

## HOW AND WHY INSURANCE COMPANIES ARE RATED

To allow insurance buyers to determine such size and financial strength, an insurance rating is assigned by various independent organizations. Those organizations that assign insurance ratings are referred to as insurance rating bureaus.

Of course these ratings are subject to change much like the financial ratings of large companies, municipalities and states are subject to change. Thus, even if the insurance rating for one of your insurance companies was quite good last year, this year when you choose to renew with them, check again on the insurance rating. This is something your insurance broker or insurance agent can do for you.

Bottom line, there is no doubt the insurance company will be there to collect premiums. However, what assurance does the insurance buyer have that the insurance company will be there, perhaps years later, to pay claims. The financial strength of the insurance company is all the assurance the insurance buyer will have that the firm will be around when it's time to collect on a policy.

The importance of the financial strength of an insurance company is important for many reasons. Let's talk about a few examples.

### CASE EXAMPLE:

A large tract builder customer requires a total of \$3.0 million in Insurance Limits under a supplier's CGL policy. Your insurance broker advises that \$1.0 million in limits can be procured through a CGL policy issued by "ABC Insurance Company". This will serve as the primary policy. Another \$2.0 million can be procured through an excess insurance policy issued by "XYZ Insurance Company". Unless the financial rating of ABC Insurance Company is A+ rated by an insurance rating bureau however, XYZ Insurance Company will not issue the excess Insurance policy because they view their exposure as more significant if ABC Insurance Company is not around to cover the first \$1.0 million in exposure.

### CASE EXAMPLE:

Your lender requires a minimum rating from every commercial property insurance company that insures personal property or real property which this lender loans money against. If there is a fire or other loss, the lender wants to make sure the insurance company has the financial strength to pay the claim.

### CASE EXAMPLE:

You review a customer contract form of a new builder within your market and see that the insurance requirements section requires your CGL carrier to have a rating of not less than A-. What does this rating entail? Does your CGL carrier have an A- rating or better?

### CASE EXAMPLE:

You have decided to outsource the delivery of your products to a local transportation company. Your counsel advises as to the need to prepare a transportation agreement setting forth the terms and conditions of the agreement. Your insurance broker suggests the insurance requirements for such arrangement and recommends a certain insurance rating for those insurance companies from whom your trucking company procures its insurance. Why should you care? Think about what happens if there is a claim at your customer's location and the insurance company for the trucking company goes out of business. The outcome to the supplier could be quite costly if the trucking company's insurance company is not around to pay the claim.

Fortunately companies do not need to spend hours poring over financial statements to determine eligible insurance companies. As mentioned previously, there are several insurance rating bureaus that specialize in issuing ratings of property and casualty insurance companies. These rating organizations include household names such as A.M. Best, Moody's and Standard & Poors. An A.M. Best rating can be located at the following website address at no charge: [www3.ambest.com/ratings/RatingsSearch.asp](http://www3.ambest.com/ratings/RatingsSearch.asp).

The rating simply attests to the financial stability of the insurance company to pay claims. Every insurance company receives a letter rating and a numerical rating. The letter rating indicates how "secure" the insurance company is in relation to its claims ability paying ability. Below are the letter ratings used by A.M. Best:

A++ and A+	Superior
A and A-	Excellent
B++ and B+	Very Good
B and B-	Fair
C++ and C+	Marginal
D	Poor
E	Under Review
F	In Liquidation
NR	No Rating

The numerical rating (Roman numerals for A.M. Best) represent the financial size of the company in terms of capital surplus and conditional reserve funds (amounts set aside for claims). Below are the numerical ratings used by A.M. Best.

I to V	\$1M to \$25M
VI to X	\$25M to \$750M
XI to XIV	\$750M to \$2B
XV	\$2B and Greater

Each insurance company would then have two ratings and it looks like this: A+XV which would mean a company with superior claims ability paying ability and more than \$2 billion in capital surplus and conditional reserve funds—in other words a very strong—in fact one of the strongest insurance company around.