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## RATING IN THE OPINION OF THE OLSZTYN INSURANCE COMPANIES

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Key words: rating note, internal and external rating, insurance companies.

### Abstract

The aim of studies was an attempt of giving the opinion about rating, its usefulness and a level of its using so far by the insurance companies from the city of Olsztyn.

The research was carried out in the year 2005 in the companies of I and II branch that had been operating on the market for more than 5 years. The research tool was a questionnaire put forward to the managers of 24 insurance companies who had given their assent for carrying out the research.

The study shows that more than a half of respondents consider rating to be a reliable and comprehensive source of evaluation. In the opinion of 92% out of the examined insurance companies, the possession of ranking note contributes to increasing investors' confidence, while only 17% think that it is not important for their clients. However, the high costs of external rating and fear of getting a low note are the barrier in using that type of tool by the insurance companies from Olsztyn.

## RATING W OPINII OLSZTYŃSKICH FIRM UBEZPIECZENIOWYCH

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Słowa kluczowe: ocena ratingowa, rating zewnętrzny i wewnętrzny, towarzystwa ubezpieczeniowe.

### Abstrakt

Celem badań była próba wypracowania opinii na temat ratingu, jego przydatności, a także poziomu dotychczasowego wykorzystania przez towarzystwa ubezpieczeniowe z terenu Olsztyna.

Badania przeprowadzono w 2005 r. w zakładach działu I i II, działających na rynku ponad 5 lat. Narzędziem badawczym był kwestionariusz ankiety skierowany do dyrektorów 24 towarzystw ubezpieczeniowych, którzy wyrazili zgodę na przeprowadzenie badań.

Z przeprowadzonych badań wynika, że ponad połowa ankietowanych uważa rating za wiarygodne i kompleksowe źródło oceny. W opinii 92% badanych firm ubezpieczeniowych posiadanie noty ratingowej przyczynia się do zwiększenia zaufania wśród inwestorów, ale tylko 17% uważa, że ma to znaczenie dla ich klientów. Jednak wysokie koszty ratingu zewnętrznego oraz obawa uzyskania niskiej oceny są barierą w wykorzystaniu tego typu instrumentu przez olsztyńskie firmy ubezpieczeniowe.

## **Introduction and the aim of research**

Along with a progress and still growing of complication level of financial market in Poland, including also the insurance sector, there is a need of working out the system of evaluation of financial institutions. Both complexity of financial decisions and risk, that is connected with that, cause the necessity of creating the opportunity of getting financial and economic evaluation of the financial market entities by the investors. Such evaluation should be depicted in a comprehensible and easily accessible way for the market participants. These are rating's abilities. The rating may be defined twofold: in wider meaning as a process of giving an evaluation note, and in narrower – as a result of that process that is established after carrying out the rating procedure by the rating agency.

The insurance rating is meant as an estimation of insurance companies' abilities to pay the policy liabilities – the economic guarantees of realness of insurance protection, including the period of their realisation – which is one of the main theoretical and practical problems in times when the growing complication level of the financial market makes necessity of developing better and better methods of evaluation of insurance companies and their products (MLEWSKI 2000).

The term "rating" is ambiguous and may be classified in many ways when taking as a criterion among others: a target of examination, time of analysis, the procedure goals or the range of used information. In the insurance line the following rating types can be separated:

1. Rating of insurance companies as issuers of debt securities (rating of short-term investment contracts, of debt securities, of short-term securities, of preferred stocks, of credit as well as dual instalments).
2. Rating of insurance companies as guarantors of insurance protection:
  - ratings of A.M.Best agency which are the opinion on the insurance company abilities to fulfil all liabilities towards the owners of insurance policies.
  - ratings of financial results – made by A.M.Best for newly arisen or small insurance companies after 3-year period of their activity.
  - ratings of financial power of insurer – the construction based on traditional models for debt securities payees

- ratings of abilities of considerations and compensations payments owing to the insurance agreements.
- ratings based on the public information given by Standard&Poor's agency without the order or company's assent basing on the numerical data obtained from the financial reports/ balances and other sources of information (ratings of solvency)

### 3. Ratings of insurance products.

Rating agencies are usually the economic entities – corporations that operate regardless of the entities evaluated on the commercial rules. They support the investors' decisive process and participate in a proper capital allocation. Currently, all over the world their number is estimated as high as 140-150 (MILEWSKI 2004). The rating agencies take fees for their services charging the market participants. The cost of such an evaluation is from a few dozens to a few hundred thousand dollars. The agencies operate on the national and international markets. In the year of 1996 the first rating agency was formed in Poland and Central Europe – the Central-European Centre of Rating and Analysis (CERA Co.). Its main founders and shareholders are: banks, insurance companies and brokerage offices, Polish Bank Association and the Stock Exchange in Warsaw (IGNATOWICZ 1996).

The advantages of CERA Co. in comparison with the foreign rating agencies operating on the Polish market are:

- very good knowledge on the Polish economy,
- lower costs of evaluation,
- shorter periods of evaluation preparation (PONIATOWICZ 2000).

The most important requirements in the rating evaluation are: rating topicality, adequacy and comprehensibility of the rating evaluation process, its independence and credibility, comparability, orientation on future and high precision of the rating evaluation process (JAWORSKI 2002).

In practice, the ratings have strict character so they are the judgement about the financial power of the insurance company. They usually show the position of the company in comparison with the market results or the results of other insurance companies.

Individual insurance companies are classified by the rating agencies, on the basis of the analysis results, to appropriate rating classes which are presented by means of letter symbols, often supplemented by a figure or signs + or –.

The opinions in form of marks, that are published by the rating agencies, standardise the risk by equating all debt instruments and organisations tools to one scale, comparative for all, in order to increase the safety level of transactions on the financial market. Rating is a dynamic category that referring to the future. A rating note is affected by, among other things: legal form, range of activity, competitive position on the market, quality of manage-

**Table 1**

Long-term rating marks of selected rating agencies

Description of the mark meaning	Moody's	Standard & Poor's	Fitch IBCA
Investment category			
Exceptional ability of delivering the taken financial liabilities	Aaa	AAA	AAA
Very high ability of delivering the taken financial liabilities	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
High ability of delivering the taken liabilities while at the same time sensibility on unfavourable economic conditions and changes of currently existing conditions	A1	A+	A+
	A2	A	A
	A3	A-	A-
Sufficient ability of delivering the taken liabilities while at the same time higher sensibility on unfavourable economic conditions and changes of currently existing conditions	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
	Baa3	BBB-	BBB-
Speculate category			
Less endangered in a short term but facing the high uncertainties that may have unfavourable consequences	Ba1	BB+	BB+
	Ba2	BB	BB
	Ba3	BB-	BB-
More exposed on unfavourable financial and economic conditions but currently is able to cover its financial liabilities	B1	B+	B+
	B2	B	B
	B3	B-	B-
Currently endangered and dependent on favourable financial and economic conditions so that its financial liabilities to be covered	Caa	CCC	CCC
Currently very endangered	Ca	CC	CC
The application for bankruptcy was applied or similar to that actions have been taken, however repayments and financial liabilities are continued	C	C	C
Deadline for paying off the financial liabilities is not kept	D	D	DDD,DD,D

Source: Self study on the basis of JAWORSKI (2002).

ment, company's financial situation. Each of the rating agencies has its own mark criteria that are selected individually depending on the analysed company.

In the situation of Poland, where the new insurance companies are arising on the market rapidly and the clearness of that market is decreasing, the ratings play an especially important part in order to warn about the unfavourable phenomena that occur in the individual companies and in the face of bankruptcy threats.

The aim of research is an attempt to develop an opinion about rating as a tool of the insurance company evaluation, its usefulness in the opinion of insurance market of Olsztyn, and also about its usage so far.

## **Methodology**

The research was carried out in the year of 2005 among 24 insurance companies that operate in the city of Olsztyn. In the research the companies running business concerning the property insurance policies (II branch) and life insurance policies(I branch) took part. These were branches, inspectorate offices, branch offices, regional offices and agencies that had been operating on the market for more than 5 years and gave their assent on carrying out a questionnaire research. Among them there were companies possessing a rating note and also those who had none.

The research tool was a questionnaire containing the ordered set of 25 open and closed questions. Among the closed questions there were scaled questions placed. The collected source material was put forward to the comparative analysis. The results have been presented in a descriptive form, in tables and charts.

## **The results of research**

All respondents, regardless of the fact if the insurance company possess a rating note or not, proved good knowledge about a tool of company's evaluation which is a rating. The most popular rating agency among the respondents was the Standard&Poor's agency – recognised by all examined. On the second place (with 25% of indications) was the Moody's agency, and on further places were the A.M.Best Company (8%), the Fitch Ratings (8%) and the CERA Co. (8%). While studying the sources from which the insurance companies take and analyse the information about the rating, it was claimed that the majority of the respondents had it from the scientific press (41%). 32% of respondents pointed the Internet as a main source of the knowledge in that subject while for 27% such a source were trainings.

Studying the opinion of the respondents about credibility and completeness of a rating note, the data pointing that a half of respondents considered them as reliable, comprehensive and complete were obtained; 42% had no opinion on that subject, and only 8% consider rating an unreliable source of evaluation.

The conclusion drawn from careful analysis is that among the respondents who consider the rating as a reliable and complete source of evaluation there

were 85% companies that possess a rating note. Therefore, one can suppose that their positive opinion about the rating is an effect of their better and stronger knowledge on that subject. The company's given rating note is more or less discussed during the trainings, the board meetings with investors, or even with clients. On a basis of such a rating note the board makes decisions about taking repair actions in these fields that may arise any dubiousness.

On the basis of the question "Is it worth trying to get an opinion of rating agencies?" all the respondents answered "yes". It can be supposed that the insurance companies are aware of rising interest among the clients interested in the realness of the insurance protection. As many as 58% of respondents claimed that possessing the rating note is dictated mainly by the competitors' activities and in some extent also by the economic reality, however 33% said that possessing that kind of a note is just essential. The insurance companies would like to have that kind of note and declare to initiate a procedure to get it. From among (about 30) companies working in the city of Olsztyn only a few possess a rating note given by an agency (the external rating).

Answering the question included in the questionnaire, about pointing the advantages of a rating note, for the 92% of respondents the most important was: detecting of weak points, increasing of the investors' trust and rating as a quality mark. For 83% of the companies the possibility of self-control was very important (Tab. 2).

**Table 2**

Value ranking of advantages in the rating note according to the respondents

Type of advantage	Importance acknowledgement of that advantage evaluated by the respondents		
	important	less important	no matter
Increasing investors' trust	22	2	0
Detecting/revealing the weak points	22	2	0
Rating as a "quality mark"	22	2	0
Possibility of self-control by the company	20	4	0
Comprehensiveness and professionalism of analysis	16	8	0
Permanent monitoring of the evaluation	16	8	0
Commonness – public announcing about a rating note	14	8	2
Supporting the deciding process	8	16	0

*Source:* Self study on the basis of pool.

Although the insurance rating seems to be a very good evaluation tool of insurance companies, it is not perfect. The most important disadvantages ascribed to the rating process are shown in the table 3.

**Table 3**

Value ranking of disadvantages in the rating note according to the respondents

Type of disadvantage	Importance acknowledgement of that disadvantage evaluated by the respondents		
	important	less important	no matter
High costs	24	0	0
Impossibility of the control correctness and lack of objectivity in the rating process	18	6	0
Rating note dependent on the analysts' competence	12	10	2
Subjectivity of some factors subjected to the evaluation	12	8	4
Subjectivity in giving weight to the individual factors	6	18	0
Limited access to procedures and data used by agencies	6	16	2
Delayed market reactions with relation to the time of giving (changing) the rating note	6	14	4
Complex procedures of evaluating	4	12	8

Source: Self study on the basis of pool.

Considering the data shown in the table 3 one can draw conclusions that high costs of giving the rating note are its most important disadvantage and the factor that significantly limits its accessibility. The second most important disadvantage of rating, that was pointed by 75% of the examined insurance agencies, is impossibility of control of correctness and lack of objectivity in the rating process. A rating agency chooses itself the fields of activities of a insurance company which are then evaluated by the agency analysts. The role of a company in the evaluation process of giving the note is limited to only delivering all essential documents and, in the final phase, to accepting the given rating note.

The next problem that was taken in the research was examining if the fact of possessing the rating note influences the increase of clients' and investors' trust, and when choosing an insurer are the clients guided by the fact of a rating note possession? In the opinion of respondents the high rating note influences favourably the investors' trust to the insurance company. The high rating note means that the insurance company is regarded as safe and solvent. The research shows, that so far clients have not taken into consideration the fact that the insurance company have the rating note while choosing the insurance company (83% of the respondents). They pay attention mostly for the common opinion about the insurance company and the height of an insurance premium.

The research gives also an answer to the question what type of rating (internal or external) is more important for the insurance company's activities.



All of the respondents considered the external rating – given by a rating agency more favourable for the insurance company's activities. However, in Poland the internal rating is most often applied in the companies because of the high costs of the external rating and the fears that getting a low rating note may affect unfavourably the further development of the insurance company. Such answers were given by 58% of the respondents. More than 2/3 of the examined companies claims that a low rating note or a lack of that note will cause in the future a decrease of the number in the potential clients and investors as well as a decrease in market share and consequently worsening the competitive position of these companies, while only 8% claim that it will not cause any negative changes for the company's future.

## Summary

The research which was carried out shows that all respondents have knowledge about the subject of rating. The most popular rating agency is the Standard&Poor's agency.

More than a half of the respondents consider rating as a reliable, comprehensive and complete source of evaluation. 58% of respondents think, that it is worthy trying to obtain the rating agency's opinion (external rating) and 1/3 of them claim that it is just essential.

As basic advantages of the rating note 92% of respondents pointed the possibility of finding weak points of a company and increasing the investors' trust. The most important disadvantage is high costs of getting the external rating note.

In the opinion of respondents the rating note affects favourably a trust of the insurance company investors. The high rating note means that the insurance company is regarded as safe and solvent. The clients, however, so far have not paid much attention for the rating note possession while choosing the insurance company (83% of respondents).

In spite of the awareness of the external rating advantages, its high costs and the fear about getting the low rating notes cause that only a few insurance companies in the city of Olsztyn have such a note.

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