

Financial-strength ratings and A.M. Best

Category: Opinion 27 September 2016

Written by Dennis B. Funa



Atty. Dennis B. Funa

INSURANCE FORUM

A.M. Best is the only rating agency that is exclusively focused on the insurance industry. It also provides financial information, statistics, and other relevant data on the industry. It runs a news bureau in Washington D.C. covering insurance news and events worldwide. It is based in Oldwick, New Jersey. Its Asia-Pacific offices are located in Hong Kong and Singapore.

More notably, it has been designated as a Nationally Recognized Statistical Rating Organization (NRSRO) by the U.S. Securities and Exchange Commission and the National Association of Insurance Commissioners (NAIC). Its ratings have been recognized as a benchmark in assessing a company's financial strength. The ratings issued by A.M. Best helps to determine the financial strength of insurance companies with respect to its ability to pay claims as well as the strength of its financial instruments. Other rating agencies, such as Standard & Poor's, Moody's and Fitch, deal with other businesses in general. All rating agencies' primary concern is determining potential default.

A.M. Best was established in 1899 by Alfred Magilton Best. Alfred was an actuary who started out as a junior clerk with the Queen Insurance Company of America. A.M. Best started with a single room, a second-hand desk, and an old typewriter in New York. It was only in 1974 when it moved to Oldwick, New Jersey. Its London office was established in 1997, its Hong Kong office in 2000, and its Singapore office in 2015. It was originally known as the Alfred M. Best Company, Inc. and changed to A.M. Best only in 1968. Towards the end of his life, he was awarded as the Insurance Man in 1958 by the Federation of Insurance Counsels. He passed away in the same year. His objective was to perform a "constructive and objective role in the insurance industry toward the prevention and detection of insurer insolvency". He did this by releasing the *Best Reports* on insurance financials and in 1904 he released monthly supplements which would later become the *Best Insurance News*. In 1915, he wrote a book, *The Younger Life Insurance Companies*.

In 1906, A.M. Best issued its first financial strength rating. The rating scales adopted have evolved over time. A rating scale adopted in 1932 had two components: the Net Resources Rating, the forerunner of today's Financial Size Category; and the General Policyholders Rating, which evolved into today's Financial Strength Ratings. From 1935 through 1975, A.M. Best did not assign letter ratings to life/health companies. Instead they had "comments." In order to complete this rating history project, a translation was devised to convert those "comments" to equivalent letter ratings. For example, from 1935 to 1952, "More than Ample" was found to be equivalent to today's "A" rating.

Today, it gives out Financial Strength Ratings (FSR) after a review of a company's performance, financial statements and business profile. The rating formulas of A.M. Best are proprietary and exclusive. Meaning its rating system, rating standards, rating codes and rating

scale are entirely different from that of other rating agencies. As an example, A.M. Best's highest insurance company credit rating is A++, meaning superior, while Fitch's is AAA for exceptionally strong, Moody's is Aaa for highest quality, and Standard & Poor's is AAA for extremely strong. It is therefore possible that companies would be rated differently by each rating agency.

Its "secure" ratings are as follows: A++, A+ (superior), A, A- (excellent), B++, B+ (good). Its "vulnerable" ratings are: B, B- (fair), C++, C+ (marginal), C, C- (weak), D (poor), E (under regulatory supervision), F (in liquidation), and S (rating suspended). It also gives issuer credit ratings (company's debt) and investment grading (of its preferred stock). A second rating symbol is numerical, it ranges from the Roman numeral I (less than US\$ 1,000,000) to XV (greater than US\$ 2,000,000,000) to indicate the Financial Size Category.

It now rates over 3,500 companies in more than 80 countries and serves over 16,000 insurers in various ways. With respect to credit ratings, A.M. Best's short-term credit ratings would show a company's ability to pay commitments due in less than a year, with rating from a high of AMB1+ to a low of D (default). Long-term credit ratings would show its ability to pay commitments maturing in more than a year, with ratings from AAA (exceptional) to D (default).

It must be emphasized that A.M. Best is a voluntary rating agency that gives out independent opinions. Its opinion is not a standard. It gives out mere opinions, not facts. It does not warrant the financial strength of a company. Several insurers in the U.S. are not rated (NR), and this does not affect its financial standing.

END.

Dennis B. Funa (dennisfuna@yahoo.com) is presently the deputy Insurance commissioner of the Legal Services Group of the Insurance Commission.