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## **Session 26TS**

### **Presenting to Rating Agencies—Putting Your Best Foot Forward**

**Track:** Financial Reporting

**Moderator:** FRANCIS DE REGNAUCOURT

**Panelists:** ROBERT L. RIEGEL  
JOSE D. SIBERON

*Summary: The presenters discuss methods for an efficient rating agency presentation.*

**MR. FRANCIS de REGNAUCOURT:** We have two top-notch speakers. They have a presentation that is merged, so they're going to alternate up here at the podium. But after that I'll open it up and hope that the best part is the questions.

Now, Robert Riegel is an ASA. He's also an MBA. He's been at Moody's 15 years now, which is, for that kind of a firm, a very long service. I lasted more than five years, which is already far more than the average. Prior to being at Moody's, Robert spent a little bit of time at Home Life; but now he's head of the life insurance analysis group worldwide.

My qualifications for introducing these two fellows are that I've spent some time there; I've been there. I've also been on the other side. There are two sides to every story, and that's a lower bound.

Jose Siberon is with Standard & Poor's (S&P). We thought we'd get you two of the top ranking firms. He's an FSA. He's also a CFA. He's been with S&P three years now. Prior to that, he spent a fair amount of time at the Prudential. So the S&P guys are what we considered the competition, but the quality competition, seen from the Moody's standpoint. I think Jose goes first.

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**Note:** The chart(s) referred to in the text can be found at the end of the manuscript.

## **Presenting to Rating Agencies—Putting Your Best Foot Forward 2**

**MR. JOSE SIBERON:** I'm going to start my presentation with some of the do's and don'ts. I think when they organized this meeting, they wanted us to present some topics that we can show to you on what are the good things to do when you're dealing with the rating agencies. So I put together a list of 13 bullet points.

### **Understand the Process**

I think that one of the do's is just understanding the rating processes. I put together a PowerPoint presentation with a lot of slides on that, but I'm only going to cover it at a high level, given that a lot of you have probably been involved with the rating processes in one way or another. I'm going to cover only about one-third of those slides. Then I'm going to finish with the insurance outlook, given that another part of the presentation was an indication of what are the current issues we are facing when we look at insurance companies.

After that Robert will continue with the insurance outlook, but from Moody's point of view; and then he's going to come back around and present his opinion on what are some of the good things that the company should do in terms of putting its best foot forward while dealing with the rating agencies. Let's start with the do's.

**Communication.** I think a lot of points I can summarize in one: It's all about communication. I know this sounds very simple, but we analyze a lot of your financials and do a lot of quantitative data back and forth between the company and the rating agencies. But it all boils down to how you communicate your stories and how we understand your company; and you have to be communicating it in a clear and consistent way.

**Share Management's Views.** We also like to see how management views themselves in terms of the company and the industry and how they view their company in terms of risk and their strategy going forward.

**Depend on Others, Too.** A lot of companies tend to rely a little bit too much on the rating agencies, the capital model here or the liquidity model there; it's a little bit too punitive for one company, but not the other. I think we use those models as tools and a starting point, but we don't rely too much on them; so I think you should not rely too much on what we do, what we think, but do your own thing. And in the long run it should pay off.

**Admit Mistakes.** If you're sitting in a CEO position or a CFO position, and you made a mistake, I think it's better to just go right out and say, "I made a mistake; these are my plans to remedy some of those mistakes and going forward this is what I'm going to be doing and this is what the company is going to be doing." I think some of those will in the end benefit you better. How we communicate to the committee and to other people in the rating agencies and how they view your company in the future is going to be a lot better than if you just surprise us and say, "I never did anything."

**Be Proactive.** Being proactive is a very important point. I think we put a lot more credibility in your company if you proactively identify the risk instead of us identifying your risk. You should understand every risk that you're involved with. I think even at the CEO level, you should understand every risk that the company gets involved with instead of being surprised that one little guy in one of the business units took a huge exposure, but nobody knew about it. I think that doesn't sit well with us or with anybody in external markets.

**Build Credibility.** A lot of these things come down to credibility. If you tell the truth—the whole truth and nothing but the truth—you'll be fine. But as you know, that's a challenge that a lot of companies have to go through. I think it would be very good advice when you talk to us to compare yourself against the industry and your competitors. We probably have a lot of that information already, but it's good for you to just lay out how you compare yourself to others in terms of different business lines or in the different ways that you view yourself against others. I think it will help us understand your company.

**Keep It Simple.** A lot of pictures and a lot of tables are always good. A lot of companies now have a lot of multi-distribution channels with a lot of products offered by different distribution channels. Instead of going through 20 pages of all the distributions and products, I think one simple table that describes by product distribution is a very powerful message that you can present. And it's easy for us to present that table forward when we talk to other people about your company.

**Bring Experts.** Bring the experts and prepare well. I think those two things are very key nowadays—there are a lot of hot issues, a lot of complex issues in the market.

For example, if your company gets heavily into interest-rate risk, you should have a lot of the ALM people sitting in at the management meeting or set up a different call outside of the management meeting with the rating agencies so they can understand exactly what your exposures are. I think at that level, at the CFO level and the CEO level, they might not be able to explain some of your Gamma risk or Delta exposures; but if you bring your ALM people, and we bring the experts too, they can communicate better and we can assess your company a little bit better.

**Keep a Good Relationship.** I know it sounds silly, but it's always important to keep a good and professional relationship with the rating agency. I know sometimes you might not agree with the rating agency in terms of your company's rating. You might be angry, you think it's unfair and you might get aggressive with the rating agency. I think in the long run, it won't sit well. I think you should keep it very professional. We all try to do it the same way, so we're all professionals. It's an opinion, and we all have opinions.

**Know the Criteria.** Finally, I'm going to go through the rating process a little bit and the criteria. A lot of the criteria are made public by S&P and many other rating

agencies; they publish different articles expressing what are the specific details of the criteria, how we judge your company in many different ways and in exact detail of how we quantify some of those risks. You should go into the Web sites, read the criteria and know that well before you go to the rating agency.

A lot of times, for example, we get a company that lost a lot of their capital. They say, "Well my NAIC RBC is still fine," and if you have read the criteria, you know that S&P has its own way of looking at capital, which is a little bit different from the NAIC RBC. So you should not be surprised to hear that we have a different opinion on capital than what the NAIC RBC looks like, if you have read the criteria before our meeting. If you don't, do the do's and you should be fine.

### **Interactive Ratings**

For those of you that do not get too involved with ratings, the interactive ratings are prepared at the insurer's request. It's public data, most of it, and we supplement it with inside information. We send a survey to the companies, and they fill out a lot of company-specific data that is not publicly available. We actually have a tool that we use to look at your credit default swaps, if your company happens to be in the credit default market.

We also look at your bond spreads; we look at your equity price if you are a public company. We look at market leverage and all the other market data. So we know exactly when the market is reacting on your company, even though a lot of people think that we don't. But we do. We do look at those things.

It takes a lot of extensive analysis to understand your company, and in the end, the analysts, if they've done their job well, should know your company as much as your CEO. Well, not as much, but close to it. We should be able to talk about the companies we follow very well at any time without reviewing any papers. You should be able to be familiar with everything that is going on continuously; and obviously the market has become more volatile, so nowadays we've been talking to companies almost on a weekly basis in some cases. So it's a very proactive communication. It's two-way communication.

A decision is not made by just one analyst; we make it on a committee consensus basis that involves different types of analysts that are covering similar companies and also the credit quality officer and other senior people in S&P. We try to make it consistent, so that when you're looking at a health company or looking at a property and casualty (P&C) company or a life company or any other corporation, an A rating means the same thing. It should not be different from industry to industry.

We try to be as prospective as possible. We usually look two or three years into the future. We actually, like I said before, disclose all the criteria in the way that we judge companies. This is all publicly available on the Web site.

**Key Rating Factors**

I'm going to go through each point very quickly.

**Industry Risk.** As you probably imagine, we start with the industry risk. Actually before that, if you're in a different country, we start with the country risk and the foreign exposure, and then we move down to the industry. In the United States it's very easy, it's all AAA; so we don't care about the country risk.

If you're a life insurance company, we'll look at your life insurance industry and see what are the key issues affecting the industry. We put out an outlook—negative, stable or positive. That's the base. For example, the health industry is usually lower-rated on average than the life industry; so by being a health company you're probably constrained to a lower-level rating unless you're really the top of the market.

**Business Review and Management.** We go then to what the company-specific information is, and we have the qualitative part, as you know—the business position or business review and management.

In the business, we look at your distribution, your products, and your sales; what your competitive advantages, your strengths, and your weaknesses are; and the credibility and strengths of management. Has management been consistent? Have they done what they said they have done? We actually, believe it or not, go back and read some of the stuff that we got three years ago to make sure that what they said three years ago is still what they're doing today; and you'd be surprised how many times they change the story from one year to another.

**Corporate Strategy.** We try to make sure that the strategy that you're implementing is consistent with your business profile. If you're trying to become an equity-type company, in which you are selling mutual funds, but you're a health company, it just doesn't make much sense. So that's not going to fit well.

**Quantitative Factors.** Then we move to a lot of more quantitative factors, such as operating performance. And in this one, at the end, if you say that you have a competitive advantage, you have a niche in the marketplace, it has to be reflected in the bottom line. You have to make good earnings if you have a niche; otherwise you don't really have a niche. So those two have to tie together.

**Accounting Issues.** When we're looking into accounting aggressiveness issues, we're not auditors; but we actually have to make sure that the accounting practices are consistent with the average company in the industry. There's no way that we can judge if your accounting is bad or the worst; but at least we can ask the same question to many companies in your industry and see what practices are a little bit more consistent than others.

**Investments.** In terms of investments, we will look at the quality of investments,

the top of the investment risk that you're trying to get into, the performance of your investments, the quality of capital and capitalization strength. We have our own model that measures the risk-based capital (RBC); but we actually look a lot into the qualitative capital. If you happen to have a lot of surplus notes, hybrids and other stuff that comprise most of your capital, then I think your capitalization strength will be a little bit lower than others, even though your ratio might be high. I think what we like to see is more of that return-earnings type of capital.

**Flexibility and Liquidity.** Financial flexibility and liquidity are very subjective, but it's how much access you have to the capital market or to capital through reinsurance. Is the reinsurance dried up? For example, I think Unum had a lot of issues of being the biggest company in the disability market. They suddenly dried up the capacity of reinsuring some of their business when they needed to; so there wasn't an easy way to get capital when things got really bad.

Liquidity is mostly pass or fail. We make sure you have enough liquidity for your business. We look at your liquid assets compared to your liquid liabilities. If you're an annuity player with more mature annuities, and if you don't have a lot of surrender protection, then we'll probably have a lot more punishing factors against those. If you have put options, then we'll probably punish you a little bit more.

**Holding Company Analysis.** At the end, everything has to tie together. If you have a holding company, we might do a bottom-up approach, which means that we look at your holding company's strength, your financial leverage and your coverage ratios. And if that's not appropriate for the rating, your financial strength rating, which is the operating rating, might come down with the holding company. We try to keep three notches differential between your holding company's senior debt and your financial strength rating at the operating level.

### **How Ratings Affect Companies**

Basically we think what the ratings do to you is a positive thing. It could be controversial sometimes, but in general, we think it's positive. We think it provides independent opinions to policyholders, investors and suppliers. Believe it or not, I do get the calls from that little old lady from Nebraska who tried to buy an annuity from your company. They do call me, and they want to know if your company has a lot of financial strength. It's hard to explain to them what it means, but we try to simplify it and explain to them that your company's good enough to provide you with the benefits that they're promising to you in the long run.

Investors, as you know, rely a lot on our ratings. They also rely on a lot of other information, but ratings are important. They also can help you or not help you in the long run. It can help you market a lot of your business. If you're an institutional company, ratings are very important. If you have an AA-type of rating, you probably can market a lot of your products. If the rating comes down, it kind of puts a little bit of a constraint in your business.

We're not in the business, as I say, to tell you what to do; we just opine on it.

### **Improving Ratings**

How do you improve your ratings? It's basically very easy—just outperform our expectations and your expectations. Not very easy to do, but if you're able to prove to us that you do it in a prudent fashion, and you actually are outperforming the industry's expectations, most likely you'll have a positive reaction to that.

You should sustain a competitive advantage. There are a lot of companies in this industry, and right now we're not seeing enough consolidation, because there are a lot of companies that think that their values are a little bit higher than what the real value is. But in general, there's a lot of competition, so you have to have some kind of competitive advantage to sell and to compete in this market. So you have to demonstrate to us that you have that and present it to us.

You also have to maintain the appropriate capital, maintain the appropriate liquidity and the appropriate risk balance, and you'll be fine.

### **Outlook for Insurance**

What are the current outlooks on the insurance industry? We have a negative outlook on all of them except the health industry, which is stable right now. Let me go through only the life and health right now and explain why.

On the life insurance side, basically we think the companies and the industry are relatively strong. However, as you probably know, there's been some deterioration in the fundamental strength. Capital and earnings have deteriorated, and a lot of that is just because of the market conditions. Some of that is out of the control of the company, and some of that is just the lack of proactive risk management of some of the companies in terms of the risk that they put on the balance sheets.

In my view, the insurance companies are going through a catastrophe period right now, and they're still in that period. We don't know when that's going to end. We hope that it's going to end soon. But the credit default, the equity market downturn and the low yields definitely have put a lot of constraints on capital and earnings; and those are two basic factors in your financial strength of a company.

Capital still is very strong, and business is very strong. On the positive side, I think they are still working a lot on efficiency. I think a lot of companies have come through a lot of projects to improve their expenses, and they have automated or provided a lot of technology for underwriting and claim processing.

We're starting to see not a lot of mergers and acquisitions, but more of specialization of companies or focus on their core business. So you see Prudential sold the P&C business. American Skandia sold its variable annuity business. So they're either selling and divesting their non-core businesses, or investing in more of their own core businesses to strengthen their focus.

We still think that a lot of companies are well-capitalized, and the average asset quality is still very good; it's mostly in the A rating—average quality. However, we've seen a lot of fallen angels increasing the high-yields percentage.

In general, the ratings are very high. These are the financial strength ratings. You have come down a little bit. That AA is more AA- now, and there are a lot more A and A+s than there were before. So I think in general the industry went down one notch. The AAAs are still very strong AAAs, and I think they now look more like AAAAs as the entire industry moved down. If they keep their AAA, they will be fine.

On the health insurance side, I think we're going through a positive cycle, where we have seen a lot of the hardening of the rates coming through. As you probably see from your own employee benefits, the health companies have been increasing rates essentially. My health insurance increased almost 25 percent this past year. We have seen that through the bottom line of some of the health companies. Total return on revenues (TROR) on average increased from two or three percent to four or five percent. We've definitely seen the improvement in earnings, which actually improved their capital—which was weak for a lot of companies. A lot of these companies also are very low-rated, so any improvement creates a positive impact into their ratings. You see the reaction to that in the upgrades being higher than the downgrades. Negative factors still continue to be a challenge in medical trends, and pricing some of this risk may be challenging.

### **Keys to Success**

Last, I just put together some of the key things to succeed in this business. The quality of risk management is one. For the insurance industry, looking back 20 or 30 years ago to now, what has changed? I think it's just the type of products that they participate in.

The deregulation of the banks, the insurance companies and the brokers create a more complex demand, more demand for complex products; so the volatility in that marketplace that insurance participates has increased. We think that to handle the volatility, a company has to demonstrate that they understand that the volatility that they used to manage 30 years ago is different now, and they need to implement proper risk management processes to handle that volatility.

You have to have competitive distribution. I think we only see a few companies keeping their career agents. Some of them are still doing well, so there's nothing wrong with just keeping one channel, as long as you know how to spread that channel to different markets.

You have to raise the profitability to a level that is appropriate for your growth. If you want to maintain a high rating, you have to demonstrate that your bottom line keeps growing, even in the difficult markets. We understand it's not going to create a 15 percent or 20 percent return on equity (ROE), but at least 10 percent to 12 percent growth should be appropriate for a highly rated company.



Develop the niche and maintain growth. As long as you keep your capital at an adequate level, you'll be fine. Capital is not tied to the rating one-to-one, as many people believe. We use capital as a starting point to look at your risk. Insurance companies are very complex. They have to put all those risks together in one place, and we use a capital model for that. If you have a lot of capital, it doesn't mean that you're going to be AAA. There are many companies that have a substantial amount of capital and they're rated BBB or A. It's usually because the different businesses do not have enough profitability to maintain that capital, and you might be able to lose that capital very quickly. So you should not give them a high rating because they're going to lose capital.

You can find a lot of the information in our Web site or actually you can call the analyst. You can call me directly if you're following one of my accounts. You can find my name and number in the publication release, and you can call me directly and ask me questions about that account.

The ratings distribution of the entire industry is shown in Chart 1. This includes health, life, P&C and reinsurance. As you can see, the ratings have moved down one notch. The averages now are A+.

Chart 2 shows upgrade and downgrade activity. There are a lot of downgrades. We hope to stop that soon, but still, many of the industries are in negative outlook, so we're still expecting more downgrades in this year. Some of them already occurring in this past month as you saw, even for large mutual companies. We took actions like Guardian which was AA+, but is now AA. It's a mutual company with a lot of strength in it, but it has had some increasing risk that we reflected in the downgrade.

There's a lot of information about what happened in the insurance industry, the equity market, the credit quality. It's still very high. The credit default is coming down, but it is still high in terms of historical perspective.

Interest rates are at a 45-year low. I refinanced my house I think two weeks ago five months after moving into my place. Five months, I refinanced; so you might have some of those mortgage-backed securities by prepaying very quickly. It doesn't matter if you get a 10 percent yield if it's going to prepay next month in 30 days.

**MR. ROBERT L. RIEGEL:** My presentation is focused more on Moody's views of the U.S. life insurance industry. I'll talk about the industry from a ratings and rating trend perspective. And then I'll discuss the key challenges that we see the industry facing and conclude with some comments on what we see as best practices in terms of the relationship with a rating agency and the benefits from good communication.

### **Average Ratings and Trends**

In this sector our average rating is an A1 insurance financial strength rating or claims-paying-ability rating. The average rating at the holding company level is a Baa1 senior unsecured debt rating. The life insurance sector is rated slightly lower than other financial institutions, including banks and securities firms.

Currently the outlook is negative, and over the last 12 months since we changed the outlook to negative, we've taken rating actions on about 20 of our 75 life insurance groups. Most of those were on stock insurance companies, not mutuals. We currently have negative outlooks on about 30 percent of our ratings.

Distribution of our financial strength ratings: we have about six percent AAA, about 55 percent AA, about 33 percent A and about 10 percent Baa and lower. If we look at rating actions upgrades and downgrades, throughout the 1990s, upgrades exceeded downgrades, driven primarily by merger and acquisition activity. In 2002, the downgrades outnumbered the upgrades by more than a three-to-one margin.

If we look at the average financial strength rating over the past 11 years (Chart 3), the middle line, which is the average for all graded companies, has trended down slightly from Aa3 at the beginning of the decade to currently closer to A1. The top line is the average rating for mutual companies, and the bottom line is the average rating for stock companies. You can see a divergence in 2002.

### **Strengths**

This is a highly rated industry. Why? We see several core strengths for this industry. First and foremost is a generally conservative balance sheet in terms of adequate capitalization and limited use of debt in the capital structure.

The investment portfolio for the most part is of good quality and, while diversified, the industry generally has good liquidity. Probably first and foremost is the unique position of being able to offer tax advantage products compared to other financial institutions.

### **Challenges**

There are several challenges facing the industry and I'll briefly discuss each of these. These challenges are putting pressure on the earnings capacity and capital formation for the industry, and that's the key reason why we changed the outlook to negative last summer.

**Investment Portfolio.** Everyone is quite aware that default rates and downgrades have been at all-time high levels in 2001 and 2002. They are trending down, but they're still at quite elevated levels compared to past levels. We do expect continued high levels of defaults and credit losses in 2003, given the environment. The industry's investment portfolio generally is well-diversified by asset class; within the bond portfolio, well-diversified by sector. And most companies have relatively prudent single-issue or limited exposures.

The aggregate exposure to below-investment-grade bonds and the actual credit losses that we've seen have not been significant in the context of the balance sheet of the industry, in terms of the capital base of the industry. It has been very significant in the context of the earnings capacity of the industry, and that's the primary problem for the industry. Compared to other financial institutions, its profitability is pretty modest and meek; and the credit losses are offsetting the vast majority of the operating earnings for the industry.

We also feel that loss recognition on the investment portfolio has been slow, and that's another reason why we expect credit losses to continue to impact the reported income for the industry this year.

The point that needs some emphasis is that the impact of credit losses is going to be very dependent on each individual company's liability structure and how much participating whole life business it has, which enables the company to pass on some of the losses to the contract holders through the dividend mechanism. So the impact is very dependent on liability structure and guarantees in those liabilities.

Below-investment-grade bond exposure relative to statutory capital: you can see the significant rise in 2002, but at 64 percent of statutory capital, this is not an alarming number for us (Chart 4). Low-investment-grade bonds relative to invested assets is roughly at the same level as it was in the early '90s; but again, at under seven percent of invested assets, that's not alarming.

The low-interest-rate environment and low investment income is clearly a negative and a challenge for the industry. It's prompted obviously by the low-interest-rate environment and also the existence of some callable and prepayable securities, active harvesting of capital gains in this low-interest-rate environment, lower returns on equity portfolios and venture capital limited partnership investments, and obviously the credit losses are impacting the investment income.

Just as I said with the credit losses, the impact of a low-interest-rate environment and lower investment income is going to be highly dependent on each individual company's liability structure and its guarantees.

The net investment yield on a statutory basis for the industry over the past 12 years has trended down (Chart 5). It's about 250 basis points lower than it was in 1990, but I'd also point out at 6.6 percent, that's a relatively healthy portfolio yield, given the level of current interest rates.

**Variable Annuity Profitability.** Another challenge the industry's facing is variable annuity profitability and the impact the depressed equity markets are having on this product.

Obviously like any asset-management business, fees and earnings are down as the assets under management decline with the level of the equity markets. Of more

critical importance is the impact from the secondary guarantees and the variable annuity products, the GMDBs and GMIBs. And that was quite painful in 2002 for some companies, in terms of statutory reserve requirements. We think as long as the equity markets remain where they are or decline further, this is going to increasingly become an issue for the profitability of these products.

With regards to the issue of deferred acquisition cost (DAC) amortization, we saw just about every insurance company take a DAC writedown in 2002. This whole environment is obviously placing greater importance on the scale of a company's operation, its distribution channels, service and technology platform and how well diversified its product offering is.

Each company's exposure to the variable annuity product has to be analyzed in the context of what guarantees it underwrote when it put the business on its books, whether it had reinsurance or not and policyholder behavior in terms of surrender rates. Just because you're big in the variable annuity business doesn't necessarily mean you're going to have a significant hit to your bottom line or your capital base.

**Demutualization.** I have a couple of comments on demutualization. It's a two-edged sword. There are clearly some positive benefits of demutualization, but we do see an inherent tension between the interests of the shareholders and the interests of policyholders and financial strength for the company.

Stock companies are under incredible stress and pressure to boost their ROEs and to show top-line and bottom-line growth; and they are under incredible pressure to optimize their capital and to deploy any excess capital. We see stock companies having lower capital ratios than mutual companies. We see stock companies using more debt in their capital structure, and stock companies for the most part stop selling any participating whole life business, a business we like from a credit prospective in terms of the flexibility it offers issuers. As I said before, we are seeing greater divergence in the ratings between mutuals and stocks.

Chart 6 illustrates the average NAIC RBC ratio for mutual companies in the top line and for stock companies in the bottom line. You can see what happened in 2001 with the demutualizations of Hancock, Met and Principal. It's about a 75-point difference now, and it's one of the reasons why we've taken more rating actions on the stock companies compared to the mutual companies.

**Institutional Spread Business.** I have a couple of comments on institutional spread business. This is just a spread lending business that a lot of life companies are in in a big way. This is just the issuance of debt or debt-like insurance contracts, taking the proceeds, finding assets and earning a spread over the funding cost.

We see this as the industry basically leveraging some of the excess capital it had, and it has less capital now to lever in this business. The key risks with this business

are the credit risks and the investments, the fact that these liabilities have long-term guarantees, and there's a lot of credit risk being taken on the investment portfolio with no flexibility to share any credit losses with the contract holders like you do have with participating whole life business or single-premium deferred annuities, for example.

We are concerned with the liquidity risk associated with putable contracts and also the liquidity risk associated with rolling over these contracts or these debt obligations when they become due. They tend to be very large, and they tend to be lumpy; so companies could have \$1 billion, \$1.5 billion, due on one day, and it had better not be relying on issuing new paper to pay off the existing paper; it had better have adequate cash on hand and alternative liquidity sources to pay it off. We just feel that these credit risks and liquidity risks in this environment are heightened.

**Capital Adequacy.** All of these issues have been putting pressure on the capital adequacy of the industry, primarily statutory capital. So we've seen significant growth in general account liabilities over the last couple of years with the growth of the institutional spread business, with the shift away from variable annuities to fixed annuities, and within variable annuities, a shift into the fixed general account fund option.

We've seen lower operating earnings over the last few years. We've seen significant GMDB reserve requirements in 2002. We've seen the credit losses, and we've seen greater stockholder dividends up to the holding company for the stock companies. What this means is the industry now has less capital cushion to absorb these risks going forward, and any additional future risks that emerge in the industry.

Looking at a simple statutory capital-to-assets ratio (Chart 7), there has been a quite noticeable decline over the last two years in 2001 and 2002. At just under 10 percent capital-to-assets, the industry still is well capitalized. But you could see it's capitalized at the same level that it was back in 1995, 1996, and the increase in capital has been wiped out pretty quickly.

### **Impact on Ratings**

The ratings impact of all these negative trends and challenges has to be evaluated in the context of a company's business mix, its earnings capacity, its capital adequacy, its financial leverage and its organizational structure, whether it's a stock or a mutual company. And although we've taken rating actions on a lot of companies, and we have a negative outlook on the industry overall, there are some companies that have held their ratings steady with a stable outlook. It's a very company-specific analysis that we do in the context of these challenges.

The take-aways are that the negative outlooks indicate that if these challenges continue, our ratings are likely to come down on the companies with a negative outlook. Clearly we think the industry has greater risks today than it did, say, 10

years ago, primarily with the tail risk associated with the variable annuity secondary guarantees. And we do feel the industry will remain a highly rated industry in the A category, but lower than it was previously rated.

### **Effective Rating Agency Communications**

I have a couple of slides now on what we see has best practices in terms of maintaining a relationship with the rating agency. The first point is at the companies. We prefer there to be one coordination person setting up the meetings, attending all the meetings and basically funneling all the information from our side to the company and funneling all the information from the company to us.

The contact person usually is a treasurer or an assistant treasurer; and I would say that it should be someone who has good knowledge of the company. It's very frustrating for us, for the analysts, to ask a question of the contact and always have to wait a day or two days to get an answer to that question. So the contact person hopefully is someone who has good knowledge of the company and can answer questions.

It's also good to have someone, the same person, in that position for a number of years. Companies that have a revolving-door contact person I don't think are helping much in terms of the relationship.

Clearly we want frequent ongoing communication. I've been at Moody's 15 years, and when I started, it was an annual review meeting, and that was it. The company also thought if they got through the annual review meeting and got the blessing of the confirmation, they were good for another year. That is all different now.

We have, I would say, quarterly meetings and/or conference calls with companies when they release their earnings. We still have an annual review meeting. We have focused, specific meetings on certain topics. It could be on variable annuities, it could be on the investment portfolio; it could be on the institutional spread business. And we have frequent e-mail communication also with the companies.

We ask companies to provide us with financial forecasts. We look at a lot of historical financial information, but we want companies to share with us their financial forecasts. And then when they present actual financial results, we ask them to put them alongside what they had in their budgets or their forecasts. In that manner, we get a sense of how reliable the company is in delivering its financial results and also how aggressive or conservative the financial forecasts are. We may, in our analysis, make adjustments if we think there are hockey stick projections in terms of sales or earnings; so we do make adjustments.

The next point is that we like to see high-level executive summary reports. If we're discussing an issue on variable annuities or accounting recognition of losses in the investment portfolio, I'm sure the board of directors is asking the company those same questions; and whatever the company prepares for the board would be very

appropriate for our review also.

We do ask companies to give us advance notification of any deals, any announcements and earnings releases. We do not want to read about any new developments in the newspaper or on the news wires, so early notification and discussion with us is a best practice.

Companies should solicit feedback and discussion and dialogue with us on issues that they're considering, whether it's issuing a new type of debt or a hybrid security; if they are looking to change their capitalization ratio, their RBC level at the operating company; if they're considering an acquisition; if they're considering entering a new product line or exiting a product line. These are all topics that companies should engage us and get our feedback and understand our views on.

Companies should provide requested information on a timely basis. We do not ask for information just for the sake of asking. There's an analytic issue that we're focused on, and it could have rating implications. We have been asking for a lot more information in the last 12 to 18 months. I'm aware of that. I'm aware it's a burden on management time, but it's important. So we've sent surveys out on variable annuities. We've sent surveys out on investment portfolios, institutional spread business, and we would like to get that on a timely basis. Frankly, it impresses us if the company is able to get the information back to us quickly and discuss it intelligently. That's a plus for the company.

Access to nonpublic confidential information: obviously we read all of the SEC filings, which are public information. We go through the statutory blanks, but we also ask for and receive nonpublic confidential information. We will not disclose that information in our research reports. We will not disclose that information to research clients who call us up and ask us a question about the company. But that information will be incorporated into our analysis and will be incorporated into our ratings.

If companies are hesitant to provide us with nonpublic confidential information, I'd say that's a strike against them. They should be willing to provide that information. The disclosure and transparency for insurance companies, both on statutory and GAAP, is lacking; and we've publicly stated that we think some changes are necessary. A lot of the information we request that is nonpublic actually should be publicly disclosed in SEC filings; so hopefully that will change in the coming year or two.

I think it's important for companies to understand our perspective of the industry and of your company. We publish a lot of research on the industry so it's worthwhile to spend the time, read it, understand it, and understand where we're coming from. I've never met a company that's satisfied with its rating level, it always thinks it should be higher. But companies should also realize that we're in a pretty unique position as analysts in a rating agency, in which we meet with senior

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management of hundreds of companies and get a unique perspective on the industry. Sometimes companies are sort of insular and inward-focused, and they don't appreciate the perspective of us seeing all of the companies in the industry, all the big companies in the industry and also the perspective of talking with the investors, the regulators, the intermediaries and being able to incorporate all of that into our analysis.

It's also important to understand peer company analysis. You should understand what group of companies we're comparing your company to, and you shouldn't complain about your rating relative to S&P or relative to another rating agency. You should look at your rating from Moody's relative to the Moody's rating on your peer companies. That's critically important. We feel we do a very good job of relative ratings in the industry, and that's critically important.

We ask companies to share their internal work on enterprise risk management, VAR analysis, capital models and liquidity models. All that would be helpful in understanding management's having its hands around risks in the company, understanding those risks and managing the risks. So we welcome that.

Discussions should be open, honest and balanced. We do not like it when companies sugar-coat their presentation material, always putting a positive spin on everything, leaving out the negatives that have happened. And if we find out something reading something in a statutory or GAAP financial statement later that the company should have disclosed to us, a relevant financial issue, that's a strike against them. So we ask the companies to be balanced and share the good with the bad.

Full disclosure and transparency is critically important. If we sense a company's hiding or restricting information from us, that's a strike against them. As Jose said, we do not like surprises. Companies should do what they tell us they're going to do. If we have a meeting with them, and they say they're heading in one direction and then six months later they don't call us, and they've headed in another direction, that's not good.

Finally, this should be a two-way communication; rated companies should get something out of the relationship with the rating agency. We do provide a lot of research on the industry, and we have a pretty unique perspective. I think if companies are willing to put the time and effort into the relationship, they will get something out of it also.

There are a number of benefits of maintaining a good relationship with a rating agency and good communication. I think, in theory, you would have more stable ratings if we are constantly in dialogue and discussion with you, and we're aware of what you're doing, and we understand your projections. I think that there is a tendency for there to be fewer surprises, and, therefore, ratings would be more stable. I don't think you would have the situation where we suddenly look at a



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company's financial statement and find 30 percent of its capital has been wiped out and we don't understand why. That's a situation where you tend to get multi-notch rating adjustments. So I think that's a positive for more frequent communication and good communication.

I think from the issuer's perspective, there would be a better understanding of our rating perspective and of your company and the industry. If you spend the time to understand our perspective, I think you can almost anticipate our reaction to some of the things you bounce off us, whether it's change in the capital structure or an entry into a new business line or an M & A deal—you sort of would be able to slip into the shoes of the rating agency and understand how we would react. And I think that's a positive.

The final thing is that the management quality and credibility is part of our subjective, qualitative analysis of a company. We have a lot of quantitative ratios and quantitative analysis. But a big portion, a significant portion, of our rating analysis and rating conclusion is qualitative. And one of those qualitative aspects is management quality and credibility.

We have a long-standing relationship with all our rated companies. There is a track record with each company and its management team in terms of its reputation of doing what it's saying it's going to do, delivering its financial projections and its reputation for sharing with us good and bad—full disclosure transparency. And that does factor into our ratings decision. So if a company has a reputation of always not telling us what's happening there, always hiding information, that's going to influence our deliberations in committee the next time.

Eventually we'll catch up to a company. Maybe once they can get away with it; but if it's a recurring theme, it will be factored into our analysis.

**MR. de REGNAUCOURT:** Those were two very high-quality presentations and very nearly right on time. Now, with your participation, the real fun begins. We get to ask these guys some questions, and I hope you'll have some. But let me throw out the first one.

You've given us some pointers on best practices and do's and don'ts; but my question to you is, "Why does this matter?" I certainly am convinced that rating agencies make every effort to be absolutely impartial and perfectly objective in their ratings. If that is the case, would a company get a different rating based on the same set of facts just because they didn't communicate well or incompletely or because you thought one of the executives was a little bit of a slimeball? And if that matters, then isn't there something else that goes into the ratings? And if the ratings are truly objective and impartial, how does this matter?

**MR. SIBERON:** Well, it matters a lot, I think. With regards to the subjective portion of the rating, you can have a lot of quantitative data, but it's very hard to

know exactly if quantitative analysis is true or not. In a lot of the examples we have faced in the past couple of years, we see a lot of accounting issues that reflected earnings that are not appropriate. I think you have to judge what you're looking at by the way that the management presents everything to you, the credibility of management.

It boils down to whether you have models and data that are credible. You cannot judge that. The only way you can judge that is to judge the people that are producing the information. So it does have an impact, and like Robert said, there are some times that if you don't have the credibility, it could affect you into a more multiple notch of downgrade than it would have if you would have had a better understanding—sometimes—of the issue at hand.

A lot of times you want to feel that a company's actually expressing or demonstrating its ability in the best way and in a fair fashion. The same way that they want us to put a rating in a fair manner, we want them to present the company in a fair manner also.

For example, we have a company that got heavily involved with credit derivatives; and in the insurance industry, it's not well known to be involved in credit derivatives, it's a bank thing. So if you get insurance companies getting involved in these other types of industries, then you have a concern. But this company came to us before they even started to do a lot of this and demonstrated the processes that they were putting in place to manage this risk and why they were going into this product line and how they thought they were going to be competitive and produce good earnings in this product line. So when we see the credit derivatives come through in the statements, I think we have a better understanding of that, as opposed to judging them quickly on a stereotype basis that no, they won't be able to handle that because they're an insurance company.

I think there are a lot of factors that are not clearly viewed in terms of the quantitative information. A lot of people think that their capital model is what their rating is about, and I think there are a lot of times you see a company that is going to produce a lot of good financial information and a lot of good earnings growth, but we just don't trust management. So it's going to be very hard for that company to be upgraded, no matter how good they are—until they demonstrate that they have changed the way that they manage their external counter parties. Then they will probably they'll have a better chance. That's my long answer.

**MR. RIEGEL:** In our ratings, obviously a key objective is that the ratings be objective; but that's not just to mean that we focus on the historical financial statements of the company.

The interactive relationship with the company is a key element of our analysis, and how credible a management team is will influence our thinking. As I said before, if a company is reluctant to provide us information when we ask them or if they tend to

provide us misleading information, that will be a strike against it. And I guess you could ask, "Well, is it better for companies to not meet with the rating agencies at all?" And I would say that's not the case. If we're not getting information from the companies, we would tend to make conservative assumptions in our analysis. I think it benefits companies to meet with us, engage us and have full disclosure. Honesty is important.

**MR. de REGNAUCOURT:** Do any of you have this experience, those of you who have kids? You hear this enormous noise in your kid's bedroom like a body being dropped to the floor; you say, "What's going on up there?!" And the answer is, "Nothing." Tell me something, you haven't called this kid a liar, but you're going to make a different assessment of the credibility of that piece of information.

When you sit in the rating agency's shoes, you have to gauge everything you see in terms of its relevance and the way you would interpret it for the purposes you're putting it to. I'm asking the question, but I sort of knew what the answer would be. Credibility and helping firms be comfortable with the information you give them, that's where the communication process really makes a difference. The actual information will drive the rating, but you can communicate it one way that looks credible, and you can communicate it in a way—even if it is true—that looks incredible.

A rating agency asks for some information, they hear nothing for two days; they call again and hear, "Why do you want it?" And they say, "Well, because it's going to affect the rating." And then another week goes by, and they get half of what they ask for. And then they call for it again. By the time the fourth time comes around, you'd be stupid not to think there's a reason it took that long to get here.

And since you're in the business of judging risks, your judgment of risk will differ based on whether the kid says, "Nothing" or "I just dropped my TV on the ground." At least in the second case, you believe the information, even if you don't like it.

I'll tell you, if I can indulge in one anecdote. The chairman of the Rating Committee at Moody's, he's dead now. But I remember one story. He only showed up at the biggest rating committees—great big international conglomerates, and insurance companies were seldom a part of it. But at one of them there was an insurance company, so I sat in and said my bit about the insurance company. It was a one-hour rating committee, great big outfit. And in the end he says, "Could I see the annual report?" It was then passed down to him, and he had a look at it. I was sitting beside him and I was sort of curious, "What does he look at in the annual report?" He turned to the back page, and he looked at the picture of the management. And you know, I asked myself "Why?" But I could sort of guess, and people filled me in.

He used to be at Dun & Bradstreet before Moody's was part of Dun & Bradstreet. And before that, he'd been a bank manager; and if you're a bank manager and you

make loans to people, you sit across the desk from them. What is it they use again? Character, capability, capital and something else, the four C's. Character matters a lot, and if you've been a bank manager and you made some bad loans with all the stuff on paper looking good, but the people on the other side being, to use that old credit word, slimeballs, it matters. And that's why we recommend to you that you put some energy and some effort into the way you communicate the information, whatever the information is.

I'm no longer able to speak for them, but I still have some history there. Now, I'd like to see some hard questions from the audience.

**FROM THE FLOOR:** I have a couple of questions. First off, what accounting games have you seen the insurance industry play in the last couple of years and how would you rank the insurance industry in terms of performance and in terms of the financial statements over the last two to three years?

**MR. RIEGEL:** I'll start. The two key accounting issues that we've been focused on are the investment portfolio recognition of investment losses and the second is the whole issue with the variable annuities and the DAC amortization process.

On the investment portfolio, we have seen significant differences in practices among companies in terms of when they take a permanent impairment through the income statement, and the accounting guidelines are currently loosey-goosey. The AICPA is working on more of a bright-line test in terms of underwater, 20 percent or more for six months or longer—that has to be a permanent impairment. I don't know if that's what they'll decide. But right now there have been significant differences among companies.

We've seen some companies hold bonds that have been trading under 80 cents on the dollar for more than a year, and they have not taken a permanent impairment. We think this is coming to a head. There will be some accounting rules put in place probably for year-end 2003, and that's been an issue. Because when you look at the reported income statement, when you look at the statutory capital, there may be additional economic losses not reflected on the balance sheet. So we try to make adjustments. We looked at the portfolio in detail, and we try to make appropriate adjustments so that companies are on an equalized basis in terms of the accounting recognition.

This is not the first time that accounting has lagged behind economic reality in the losses. That's one key issue.

**MR. SIBERON:** Let me add a point. I think we have a high concern on the statutory capital of a lot of companies, because if they write down on a GAAP basis, but they have different treatment on the statutory basis, if the bonds are impaired it doesn't matter what accounting you use. But for statutory accounting, they are lagging, so basically the capital is overstated right now. So we look at gross losses

versus net losses and try to make sense with what they're doing in GAAP. And if we have enough data, we will write it down in the statutory capital in our own models, even though the company doesn't feel it's fair.

**MR. RIEGEL:** The second accounting issue is on the DAC amortization process, and the industry was egregiously aggressive with the reversion to the mean process. We saw companies assuming 15 percent, 16 percent, 17 percent annual returns on the equity portfolios for the next five years. Some companies are still maintaining those types of overly aggressive assumptions. Most of them have taken a fresh-start approach where you basically assume a more reasonable equity market assumption, eight or nine percent going forward. It's just the intangible on the balance sheet; the DAC associated with the variable annuities has to be haircutted, whether it's 50 percent, whether it's 75 percent. But it's not going to be recovered, so that's the second key accounting issue.

**MR. SIBERON:** I will add that, in general, the insurance industry has aggressive accounting. They are allowed to put up DAC, and they are allowed to put up a lot of intangibles.

We now, more than ever, are looking at capital in two different ways. We have this measure that's called hard capital-adequacy ratio (CAR) and soft capitalized adequacy ratio. The soft is a normal ratio and the hard is where we take all the intangibles out. If you know of the S&P capital ratio, if you have 175 percent, that's AAA capital; but you take out all the intangibles, you have less than 100 percent. Then we will have an issue. It doesn't mean that we're going to put you in a BBB level from AAA or AA; but if we can put you to the other peers in the same market, and for all of them, it goes down from 175 to 150, and you go from 175 to 100, suddenly we will have an issue with your company.

Actually the other accounting issue that we see is the variable interest entity (VIE). There's a lot of training and still a lot of work's been done this year, so we'll be seeing the effect on that in the second half of the year for most companies.

**MR. DANIEL J. KUNESH:** I would say on your comment that the accounting is perhaps not conservative. I think that's an arguable position. I assume you're referring to GAAP accounting and not statutory. I think you'd have to be careful to not pass judgment on any company in general or the industry as a whole for an accounting methodology that hasn't been developed by them. I think you have to be very careful there, which leads me to my second question.

You carry a lot of clout as rating agencies in many, many ways and you know that. There aren't many rating agencies, and a small handful of people are making decisions on the fate of companies. What do you do in your individual organizations to make sure that you are adequately prepared to do what you're doing? I mean, you're going into subjective areas; you're going into quantitative analysis. What organizations do you deal with on a constant basis? How do you keep up with the

trends in the industry, because you deal with many industries, as you know?

**MR. RIEGEL:** That's a very good question. Moody's has actually put in place a company-wide initiative, not just the insurance rating team. But post-Enron and WorldCom, clearly we realized that we could have done a better job. And over the past 12 months, we initiated something called the enhanced analysis initiative, where we are hiring specialists in three areas. One is financial reporting, so we are hiring accountants. The second area is corporate governance, and the third is off-balance-sheet derivative risk exposure.

In total we have about 20 specialists on board, and they are working in tandem with the fundamental analysts on those three areas. They don't have account portfolios of their own, but they are there just to deal with initially the largest issuers with the most debt and the most complex companies. And we later this year will actually be publishing research in those three areas; so we will be publishing financial reporting assessment, corporate governance assessments and off-balance-sheet risk assessments. Those are three key areas that are attracting a lot of attention and that's one response.

**MR. SIBERON:** It's very similar at S&P. We now have a chief accounting officer, and we have expanded various risk quality officers. We have a continuing education program now that every analyst has to go through so many credits of training every year. We're constantly doing training.

We also have put in place more analysis in terms of the accounting, the corporate governance and also implemented as of this year a system that's called the credit-tracking system to look at market data such as bond spreads, reactions in the market, credit-default swap and equity prices.

There are different models that we implemented that are market-based models, such as credit grades and various other market-based models for public data, for public companies.

For mutual companies, it's still a challenge to get the data. You just have to push the company to get the data. But we've been having more high-level individuals coming from top-quality companies to manage the training process and to teach us more into what are some of the schemes that are out there and how we should be aware of them.

**MR. RIEGEL:** We're doing a lot of the same things at Moody's that Jose said. One thing that has occurred in the last 18 months is smaller account loads for analysts. When I started at Moody's, a typical account load in the insurance team might have been 20 or 25 credits. Now obviously with consolidation, you have much bigger complex companies; but within the team now, we have average portfolio sizes of about 10 or 11 credits per analyst.

It used to be a more socialistic approach, where all the rated companies sort of got the same amount of time and attention from the managing director and from analysts. And now we're spending much more time on the bigger, more complex companies that have more debt outstanding. And some of the smaller companies that have a very low-risk profile, we're spending less time with them. I think that's a more appropriate way to react to this type of environment.

**MR. de REGNAUCOURT:** I think these guys have given some very good answers to your question Dan, but they might have skipped over what I think is very important that I remember from my time. What better education than to go visit all the managements across the country and have them give you, in effect, the same education, talk about the same industry issues? You very quickly sort out what is consensus, what people agree to, what is controversial and what people don't agree to.

I'm going to tell you something these guys can't say. You think for a minute that companies don't also plant in your mind the seeds of problems of their competitors? Some come right out and name the competitors. Others who think that they're clean think that they'll get an advantage by telling you some of the problems. That doesn't mean you make up your mind on that, but it sure lets you know what questions to ask and what things to investigate.

You have access, in effect, to the best experts in the industry who are there on behalf of their own company educating you constantly every day with every communication. That was one of the joys of the job, and every now and then when you heard some not-so-well-intentioned gossip, well it made you a better analyst and it was also sort of fun; but it was in limited quantities, and that's all part of learning the industry and trying to get it right.

Now, I'm going to solicit at least one more question. You don't get these guys very often, and they're too good to not challenge them a little bit.

**MR. ALLAN J. ROUTHENSTEIN:** Risk management has clearly been evolving throughout the industry, and you see a lot of confidential things that each company does its own unique approach to risk management. Can you share with us—obviously not anything company-specific—but sort of industry trends as far as where you see this going and how you view this as far as where it is now versus where it ought to be?

**MR. SIBERON:** Risk management is a hot topic in the industry, as you probably know. It's amazing how it has evolved in the past few years.

We still have a lot of struggles with some companies that don't communicate to us how they do their risk management practice. There are a lot of companies that just say, "Yeah, we meet on a quarterly basis on the ALM committee, and we have the other investment committee that meets once a month." That's their entire view of

risk management.

As you probably know from the task force of the Society of Actuaries, there's a lot more to risk management than just your quarterly ALM committees. It's usually the top companies that start the trends and then everybody follows. There are a few companies that have created amazing processes that are in place to deal with risk management.

There's one company I remember that struggled a few years ago with the portfolio, and they had a lot of losses. They never looked into the underlying assets inside, and when I challenged them on their risk management processes, they said, "No, we do have the proper risk management; we oversaw this exposure concentration." And then I asked them for reports. That's another way to judge the risk management process. We ask them for reports; if they don't produce them within a week, then you don't have this risk management process. They couldn't produce the same reports that I was asking for.

The year after that, they changed management. And they presented to us how they do risk management now, and they admitted it—they didn't have proper risk management before. Now they have in the intranet all the exposures real-time to everybody in the company at different levels on their desk at any time. Before it was a paper environment where they wrote a memo and passed it around, people put it in a binder, it went to the shelf and nobody saw the limits. Now everybody knows what their exposure limits are at any point in time; so there's a whole different environment when you look at that, what you were presented before. And it was clear throughout our review that there wasn't proper risk management.

There are a lot of companies now that can tell you on a projected basis what their exposures are coming from equity, from interest-rate risk, from other exposure, from the product liability. And they graph it. They do have different measures of earnings.

We like to look at the GAAP earnings and the return on assets (ROA) and the ROEs; but if your company has different way of measuring earnings, we also like to see that. And we might even judge you differently than just looking at the ROA. Some companies have a better value, earnings at risk and different type of earnings measures; some of them have been developed from Europe, because Europe is little bit more advanced in those types of measurement. But a lot of other companies are catching up with that, and I think this is the way in the future to do in this volatile environment. You have to know your exposures.

We asked, for an example, when all these large companies were defaulting—K-Mart, Worldcom, Enron—and when we asked what is your exposure to K-Mart and one company, my contact would call me back the same day and say "\$100 million." And I'd say, "OK, that's reasonable based on your capital." The first thing we look at is capital. It's like, "OK, that's two percent of capital; that's fine."



Then a week after that, they say, "Actually we found we had commercial mortgages we didn't account for; it's actually \$400 million." And we're like, "How come you didn't know that? It took you a week to figure out you have \$600 million exposure?" And then a month after that, they find another \$300 million. So at that point, all bets are off—you don't have that control of your management or your risk. How are you going to run in the insurance business if you're in the business of taking risk, but you don't know what risk you're taking? You're basically gambling, and that's not the proper way of managing an insurance company.

**MR. RIEGEL:** I think risk management at life insurance companies is light years behind banks and securities firms. Senior management and boards are just now beginning to focus on risk management.

Of our 75 rated life insurance groups, I would say 10 have a chief risk officer; that's about it. Probably a similar number are doing some kind of enterprise risk management or value-at-risk, earnings-at-risk analysis.

In terms of best practices, there's one company, which has a noninsurance parent company, that probably is the best of the breed. They have a chief risk officer who reports to the president and CEO of the insurance company and to the chief risk officer of the parent company. And they have a series of risk management committees. Just to give you an example, every product that gets developed has to go in front of this risk management committee, and there's a series of steps that every product has to go through. It's the best I've seen through the life companies, and that's not a life insurance company.

**MR. SIBERON:** In my view, everything starts with products. I think a lot of the key products that burn a lot of companies, if the companies went back and did the proper risk management from the get-go, they would have probably not even gone to the produce. Or even with the reinsurance, they would never have reinsured that product.

But I think marketing, lack of underwriting discipline, just fell off, and to grow, they got caught up in this late '90s bubble. The other thing is that, in general, among the Canadians, I think I've seen three companies that are a little bit ahead of some of the U.S. companies, and that's driven because the regulatory environment forces them to do more risk management.

I think hopefully it won't take the regulators to put more pressure into insurance companies, but I think that's a way they can probably enhance it.

Chart 1

**Insurance Ratings Distribution**  
 “A Noticeable Shift In Ratings”

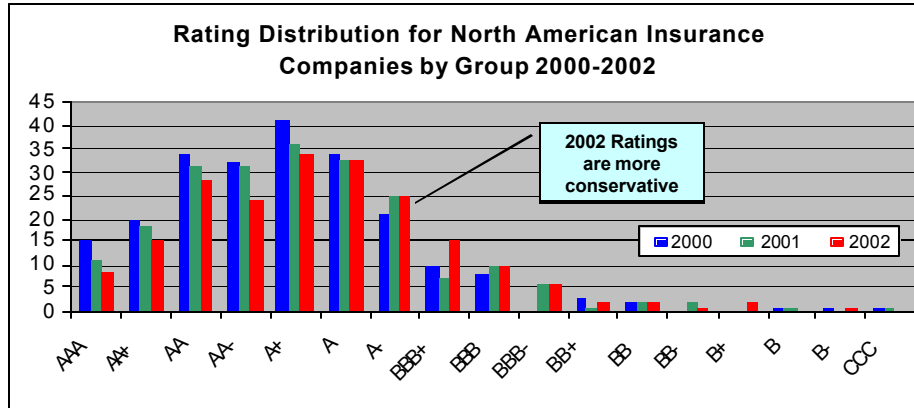


Chart 2

**2001-2002 Interactive Rating Actions**  
 “A Busy Time”

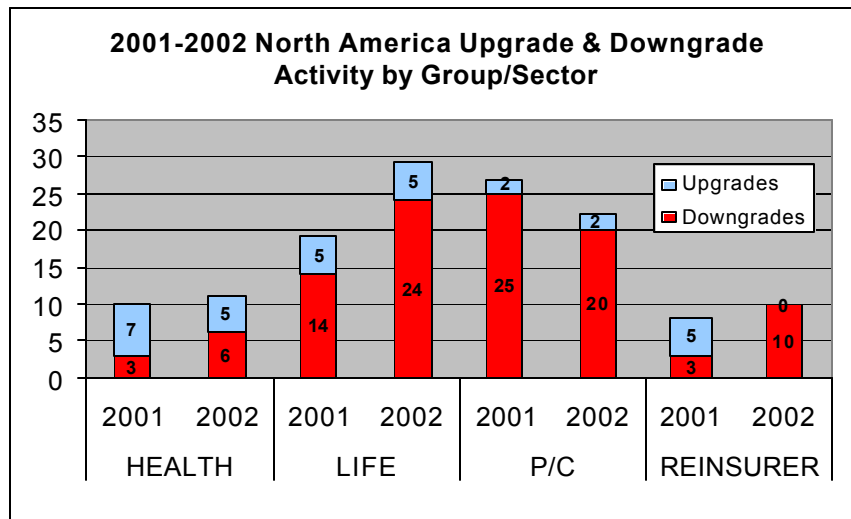


Chart 3

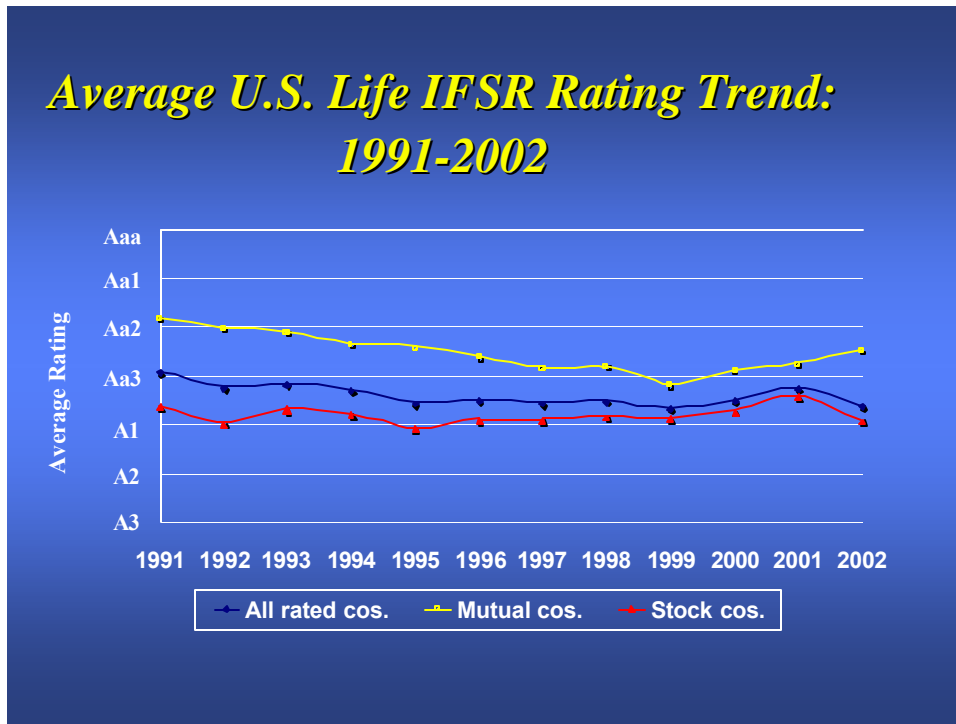


Chart 4

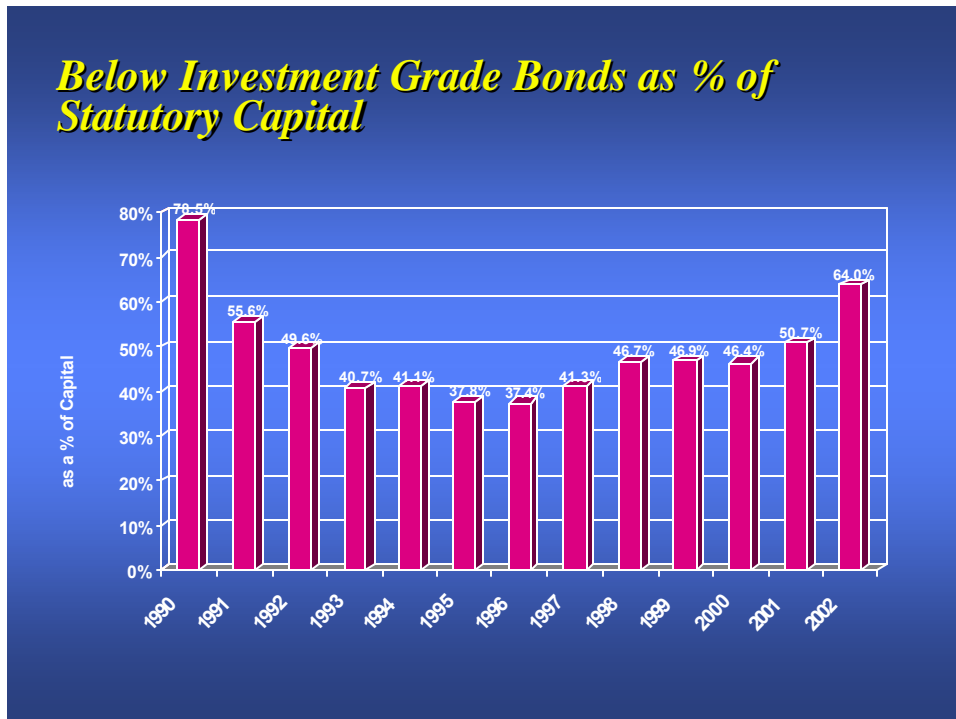


Chart 5

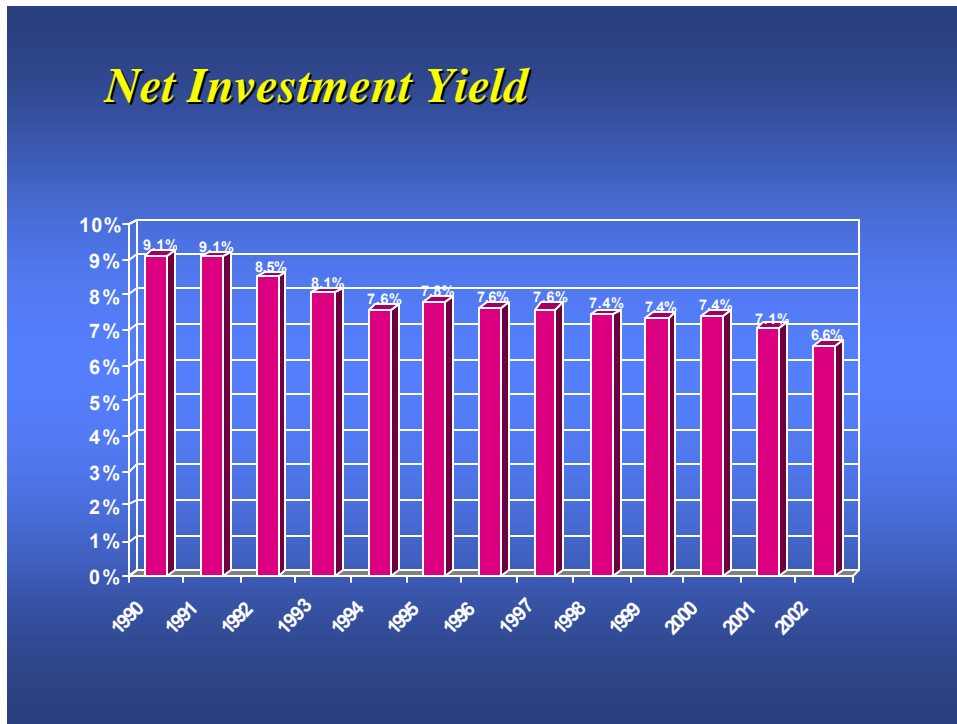


Chart 6

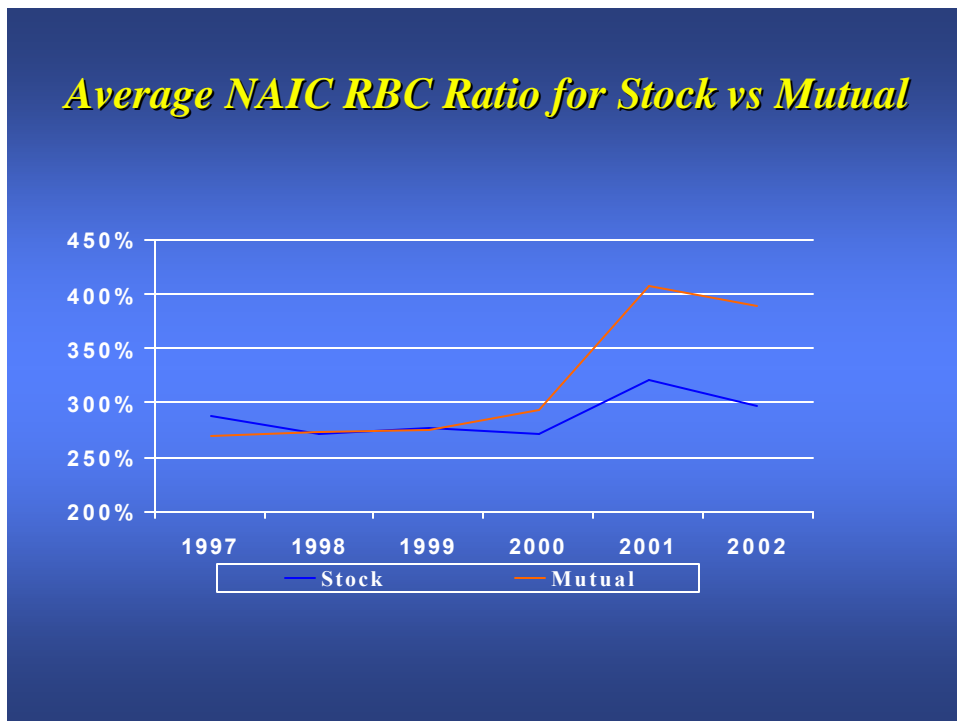


Chart 7

