



ELANY conducts ongoing financial review and oversight of the nonadmitted market as part of its support of the excess line community. We produce concise two-page financial analyses of all the foreign insurers on the [ELANY eligibility list](#) providing a brief thumbnail summary of each insurer's important financial numbers.

These thumbnails zero in on the following major features:

1. **Balance Sheet:** The amount of assets controlled by an insurer is an indicator of the size of its financial footprint. The larger the balance sheet, the more resources available to pay policyholders' claims and to withstand any unexpected shocks or vagaries in the marketplace. Policyholder surplus is the capital cushion available to the insurer to withstand these shocks and unexpected losses.
2. **Quality of Invested Assets and Liquidity:** Are marketable securities the lion's share of an insurer's investment portfolio? What percentage of total assets is represented by invested assets? The greater the percentage of invested assets to total assets, the stronger the balance sheet. Are reinsurance recoverables a large percentage of admitted assets? How much represents soft assets (deferred acquisition costs, deferred tax assets, goodwill, intangible assets, etc.) in relation to policyholder surplus? Soft assets cannot pay claims, are not readily convertible into cash and in all likelihood end up being written down for a company that ceases to be a going concern.
3. **Loss & LAE Reserves Leverage:** How much are reserves in relation to surplus, i.e. a ratio of 1.00 to 1.00 or 4.00 to 1.00? A ratio of 1.00 to 1.00 is conservative and represents a strong balance sheet. For example, at a leverage ratio of 1.00 to 1.00, a 25% adverse development of loss reserves results in a commensurate 25% reduction in policyholder surplus. However, at a leverage ratio of 4.00 to 1.00, which represents a stressed balance sheet, that same 25% adverse development in loss reserves equates to a 100% reduction in policyholder surplus, effectively rendering the insurer insolvent.
4. **Premium Leverage:** What is the gross written premium to surplus compared to the net written premiums written to surplus? How much business is the insurer writing in relation to its policyholder surplus, i.e. how fast is the insurer going, 30 mph or 80 mph? 30 mph represents a conservative business model

The greater the percentage of invested assets to total assets, the stronger the balance sheet.

that is less likely to lead to an accident, while 80 mph represents a reckless business strategy where there is a much greater chance of an unfavorable outcome. An insurer that writes more business than can be supported by its policyholder surplus is taking on outsized risks and increases the likelihood of negative consequences.

5. **RBC Ratio:** This is a metric utilized to gauge how much capital an insurer has in relation to its operational risk as concerns its investments, underwriting, growth, credit risk, loss reserves and related party transactions. An insurer's RBC ratio is similar to an individual's consumer credit score. Although not an absolute, it provides a metric of the financial history of the insurer and its ability to make future payments. The higher the percentage, the more capital the insurer maintains in relation to its overall operational risks. Any RBC ratio lower than 300% is cause for more scrutiny of an insurer's financial statement. Anything under 200% requires corrective regulatory measures.
6. **Loss Reserve Development:** Does the insurer have a history of underreporting its loss reserves (loss reserve deficiencies), and thus overstating its policyholder surplus, i.e. stair-stepping loss reserves? Are loss reserves set conservatively, wherein loss reserve redundancies develop? Large loss reserve deficiencies are indicative of balance sheet instability, while loss reserve redundancies are indicative of stability and strength.
7. **Affiliated Investments:** How much of the insurer's assets are tied up in affiliated investments? These types of investments can prove to be illiquid and may represent a doubling down of an insurer's underwriting risk if invested in an affiliated insurer, i.e. the insurer's own writings plus the writings of its affiliates.
8. **Quality of Reinsurer:** Are the insurer's reinsurers highly rated? An "A" rated reinsurer denotes a strong financial position. Not all reinsurers are the same; some have questionable financial strength and staying power. Will the reinsurer be there to stand behind the insurer in the event of a large loss? How reliant is the insurer upon the credit balances due from reinsurers? Does this amount represent 10% of an insurer's net worth? 200% of net worth? The inability of a reinsurer to make good on reinsurance balances directly affects an insurer's bottom-line and financial stability.
9. **Ratings:** What are the insurer's financial strength ratings? A.M. Best, Standard & Poor, Moody's and Fitch rate the financial strength of most companies and write a useful, concise summary of the strength, stability and operations of each insurer and its holding company.
10. **Profitability:** Is the company making money, losing money or treading water? Many factors contribute to profitability including underwriting discipline, legacy books of business, catastrophic losses, sale of a business segment, etc.
11. **Combined Ratio:** Combined ratio is made up of three components in relation to premiums earned—losses incurred, loss adjustment expenses incurred and underwriting expenses incurred. If the combined ratio exceeds 100%, it indicates that losses and expenses are in excess of premiums earned in a given period, usually on a calendar year or calendar quarter basis depending upon the timing

An insurer's RBC ratio is similar to an individual's consumer credit score.

- [illegible]

All of these factors are important in analyzing the financial strength and outlook of an excess line insurer. It is important to consider the transparency or opaqueness of an insurer's financial reporting since this either adds to or detracts from the degree of confidence an analyst can infer from the numbers. For example, do the insurer's financial statements include a number of one-off transactions materially affecting their presentation such as loss portfolio transfers, reshuffling of intercompany pooling percentages, reinsurance based in offshore jurisdictions, jurisdictional arbitrage, restacking of insurance subsidiaries, material unexpected loss reserve deficiencies, etc. Without proper transparency, a reliable analysis is difficult to achieve.

It is important to consider the transparency or opaqueness of an insurer's financial reporting.

