



Rating agency approval

Guidelines Insurance Sector

Insurance Policy
Prudential Supervision Department

December 2010

Purpose of this guideline

- 1 This document sets out the Reserve Bank of New Zealand's (Reserve Bank) guidelines in relation to the approval of rating agencies. These guidelines elaborate on the matters to which the Reserve Bank must have regard in deciding whether to approve a rating agency for the purposes of [section 62](#) of the [Insurance \(Prudential Supervision\) Act 2010](#) (the Act).
- 2 This guideline relates solely to the requirements under the Act and does not cover requirements of other legislation that may also be of relevance to licensed insurers.
- 3 Nothing in this guide overrides the provisions of the Act.

Approval guidelines

- 4 When deciding whether or not to approve a rating agency, the Reserve Bank will consider how a rating agency or its activities compare to the guidelines on the following matters:
 - (a) the independence of the rating agency;
 - (b) the adequacy of resources available to the rating agency;
 - (c) the credibility and objectivity of the rating agency's methodology;
 - (d) the consistency and comparability of the rating agency's ratings when assessed against industry practice;
 - (e) the adequacy of the rating agency's disclosure of information, including information about its processes, experience and ownership; and
 - (f) relevant international standards, codes and recommended practices relating to the ratings industry.

Independence

- 5 A rating agency should be independent and should conduct itself in a manner that supports its independence. It should have processes designed to prevent it from being subject to political, commercial or economic pressures that could influence a financial strength rating or its financial strength assessment processes.
- 6 A rating agency should have clear operational policies and procedures to identify and manage potential conflicts of interest, including between the financial strength rating activities of the rating agency and other interests of its shareholders or directors.
- 7 A rating agency should:
 - (a) have high standards of corporate governance that are effective in safeguarding the independence and integrity of its financial strength assessment processes;
 - (b) have periodic, rigorous and formal assessments that are independent of the company or group under review and that consider:
 - (i) its methodologies and models; and
 - (ii) any significant changes to its methodologies and models;
 - (c) have firewalls separating its financial strength rating activities from any affiliated businesses to help prevent conflicts of interest; and
 - (d) adopt and adhere to a code of conduct that reflects market standards and internationally recognised principles.

Resources

- 8 A rating agency should have sufficient financial and human resources to carry out high quality financial strength assessments and the capability to provide the information required by the Act.

- 9 A rating agency should:
- (a) be able to develop and maintain systems on an ongoing basis to produce timely, consistent and credible financial strength assessments and ratings;
 - (b) allocate a sufficient number of appropriately qualified and competent people to the analysis, review and approval processes for the production of ratings; and
 - (c) have sufficient resources to allow for regular substantive interaction with the subjects of its financial strength assessments.
- 10 A rating agency's financial viability should not depend upon a small number of clients.
- 11 Rating decisions should be made by a rating committee composed of adequately qualified and experienced individuals in accordance with the rating agency's methodologies.

Objectivity

- 12 A rating agency's assessment methodologies should be:
- (a) documented;
 - (b) rigorous and systematic;
 - (c) applied consistently;
 - (d) where possible, validated by substantial historical experience;
 - (e) based on both qualitative and quantitative approaches; and
 - (f) subject to ongoing review.
- 13 A rating agency's assessment methodologies should, where possible, be established for a sufficient period of time to provide for them to be rigorously back-tested and refined to a high level of confidence.

- 14 The ratings produced by its assessment methodologies should:
- (a) provide credible and consistent measures of financial strength;
 - (b) be responsive to changes in financial condition;
 - (c) be continuous (that is, not be point in time ratings); and
 - (d) be subject to ongoing review, including:
 - (i) after all significant events; and
 - (ii) at least annually.

Third party access to ratings

- 15 A rating agency's publicly disseminated financial strength opinions, analysis, reports and similar or related products should be accessible on equivalent terms to persons who have a legitimate interest in them, regardless of the jurisdiction in which they operate.
- 16 A rating agency should not use unsolicited ratings as a sales tool to pressure insurers who are the subjects of those ratings to use their services.
- 17 A rating agency should not prevent the financial strength rating of a licensed insurer from being disclosed by the insurer.

Disclosure

- 18 A rating agency should publicly disclose and maintain in a readily accessible form the following information:
- (a) its ownership and corporate structure;
 - (b) its code of conduct;
 - (c) its process for assigning, monitoring and changing its financial strength ratings;

- (d) definitions for each of its rating categories and rating modifiers, including:
 - (i) the definition of financial strength;
 - (ii) the time horizons, where applicable; and
 - (iii) the full rating scale;
- (e) the actual insurer failure rates experienced in each rating category over time;
- (f) the probabilities associated with transitions between rating categories, (for example, the likelihood of AA ratings becoming A over time);
- (g) its policy on the release of ratings, including changes in ratings or rating modifiers; and
- (h) its policy on unsolicited ratings.

Consistency and comparability

- 19 Ratings should represent financial strength:
 - (a) in a consistent and comparable manner with regard to established practices for ratings in general; and
 - (b) in a manner that enables comparisons with ratings provided by other rating agencies (to the extent possible).
- 20 A standard rating classification system should be used which has regard to existing practices and with particular regard to an insurer's ability to meet its policyholder obligations.

Credibility

- 21 The Reserve Bank may have regard to other factors in assessing a rating agency's credibility including, for example, the extent to which its financial strength assessments and ratings are used in the market by participants such as insurers, insurance brokers and consumer organisations, or the extent to which a rating agency is recognised under other regulatory regimes.

Website

<http://www.rbnz.govt.nz/regulation-and-supervision/insurers>

Email

insurance@rbnz.govt.nz

Telephone

+64 4 471 3951

Mail

Reserve Bank of New Zealand
Prudential Supervision – Insurance Policy
PO Box 2498
WELLINGTON 6140