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METHODOLOGY

FOR RATING OF THE ABILITY OF INSURANCE COMPANIES TO PAY CLAIMS

The present methodology represents BCRA's analytical framework for Rating of the ability of insurance companies to pay claims (RAPC).

BCRA rates the ability to pay claims of insurance and reinsurance companies in both Non-life and Life insurance sectors. This rating constitutes an opinion about the ability of the insurance company to pay claims of policyholders and to meet its obligations on time. It does not reflect the ability to meet / pay individual insurance obligations. The assessment is based on quantitative and qualitative factors and detailed discussions with company's management.

The present methodology outlines the analytical framework for the rating assessment of Non-Life insurance companies and Life insurance companies. The analysis includes an assessment of the insurance market, regulatory environment, management of the company, insurance and reinsurance activities, financial analysis and investment quality.

ANALYTICAL FRAME

BCRA's rating of the ability to pay claims represent our long-term risk assessment related to the ability of the rated insurer to meet its policy claims on time RAPC by necessity is placed in the future and represents projections since they are applied to obligations, which may be payable over a long period of time. Critical to the process of preparation of a RAPC is the analysis of the main business indicators of a given insurance company and its competitive position on the market. RAPC is a culmination of an analytical process, which explores the dynamics of the market, the regulatory framework and the main operative and financial indicators of the given insurance company. The analysis of the market focuses on the structure of the competition in the operating environment and the competitive position of the company in this structure. The analysis of the main operative indicators of the company, on the other hand, concentrates mainly on reputation, market share, distribution channels, management, organizational structure/ownership and insurance and reinsurance activities strategy. The financial risk analysis of a given insurance company includes an assessment of key indicators, including profitability, liquidity, operating and financial leverage, capital adequacy and asset/liabilities management.

I. Operating environment

The analysis of the operating environment is focused on two areas, which determine the state of the insurance companies and the prospects for their development - **sovereign risk and risk of the insurance sector.**

Aiming to clarify the risk of the operating environment, besides assessing sectoral risk, we also asses the risk arising from the general economic situation in the country. Thus, the common risk for the operating environment is based both on the sovereign and sector risk assessments.

1. Sovereign Risk

The sovereign risk is assessed by BCRA using the Sovereign Rating Methodology which focuses on the following rating factors:

a. Political Risk,

b. Macroeconomic Stability,

c. Fiscal Flexibility

d. Effectiveness of the Monetary Policy

2. Sector analysis

a. State of the sector

Generally, lower risk levels in the sector imply potentially higher rating levels for companies operating in it. Hence, a major factor influencing the financial strength of the insurance companies is the potential of the insurance market. In this regard, BCRA estimates:

- The state of the sectors which form largest market share of the insurance companies – motor vehicle trade and real estate market;
- Dynamics of gross premium income in the sector;
- Growth potential of the sector;
- Levels of insurance density - realized gross premium income per capita.

Positive factors include overall growth of the insurance market (measured by the increase in gross premium income), growing consumption and purchasing power of the population; rising indicators of insurance density and insurance penetration;

- Intensity of competition and volatility - strong competition in the insurance sector is seen as a risk factor;

- Increase in the indemnities for liability insurances, coupled with strong competitive pressure on prices, implies a risk from large losses. In highest degree this is related to the compulsory third party liability insurance, which occupies a significant market share.
- Bargaining power of the customers - consumer price sensitivity, position of the large corporate clients;
- Impact of the regulatory framework and the adopted accounting standards;
- Threat of new entrants on the market;
- Consolidation, merger and absorption processes.

In the rating report, analysts present quantitative information on:

- The market share of the leading companies in the sector and share of the rated company for a period of 5 years. The main reasons in case of change in these shares.
- Gross premium income from main insurance products.

b. Regulatory environment

BCRA evaluates the current regulatory environment, as well as possible changes in the normative acts and tax laws, which could influence the competitiveness of a given insurer or could lead to restructuring of the market segments. The local supervising authority sets the rates of capitalization, calculation of solvency and technical provisions, as well as rules on the composition and structure of investment portfolios for companies operating in the sector.

Key rating factors
• Dynamics in realized gross premium income during the period analysed; • Insurance density and penetration indicators; • Competition intensity in the sector; • Market shares of the leading companies in the sector, gross premium income and development trend for main insurance products; • Regulatory environment.

II. Ownership / Corporate Governance

1. Ownership

A participation in an insurance joint-stock company can be described as a "qualifying holding" when it represents 10% or more of the shares and/or voting rights in the company, which makes it possible to exercise significant influence over the management of that insurer or reinsurer respectively. Qualified holdings in the financial sector are subject to special consideration and prudential assessment by the relevant regulatory authorities.

The financial strength of the parent company is an important source of financial flexibility for the insurer. BCRA assesses the significance of the rated insurance company in the group structure, the free cash flows of the group, and the availability of these flows to meet policyholders' claims, especially during periods of stress. It is also important to evaluate the financial strength of the parent company in view of the fact that it can finance subsidiaries by borrowing funds to increase their capital adequacy.

2. Corporate management

The management system of the insurance company should be formed in accordance with the best corporate practices. The organizational structure must ensure reliable and stable governance by clearly distinguishing features. The actuarial function, internal control, risk management and compliance function, as well as other functions that the company determines as key, must be clearly identified, documented in relevant policies and rules and proper implemented.

When assessing the management of an insurance company, BCRA takes into account achievements in areas such as investment, distribution and creation of new products:

- The company's high innovation potential (reflected in the promotion of new or modified insurance products on the market) is positively considered;
- The presence of a qualified distribution network with a wide territorial scope is also positive;
- The existence of an effective internal information system, an effective system for claims liquidation, correct selection of insurance objects, etc. are also considered as positive factors.

BCRA's analysis involves intensive interactions with the management of the rated insurer. Throughout the evaluation process BCRA seeks to form an opinion for the qualities of management. This opinion is key to assess the ability of management to cope with challenges. Important are the long-term vision of the insurer, the attitude to risk in relation to operational and financial leverage, strategies for capital raising and views on shareholder value creating. It is essential for the company to have an effective risk management system. The characteristic components of this approach are as follows:

Goal	Main Business Goal formulated by the Managing Authority.
Risk capacity	The level of risk the company can take. It is valued using all applicable capital measures, according to the expected future earnings.
Business strategy	Business goals and plans to achieve them assimilated to the main business purpose.
Risk Philosophy	The relationship between the upper level of risk appetite and the capacity of risk. Shows the size at which risk-taking capacity is used.
Risk appetite	Quantitative indicator of the level of risk that the company seeks to achieve profitability and development.
Risk tolerance	A qualitative indicator of company's readiness to take risks for a strategic business unit.
Risk and operational limits	Specific thresholds for key indicators on risk dimensions and classifications.

- Positive from the rating point of view is the low risk tolerance of the management which is reflected in a less aggressive business strategy.
- Positive factor is the adequacy of the strategy in terms of activity, size and potential of the company;
- Strategy aimed at achieving more moderate and adequate leverage levels (balancing the interests of owners and creditors) shall be assessed as a positive factor.

The discussions with the management team serve to clearly identify the products and markets which the company intends to target.

3. Operational advantages

The assessment of insurer's operational indicators focuses on its market competitiveness and other characteristics that may help to create lasting value. In particular, BCRA assesses the quality of insurer's products and distribution systems, its reputation and image. In addition, BCRA examines whether the insurer has sustained advantages in its core business and appreciates its ability to use these advantages in other areas. The mechanism by which an insurance company provides its products, especially for widespread use, is another fundamental aspect of company's business profile. BCRA pays considerable attention to this aspect when assessing the company's financial strength. Whatever the strategy, BCRA considers the control exercised by the insurer over the distribution system as an important indicator for its competitiveness.

Key rating factors
• Impact of ownership on the company's activities. Opportunity for support from majority shareholders; • Corporate strategy; • Experience of the management team; • Attitude to risk; • Distribution network;

III. Insurance business

1. Financial result and Income

A unique feature of the insurance business is that the price to the client is an estimate based on the amount needed to cover costs, most of which would have occurred and will be paid in the future. The price of an insurance premium for a given insurance policy can vary and depends on a variety of factors. Therefore, the premium calculation, as well as the policy-signing process, should be monitored and evaluated. BCRA assesses the different market segments in which the insurance company operates, first by reviewing historical results, and second, by reviewing the current policy procedures that will affect future profitability levels.

Premium - the price of an insurance policy (once or regularly) paid by the policyholder in favour of the insurance company.

Premium income - revenues that an insurer receives as premiums paid by its customers for insurance products over a certain period, or by defined policy or portfolio of insurances.

Gross premium income - total accrued income from policies during the year

Net premium income - gross premium income - premiums remitted to reinsurers. It reflects the risk that the insurance company keeps within its insurance group

Net earned income - is calculated as it follows: net premium income - net change in provision for unearned premiums - change in deferred acquisition costs - changes in other insurance reserves, net of reinsurance, which are not included in other articles.

Earned revenue is part of the amount of the policy, which is determined based on the time elapsed since its conclusion. The remainder of the policy amount is set as provisions for unearned premiums. Insurance companies are obliged to maintain provisions for unearned premiums for the contracted policies. Net earned income is calculated as it follows: net premium income + unearned income at the beginning of the year (provision for unearned premiums at the beginning of the year) - net income at the end of the year (provision for unearned premiums at the end of the year) + deferred acquisition costs at the beginning of the year - deferred acquisition costs at the end of the year + other insurance provisions, net of reinsurance, at the beginning of the year - other insurance provisions, net of reinsurance, at the end of the year.

For example, one-year policy (with a premium paid at the beginning of the period) which is concluded 90 days ago: 90/365 of the policy amount is considered as premium earned, and 275/365 of the amount is included in the provision for unearned premiums.

The key objective is to analyse the specific risk of the company's business mix. To some extent, focusing on more volatile business activities will be seen as a risk for policyholders, regardless of the overall outcome from policy conclusion. Pricing will also be judged from the point of view of the ability to set fair prices based on the expected portfolio losses.

Risk factor for the rating is the existence of a pricing system that does not consider the long-term profile of an insurance policy, payment of claims on which is very delayed in time, such as all liability insurances. If the company recognizes significant reinsurance premiums written and written off receivables on previously terminated contracts, the analyst should state the reasons for this and analyse the possible consequences.

2. Business development and Market share

The rating report includes information on:

- Business profile of the company:
    - Life insurer;
    - Non-life insurer
    - A mixed-activity insurer
    - Reinsurer
    - Captive Insurer

- Gross premium income by:
  - types of insurance;
  - business lines - groups of insurances, such as: motor vehicle insurance, property insurance, health insurance, etc.;
  - insurance products.
- Market share by type of insurances and individual business lines
- Historical structure of company's insurance portfolio (for at least 3-year period).

Th growth of company's revenue, in line with the market growth (if any) or overtaking it, is considered as a positive rating factor.

Positive factor may be an increase in the market share of the rated company under the leading types of insurance, a growing share of insurance types with favourable development prospects or a high share of well-developed products in stage of maturity or decline of their life cycle.

Entering into new market niches is positive from a rating point of view. This is an indication of rapid adaptability and high innovation potential;

The high diversification of the portfolio is a positive factor.

A positive factor is considered if the company has predominant exposures on insurances characterized by moderate claims ratio and small-scale pending claims on old policies.

Portfolio concentration to a higher degree than the average for the non-life / life insurance market is important rating factor.

- A high share of insurances with a more pronounced risk profile is considered a negative factor.
- Specialization in a given type or group of insurances can be considered as a positive factor only if the company has specific competencies and know-how that enable it to ensure the long-run stable development of such a portfolio.

Total claims ratio and claims ratios of the company's major insurance products are matched to the average industry level.

3. Indicators of insurance activity and claims

- Net Claims Ratio
- Expense Ratio
- Net commission Ratio
- Combined Expense Ratio

Key rating factors
• Trends in the overall market share of the company; • Market share of main insurance products; • Development and coverage of company's distribution network - for life insurance companies, special attention is paid to the diversification of distribution channels and company's control over them; • Structure of the insurance portfolio; • Risk profile resulting from the portfolio structure; • Diversification of the portfolio; • Development of new products; • Pricing of the offered insurance products; • Historical analysis of Gross and Net Claims Ratios, Expense Ratio, Net Commission Ratio - reasons for changes in the indicators and comparison with the main competitors; • Combined Expense Ratio - return on main activity - reasons for changes in the indicator and comparison with the major competitors; • Net Commission Ratio - comparison with the major competitors; • Expense Ratio - comparison with the major competitors.

IV. Investment quality

Emphasis is placed on the quality of the portfolio and the opportunities for maintaining the investment flow. BCRA assesses the quality of insurer's assets by examining its investment portfolio. Credit risk and interest rate risk relevant to the nature and aggregate of insurer's liabilities are considered. Particular attention is paid to the diversification degree and the liquidity of the portfolio. High degree of concentration on concrete asset type raises concerns about market and credit risks and income sustainability. Insurer's investment analysis also includes an understanding of the insurer's investment objectives and the regulatory constraints that affect the portfolio structure. Insurer's investment strategy is usually a function of management's risk tolerance, the characteristics of the liabilities, and the extent to which its future premium receivables will be available for claims payments.

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1. Portfolio Diversification

With the entry into force of the Solvency II regime, the list of "eligible assets" with corresponding investment limits was replaced by the Prudent Person Principle. All insurance companies should comply with this principle in their investment business, whether they have access to the EU single market or not. Among the other rules, this principle specifies the appropriate assets diversification to avoid over-reliance on a single asset, individual issuer, group of companies or a market, as well as to avoid too high build-up of risk in the portfolio as a whole.

It is essential to determine how and why the company has invested in certain securities that may carry credit risk. BCRA tracks the existence of excessive concentration by type of investment asset, economic sector or individual company. It is important to trace the investments in securities issued by different legal entities, part of common economic group.

In the rating report, analysts represent quantitative information about the current investment portfolio structure (cash, bank deposits, government securities, equity shares, real estate, etc.).

2. Regulatory restrictions

The investment portfolio of the insurance company should be formed in accordance with the regulatory framework for investment diversification.

3. Return and quality of the investment

In the rating report analysts present quantitative information on:

- Achieved return on investment;
- Investment income structure (interest income, income from asset sales, asset revaluation).

A large dependence of the investment income on the revaluation of securities (unrealized income) is considered as an unfavourable rating factor.

4. Investment Portfolio Liquidity

Liquidity management of the insurance company should ensure that the assets are able to meet both short and long-term liabilities. Liquidity management of the investment portfolio is a particularly important factor for the valuation of a life insurance company as its portfolio structure includes long-term and savings products.

Key rating factors
• Investment coverage of technical provisions; • Structure of the investment portfolio, degree of diversification (resp. concentration), and meeting of the regulatory requirements; • Return on investment; dependence of the investment income from assets revaluation; • Investment portfolio liquidity.

V. Reinsurance

Insurance companies use reinsurance protection to cover the risks they face. In the reinsurance process, the insurance company transfers risks to a reinsurance company that could assume higher risk levels due to larger equity capital. Reinsurance provides additional capital that allows the company to achieve additional growth in its customer base and gross premium income without being limited by the solvency requirements imposed. Reinsurance, on the other hand, helps insurers to limit the impact of high risk levels and thus avoid volatility in the amount of insurance income. For example, motor casco insurances are characterized by the presence of high levels of self-retention, due to the fact that most of the claims are low and that the number of sales is high, thus providing adequate coverage of the risk. Property and fire insurances have contradictory nature so their self-retention rate is low.

Reinsurance plays an important role in reducing the exposure to disastrous risk and increasing the operating leverage of the insurer. BCRA assesses the extent to which the insurance company relies on reinsurance protection to control leverage levels. The quality of reinsurance activity is a key factor in the analysis. BCRA assesses the reinsurance programs in relation to the potential maximum loss (to which the company is exposed) and the exposure to catastrophic events in the past. Evaluating the quality of reinsurance receivables is also an important part of the analysis. It includes identifying the reinsurers, against which the company has the largest receivables and exposures. Review of reinsurers' creditability is based on their international (and local) financial strength ratings, payment history, etc.

Reinsurance is a process whereby one entity (the reinsurer) takes on all or part of the risk covered under a policy issued by an insurance company. The insurance company transfers part of the premium income to the reinsurer and receives a reinsurance commission. The company that passes risks from its insurance policy portfolio to a reinsurance firm is called a ceding company. The company providing reinsurance protection is called a reinsurer. The ceding company may purchase reinsurance protection directly from a reinsurance company or through a broker or reinsurance intermediary. When a company reinsures the risk of its insurance group in another company, then it carries out a passive reinsurance. When a company assumes an additional risk of another company, then it carries out active reinsurance.

Insurance companies seek reinsurance protection for the following reasons:

- To limit the impact of specific risks;
- To stabilize losses from claims;
- To protect themselves against catastrophic events;
- To increase their capacity.

Depending on how the premium and liability are distributed, reinsurance can be proportional and non-proportional. In the case of proportional reinsurance, the reinsurer accepts a fixed percentage of the liability, receives a reinsurance premium, proportional to the accepted percentage of participation and meetss the same percentage of claims incurred (according to the highest insurance sum of the reinsured aggregate stated in the reinsurance contract). Thus, liability between the ceding company and the reinsurer is allocated in a certain proportion.

The two basic forms of proportional reinsurance are:

- Quota share;
- Surplus share.

The non-proportional contract limits reinsurer’s risk by requiring the ceding insurer’s loss to exceed a specified level before triggering the reinsurer’s liability. When the limit is defined as a value, the contract is called "excess of loss”. The limit may be expressed also as a percentage (“stop loss”) or as an annual value (“aggregate excess loss”).

Depending on the reinsurance cover, the following types are distinguished:

- Treaty reinsurance is a type of reinsurance in which the reinsurance company accepts all of a particular type of risk from the ceding insurance company.
- Facultative reinsurance covers single risk or a block of risks held in the primary insurer's portfolio. Each facultative reinsurance is a separate standalone contract.
- Optional-billable contract

The degree of reinsurance leverage can be measured by the self-retention ratio. It reflects the level of risk retained by the insurance company.

The self-retention ratios of the rated company are considered in the context of the average industry and leading companies levels.

Increasing self-retention levels may result in:

- Higher Net Premium Earned
- Lower stability in Net Claims Ratios;
- Better coverage of fixed costs and higher Expense Ratio;
- Lower income from reinsurance commissions.

Accordingly, decreasing levels of self-retention may result in:

- More stable Net Claims Ratios;
- Lower Net Premium Earned
- Lower coverage of fixed costs;
- Risk exposure to reinsurers' credit risk.

Self-retention rates higher than 50% may be an indication of reinsurance over-reliance. A company that reinsures more of its business than needed may not take most of the advantages of its insurance options. Over-reliance on reinsurance limits operations, especially if reinsurers fail to provide lasting support in difficult times. This is less important for companies participating in pooling agreements and insurance groups with a high credit rating of the parent company.

BCRA considers advisable to maintain lower levels of self-retention for an insurance company with a short history of existence and a short record of claims.

BCRA tracks reinsurance commissions. The presence of reinsurance commissions means that the company uses a proportional reassurance of its risks. The indicator gives information about the annual returns from passive reinsurance.

Overall, this part of the analysis relies heavily on an assessment of qualitative factors and information regarding reinsurers, types of reinsurance contracts, contract terms, etc.

Key rating factors
• Reinsurance strategy and its linkage to the growth strategy; • Historically self-retention levels. Relation between the self-retention levels and claims ratios; • Reinsurance program history - reinsurance forms used, self-retention levels under individual reinsurance contracts, maximum exposure of the company; • Credit risk of the major reinsurance partners; • Reinsurance commissions and share of reinsurers in the technical provisions.

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VI. Financial analysis

The analysis is based on the annual audited financial and accounting records as well as on the interim reports of the rated insurance company. The analysis (depending on the availability of the information) is based on 5-year historical period.

Insurance companies with access to the EU single market compose Solvency II balance sheet and IFRS balance sheet. The Solvency II Balance Sheet is prepared in accordance with IFRS. Only when Solvency II prescribes a different accounting coverage this special account is taken into account.

The difference between Solvency II accounting and IFRS accounting is reflected in the reconciliation reserves. As Solvency II prescribes the use of the market valuation approach, reconciliation reserves represent the revaluation of assets and liabilities in accordance with the Solvency II principles. Typical differences between the IFRS balance sheet and Solvency II can be summarized in the following areas:

- Revaluation of intangible assets;
- Revaluation of financial assets measured at amortised cost;
- Revaluation of technical provisions;
- Deferred tax assets and liabilities arising from the above revaluations.

The financial analysis includes an assessment of the formed technical provisions, capitalization levels, yield and liquidity.

1. Technical Provisions

Technical provisions represent the main obligations of insurance companies.

Life insurance companies form the following types of reserves:

- Provision for unearned premiums;
- Provision for claims outstanding;
- Unexpired risk reserve;
- Mathematical Reserve;
- Capitalized value of pensions;
- Reserve for future income participation;
- Technical provisions under life insurances for which the policy holders bear the investment risk;
- Reserve for benefits and rebates;
- Other Reserves.

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Non-life insurance companies form the following types of reserves:

- Provision for unearned premiums;
- Provision for claims outstanding;
- Unexpired risk reserve;
- Reserves for non-technical risks;
- Reserve for benefits and rebates;
- Other Reserves.

Insurers with a right of access to the EU single market form their reserves under REGULATION (EU) 2015/35. The technical provisions under this regulation are two types: premium and claims reserves.

2. Technical provision valuation

The amount of the provisions is calculated based on the amount of the liabilities assumed by the company that are expected to be performed in the future under the contracts in force, the related costs and the value of the potential unfavourable deviation.

Under the Solvency II Balance Sheet, liabilities are measured based on their market value. The value of technical provisions shall be equal to the sum of a best estimate and a risk margin and "the best estimate shall correspond to the probability-weighted average of future cash flows, taking account of the time value of money".

Since there is no liquidity market for insurance liabilities, the economic value is defined as the sum of the best estimate and the risk margin. This ensures a market-consistent assessment. Depending on the nature, extent and complexity of the risks assumed for the insurance, some simplifications are applied.

The best estimate corresponds to the net present value of the future cash flows. The risk margin is equal to the amount that another insurer would require in order to take over the insurance obligations. The risk margin shall be calculated by determining the cost of providing an amount of own funds, equal to the Solvency Capital Requirement, necessary to maintain the reinsurance obligations while they exist.

The excess or insufficiency of insurance companies' technical provision reflects not only the profit but also their capital adequacy. Insufficient provision may jeopardize the solvency, while excess of reserves may reduce the return on capital. Therefore, BCRA considers provision adequacy as an important factor for the financial stability of the insurer.

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3. Capitalization

When assessing capitalization levels, BCRA considers the levels of operational and financial leverage, the compliance with the regulatory requirements for SCR / solvency margin, MCR / guarantee capital and potential for an increase in the equity of the insurance company.

Adequate capitalization levels provide an indication for the ability of an insurance company to withstand catastrophic risks, adverse changes in the outcome of insurance business, and volatility in investment income.

Central part of the analysis is the assessment of company's financial and operational leverage. The following indicators are observed:

- Operational leverage
- Insurance leverage
- Financial leverage
- Technical Provisions + Shareholders' Surplus / Net Premiums
- Annual change in net premiums

The indicators are benchmarked with the industry averages and the defined competitive group. High levels of leverage may lead to increasing shareholders' returns but also to a higher risk for policyholders. Rising values are indicative for higher risk levels.

An important part of the analysis of the capitalization is the assessment of equity's dynamics and the potential to increase the equity size (through shareholder contributions, reinvestment of profits, etc.). It monitors the dependence of company's capital on assets revaluation, which by their nature represent unrealized income.

4. Profitability

The profitability analysis aims to identify the quality and the ability to maintain company's revenue. Insurance companies generate revenue in two ways – by signing insurance contracts and by investment activity.

The analysed profitability indicators are:

- Expense Ratio
- Gross Commission Ratio
- Net Acquisition Ration
- Gross Claims Ratio
- Net Claims Ratio
- Combined Expense Ratio

Claims ratios reveal the company's ability to achieve favourable pricing and operational efficiency.

Other metrics analysed:

- Return on Equity
- Return on Investment Portfolio

5. Liquidity

All insurance companies should maintain high liquidity in order to meet pending payments (in the provision for claims outstanding) and exposures to disastrous risks.

- The primary source of liquidity for insurance companies is derived from the operating cash flow;
- The secondary source of liquidity is the investment portfolio of the insurance company;
- Other external sources of liquidity, such as bank credit lines, are also taken into account.

Liquidity Indicators:

- Liquidity ratio;
- Liquidity ratio of the technical provision;
- Liquidity ratio of the provision for claims outstanding.

Key rating factors
• Size and structure of technical provision; • Capital adequacy in terms of regulatory requirements; potential to increase the equity of the company; return on equity; • Leverage levels - operational and financial leverage; • Liquidity; • Result from insurance business.

Each of the rating factors, considered by BCRA, "generates" a certain conclusion about the rating level and receives a separate (internal) risk assessment. Strengths in a given area of analysis may offset weaknesses in another. Evaluations of the individual rating factors are aggregated and weighted to form a conclusion about the company’s rating ability to pay claims.

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Base Rating, Ceiling, Final Rating

Based on the above analysis, the so-called base rating is formed. The final stage of the rating calculation is the potential adjustment of the base rating due to the general sovereign-risk factors, as evaluated by BCRA using the Sovereign Rating Methodology (see https://www.bcra-bg.com/en/methodologies). The analysed rating factors in this Methodology are: 1) Political Risk, 2) Macroeconomic Stability, 3) Fiscal Flexibility, and 4) Effectiveness of the Monetary Policy. Slightly less limited are the ratings of those subsidiaries whose direct or indirect majority shareholder is a foreign legal entity, able in one way or another to make up for the deleterious effects of the local environment. The ceiling of local subsidiaries may surpass the sovereign rating by one or more notches, which in turn cause their final rating to surpass the sovereign rating.

$$Final\ rating = \begin{cases} ceiling, & ceiling < base\ rating \\ base\ rating, & ceiling \geq base\ rating \end{cases}$$

National-Scale Rating

BCRA could also issue a national-scale rating to entities or issues (see https://www.bcra-bg.com/en/rating-scales). This type of rating is relative, in comparison to other rated entities in the country, taking into consideration only the specific risk factors of the entities and not the effect of the local environment on them. That is, the national-scale rating does not represent an absolute evaluation of creditworthiness, but only a relative evaluation within the bounds of given country. For this reason, it is impossible to draw any comparison between national-scale ratings of entities or issues from different countries. BCRA issues national-scale ratings when a sufficiently large sample size of rated entities is available for the given country, which would allow one to draw comparisons between those entities.

Effective as of June 21st 2018.