

The Financial Health of Insurance Companies: It Still Matters

We've offered two articles on insurance companies' financial health and their financial strength ratings. Since WASB members are entering the 2021 property and casualty insurance bidding season, we thought we'd offer the CliffsNotes version of those articles.

Why do financial strength ratings matter? Carrier financial strength ratings are one way of assessing their long-term ability to pay claims 20 years from now.

But policies are only issued for one year. Why should our school district care? The most worrisome long-term liability concern for Wisconsin public school districts is a sexual assault claim involving a minor — due to the alleged harm caused to the child involved, and because a civil claim alleging sexual assault can be initiated until the alleged victim turns 35 years old.¹ You want your insurance company to defend you years from now, if necessary.

Has an insurance company insuring WASB members ever become insolvent? Yes. Legion Insurance Company/Villanova Insurance Company insured several Wisconsin public school districts. It went from being rated 'A' by A.M. Best in January 2000, and to being ordered into liquidation in July 2003.

What was the result of Legion's liquidation on WI public school districts? In 2013 (ten years later), some Legion-insured Wisconsin public school districts received claim reimbursements from the liquidator, though it is unknown whether the payments equaled 100 percent of the claim paid *upfront* by the school district. Some districts received nothing.²

Bottom line? Even with exceedingly tight budgets, purchasing insurance from the most financially strong carrier absolutely matters; even if at higher premiums.

How do insurance company financial strength ratings work? Insurance companies often apply for or receive financial strength ratings, which are opinions on carriers' financial strength and ability to meet ongoing insurance policy obligations, like paying claims.

Two prominent ratings players in the business are: A.M. Best, which is the oldest and issues the most financial strength ratings; and Weiss Ratings, which issues the second most.

¹ Wis. Stats. §893.587 and §948.095.

² In Re: Villanova Insurance Company (In Liquidation), No. 1 VIL 2002, "Liquidator's Final Accounting, Plan for Final Distribution, and Application for Approval of Notice - Exhibit B," Filed 10/31/18, Commonwealth Court of Pennsylvania, https://www.insurance.pa.gov/Regulations/LiquidationRehab/Documents/Villanova/VILLANOVA_JAN_17_2019_EXHIBITS_B_AND_C_TO_FINAL_ACCOUNTING_FOR_DISTRIBUTION.pdf.

How does a carrier get a rating? Obtaining a financial strength rating from Best comes with a price — literally. In return for a fee from the carrier, Best performs quantitative analyses of carriers’ financials, reserving and pricing policies, reinsurance arrangements and capital management strategies.³

Weiss issues ratings based solely on publicly available information, and carriers do not pay for the Weiss rating. Weiss’ revenue comes from the consumers and companies who buy the ratings. Per the U. S. General Accounting Office, “Weiss places far less reliance than the other agencies on analysts’ judgement.”⁴

Are ratings from credit rating agencies equivalent to one another? No. An A- from Best is not the same as an A- from Weiss, and the distribution of comparable ratings between them is different.

Approximately 72 percent of the carriers rated by Best receive an Excellent (A-) to Exceptional (A++) rating. Weiss ratings tend to distribute more moderately with only 35 percent of companies receiving a rating comparable to the same Best category.⁵ Weiss is known as the “hard” grader and is usually one full letter grade below Best.

What ratings are acceptable? All other things being equal, an A- from Best or B- from Weiss are often the minimum ratings acceptable to, and recommended by, most independent risk management consultants (those who do not sell insurance) and international, national and regional insurance agents and brokers.

Locally, the University of Wisconsin System requires its universities to contract with vendors that carry insurance with a company rated no less than A- by Best.⁶

Why fret over ratings as long as you choose one in the secure range, which for Best begins at B+?

Rating agencies divide their ratings into two general groups: secure and vulnerable.

Best’s secure group begins with a B+ rating and goes up by five more levels to A+++. Insurance agencies and brokerages usually set the minimum acceptable rating bar at no less than A- on the Best scale.

Weiss’ secure group starts at C- and improves from there.

Insurers rated at the bottom of the secure range are more likely to fall into the vulnerable range and are more likely to become impaired or insolvent.²

³ Tom Stephenson, “The Value of (or problem with) Rating Agencies,” *Robus Research*, July 5, 2013, <<http://www.robust-risk.com/the-value-of-or-problem-with-rating-agencies/>>.

⁴ William J. Kravant et al., “Insurance Ratings – Comparison of Private Agency Ratings for Life/Health Insurers,” (GAO/GGD-94-204BR Insurance Ratings), *United States General Accounting Office, Briefing Report to the Chairwoman, Subcommittee on Commerce, Consumer Protection, and Competitiveness Committee on Energy and Commerce House of Representatives*, September 1994, <<http://www.gao.gov/products/GGD-94-204BR>>.

⁵ The Weiss Approach ©2003, <www.WeissRatings.com>.

⁶ See University of Wisconsin System information at <<https://www.wisconsin.edu/risk-management/manual/vendor-certificates/>>.

What if a carrier doesn't have a current rating from Best? Do your homework and gather information:

- If a carrier doesn't have a rating from Best, ask the carrier or agent why and obtain the response in writing.
- If a carrier had a rating from Best, but the rating was withdrawn, ask:
 - For how many years did the company have an AM Best rating?
 - What were its ratings over the last five years that a rating was issued (any discernable trends)?
 - What year was the AM Best rating withdrawn?
 - Why was the rating withdrawn?

Request these responses *from the carrier and/or agent in writing*.

- Obtain the carrier's Weiss ratings. We recommend carriers with Weiss ratings of B- or better.
- Ask bidding agents to provide in writing the last five year-end combined ratios for the carriers offering to insure your district. A combined ratio considers a carrier's losses and expenses (money out divided by premiums (money in)). A ratio of 100 or more means the carrier is losing money on its operations. Are there discernible trends?

Summary. Deciding which property and casualty insurance company to buy from can have potentially devastating financial implications on your district 20 years from now, so buying from financially stable carriers is recommended.

Have bidding agents do the homework for you by obtaining the following information from bidding insurance companies. **For the current and last five years:**

- A.M. Best and Weiss Ratings. If no A.M. Best rating exists, ask the questions noted above.
- Year-end combined ratios.

For questions, review and interpretation of ratings and ratios, call Joy Gänder, CPCU, ARM, Principal, (608) 286-0286, Gänder Consulting Group, LLC. Joy provides complimentary risk management counsel to all Wisconsin public school districts and CESAs as a member service.

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