can build a strong foundation for growth and long-term success.

*The previous version of this document can be found in  
<https://www.brickworkratings.com/download/Criteria-GeneralInsuranceCompanies%20v1.1.pdf>*

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