

Rating Agency Expert Rating
 September, 14th, 2009

THE REPORT

on calculation and awarding to IC NOVA of public stability rating

A. Characteristics of the updated calculation method of ‘Pi-rating of stability for insurance companies of Ukraine’ in 2009’. The estimation is performed based on the public information from insurers.

The analysis of technical defaults of insurers following the results of 2008 (pi)-rating has shown that the method for estimating the stability of insurers needs improvement. The Agency decided in 2009 to abandon the technique of SCRFSM which does not take in consideration the quality of assets, is not fully correct in estimating solvency of the companies, and also is somewhat mischievous in the interpretation of insurer cooperation with reinsurers. The changes introduced to the method are matching the international standards of rating estimation and consist of several groups of factors. These groups of factors and ratios are listed in the *table 1*.

Table 1

Main factors considered at producing (pi)-rating of stability of insurance companies

<i>Group of factors (Share of the Group in the III)</i>	<i>Name of the factor (Share in the group)</i>	<i>Numerator</i>	<i>Denominator</i>
Financial condition (40%)	Inverse indicator of solvency (40%)	Total liabilities (F1: 280 - Net capital)	Net capital (F1: 280-010430-480-620-630)
	Liquidity (30%)	Highly liquid assets (F1: 220+230+240)	Total liabilities (F1: 280 - Net capital)
	ROE (30%)	Net profit (F2: 220)	Net capital (F1: 280-010-430480-620-630)
Diversification of insurance activities (25%)	Share of the top 3 insurance kinds (50%)	Gross premiums written with 3 top insurance kinds in the company	Gross premiums of the company (P1:010)
	Hull insurance share in gross premiums (50%)	Gross premiums written for hull insurance	Gross premiums of the company (P1:010)
Business activity (20%)	Business growth rates (50%)	Growth of gross premiums for 12 months (P:10)	Gross premiums of the company (P1:010)
	Accounts receivable ratio (20%)	Accounts receivable (F1: 050+060+160+170+180+190+200+ 210)	Net capital (F1: 280-010-430-480-620-630)
	Level of sales costs (30%)	Sales costs (P1: 300+310)	Gross premiums of the company (P1:010)
Assets quality (10%)	Share of liquid assets in the circulating assets (100%)	Highly liquid assets (F1: 220+230+240)	Circulating assets (F1: 280-080)
Insurance risks (5%)	Net premiums/Net capital (50%)	Net premiums (P1:010-20)	Net capital (F1: 280-010-430-480-620-630)
	Payout ratio (30%)	Payouts and expenses (P1: 240+320+330)	Gross premiums of the company (P1:010)
	Times burden covered ratio (20%)	Payouts and expenses (P1: 240+320+330)	Net capital (F1: 280-010-430-480-620-630)

Group of additional factors (III correction by premium factors)	Information transparency	Accounting reports presented to SCFSMR as of 31.06.2009 have been submitted to RA Expert Rating of. Annual report is publicly available on SMIDA website
	Scale of company work	Share of company gross premiums in the total amount of gross premiums written by the companies taking part in the rating

Source: PA "Expert-rating".

Note: F1 — balance sheet of the insurer, F2 — profits and loss report, P1 — income statement of the insurer.

The specific weight of the group in the **aggregated integrated indicator (AII)** is shown in brackets near each group of factors, also near each factor its specific weight in the group is shown. When calculating the following algorithm was used:

1. The factors were calculated using formulas shown in *the table 1*.
2. The factors were converted to the points, each factor may give the company 1,3,6,9 or 12 points. The lower the number of points for the factor, the higher the Agency assessed the value of the factor for the stability of the company. The factors were assigned intervals using the ranges which accounted for the specificity of work of insurers under crisis circumstances. For example, we had not very severe approach to the estimate in the presence of losses or at decrease of gross premiums.
3. The intermediate integrated indicator (III) was calculated adding the productions of points on each of the factors to their specific weight in the group of factors.
4. The III was adjusted for premium factors. Namely the III was multiplied by the factor due to information openness and by the factor reflecting the level of external support. The resulting production value was divided by the premium for the work scale. The premium for the work scale was calculated based on the specific weight of gross premiums of the insurer in the total amount of gross premiums of all the companies taking part in the rating.

5. All the companies were divided on three groups of stability:

*Group A** — **high level of stability**. The given group included the companies with up to 2 points.

*Group B** — **good level of stability**. This group included the companies with more than 2 but less than 3 points.

*Group C** — **satisfactory level of stability**. This group included the companies with more than 3 points.

The premium factors have not been standardized, that was one of the basic innovations in the method. Thus, the premium factor for information openness could have only 3 values: 0.75, 0.85 and 1. The lower the value of this factor, the better for the company. The factor 0.75 was assigned to those companies which submitted the full version of the reports to SCRFSM. The Agency was especially interested in the sixth section of the insurer report to the regulator, which data allowed to analyze quality of assets. The companies which have provided the report only in part, for example, only with balance sheets and profit and loss statement and section 1 of the report to SCRFSM, have been assigned the factor 0.85.

Also this year approaches to external support assessment have been changed: its estimation became more selective and differentiated. The companies were assigned 0.5, 0.75, 0.85 and 1 point for the external support. It was difficult for us to define the level of external support in the insurance market, especially due to the fact that several additional liability companies (ALC) participated in the rating which did not disclose information on their shareholders.

The factor 0.5 was assigned to the companies which external support we appraised as very high one. We included into the number of such companies the insurers having largest western insurance holdings among their shareholders, and also the companies which have proved having high level of access to the capital market. Factors 0.75 and 0.85 have been assigned to the companies with a non-defined level of external support, however the Agency is strongly confident in its availability. In spite of the fact that an expert opinion is rather subjective, this was the way the Agency used to define whom to assign 0.85 and whom 0.75 points. The factor 1.0 was assigned to the companies whose level of external support was evaluated by the Agency as zero.

**The Agency draws attention to that the (pi)-rating scale is non comparable to the national scale and is a limited reference point on the market.*

B. Calculation of the aggregate integrated indicator (AII) in insurance companies (pi)-rating of stability for IC NOVA (31241449).

The calculation of the aggregate integrated indicator in insurance companies stability Pi-rating for IC NOVA is made based on the key performance indicators of the company in 2008. The insurance company NOVA takes part in (pi)-rating of stability of insurance companies by RA Expert Rating already during 4 years on end, maintaining high transparency level, thereby matching the expectations of the insureds.

Stage 1. At the first stage the indicators participating in the estimate of stability are calculated. The example of the calculation is given in the *table 2*.

Table 2

Example of calculation of the indicators participating in the calculation of the intermediate integrated indicator for IC NOVA (th. UAH)

<i>Group of factors (Share of the Group in the III)</i>	<i>Name of the factor (Share in the group)</i>	<i>Numerator</i>	<i>Denominator</i>	<i>Indicator value, %</i>	<i>Indicator value, points</i>
Financial condition (40%)	Inverse indicator of solvency (40%)*	Total liabilities (F1: 280 - Net capital) 89815.5-37822.2 = 51993.3	Net capital (F1: 280-010430-480-620-630) 37822.2	137.47%	1
	Liquidity (30%)	Highly liquid assets (F1: 220+230+240) 45532.9	Total liabilities (F1: 280 - Net capital) 89815.5-37822.2 = 51993.3	87.57%	3
	ROE (30%)	Net profit (F2: 220) 1034.1	Net capital (F1: 280-010-430480-620-630) 37822.2	2.73%	1
Diversification of insurance activities (25%)	Share of the top 3 insurance kinds (50%)	Gross premiums written on 3 top insurance kinds in the company	Gross premiums of the company (P1:010)	76.3%	3
	Share of hull insurance in gross premiums (50%)	Gross premiums of hull insurance	Gross premiums of the company (P1:010)	48.6%	3

Business activity (20%)	Business growth rates (50%)	Growth of gross premiums for 12 months (P:10) 100088.9-74398.2 = 25690.7	Gross premiums of the company (P1:010) 74398.2	34.53%	1
	Accounts receivable ratio (20%)	Accounts receivable (F1: 050+060+160+170+180+190+200+ 210) 18578.5	Net capital (F1: 280-010-430-480-620-630) 37822.2	49.12%	1
	Level of sales costs (30%)	Sales costs (P1: 300+310) 6717.0	Gross premiums of the company (P1:010) 100088.9	6.71%	1
Assets quality (10%)	Share of liquid assets in the circulating assets (100%)	Highly liquid assets (F1: 220+230+240) 45532.9	Circulating assets (F1 280-080) 89815.5-25621.6 = 64193.9	70.93%	6
Insurance risks (5%)	Net premiums/Net capital (50%)	Net premiums (P1:010-20) 82973.8	Net capital (F1: 280-010-430-480-620-630) 37822.2	219.38%	1
	Payout ratio (30%)	Payouts and expenses (P1: 240+320+330) 60647.2	Gross premiums of the company(P1:010) 100088.9	60.59%	3
	Times burden covered ratio (20%)	Payouts and expenses (P1: 240+320+330) 60647.2	Net capital (F1: 280-010-430-480-620-630) 37822.2	160.34%	12

*This indicator can differ from that published in the rating on 0.5–1% because at the calculation of the rating not the *net capital* but *capital* was used as a denominator; this fact does not influence the final estimate.

Stage 2. Calculation of the Intermediate Integrated Indicator (III).

Table 3

An example of calculation of intermediate integrated indicator for IC NOVA (th. UAH.)

<i>Name of the factor (Share in the group)</i>	<i>Indicator value, %</i>	<i>Indicator value, points</i>	<i>Specific weight of the indicator in the group</i>	<i>Specific weight of the group in the III</i>	<i>III value</i>
Inverse indicator of solvency (40%)*	137.47%	1	0.4	0.4	0.16
Liquidity (30%)	87.57%	3	0.3	0.4	0.36
ROE (30%)	2.73%	1	0.3	0.4	0.12
Share of the top 3 insurance kinds (50%)	76.3%	3	0.5	0.25	0.375

Hull insurance share in gross premiums (50%)	48.6%	3	0.5	0.25	0.375
Rates of business growth (50%)	34.53%	1	0.5	0.2	0.1
Accounts receivable ratio (20%)	49.12%	1	0.2	0.2	0.04
Level of sales costs (30%)	6.71%	1	0.3	0.2	0.06
Share of liquid assets in the circulating assets (100%)	70.93%	6	1.0	0.1	0.6
Net premiums/Net capital (50%)	219.38%	1	0.5	0.05	0.025
Payout ratio (30%)	60.59%	3	0.3	0.05	0.045
Times burden covered ratio (20%)	160.34%	12	0.2	0.05	0.12
III					2.38

Therefore, the III for IC NOVA makes **2.38**. Later on the III should be adjusted to premium factors.

Stage 3. III adjustment to premium factors.

RA Expert Rating method provides 3 premium factors:

1. Premium for external support — 1.0

The company does not have non-resident shareholders from among large non-resident insurance holdings; the shares of the company are not traded at stock exchanges; the state does not participate in company capital. Therefore RA assigns the premium for external support at the level **1.0**.

2. Premium for information openness — 1.0

The company did not provided to RA the whole set of reports to SCRFSM, having filled in only the rating questionnaire. The set of reporting documents is not obligatory for the participation in the rating, however when it is not provided, the premium for information openness makes **1.0**.

3. Premium for the work scale:

$$(1 + 20 * (100088.9/9084110.14)) = 1.2203603841377467050393997094359,$$

where:

9084110.14 — cumulative gross premiums of all companies participating in 2008 rating;

100088.9 — gross premiums of IC NOVA for 2008;

20 — multiplier.

Stage 4. Calculation of the Aggregate Integrated Indicator (AII).

$$AII = III * 1.0 * 1.0 / 1.221 = 1.9492219492219492219492219492219.$$

Stage 5. Conversion into rating scale of pi- rating.

AII = 1.9492219492219492219492219492219 that corresponds to **group A**.

Thus, IC NOVA is assigned (pi)-rating at the **level A*** that indicates **high level of stability of the company**.

