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Rating Perspectives on an Insurance Holding Company and its Subsidiaries

1. Rating an insurance holding company

In general, the scope of the business of an insurance holding company is limited to the "business management of subsidiaries and incidental businesses" based on the provision of Article 271-5 of the Insurance Business Act. Namely, an insurance holding company is a pure holding company and cannot earn income from its own business. Consequently, its main income source is dividend income from subsidiaries (and interest on any loans provided). Subsidiaries will never pay dividends if they do not pay interest or repay general loans. As a result, dividends are naturally subordinate to general loans to subsidiaries. When a subsidiary cannot maintain capital as required by laws and ordinances such as a solvency margin ratio regulation, the payment of dividends will be restricted regardless of the existence of earnings that may be paid as dividends under the Commercial Code. Accordingly, the income of an insurance holding company is significantly affected by the earning power and financial strength of its subsidiaries, which are insurance companies, and is subordinate to general loans to subsidiaries. From the viewpoint of rating, the liabilities of an insurance holding company are structurally subordinate to the liabilities of its subsidiaries.

Whether or not this subordination should actually be reflected in the rating will be decided in consideration of both the quality and quantity of the non-consolidated cash flow balance of an insurance holding company. The cash flow balance indicates a balance between cash inflow and cash outflow. In general, the cash inflow of a pure holding company consists primarily of dividends from subsidiaries, management guidance fees, interest on loans and lease fees. Meanwhile, the cash outflow consists primarily of selling, general and administrative expenses and interest on debts. The quantity of the cash flow balance denotes the sufficiency of cash inflow in comparison with cash outflow. The quality of the cash flow balance denotes the stability of the cash flow balance, namely the ratio of dividend income to cash inflow, and the stability of dividends (possibility of restriction on dividends and annual volatility). The criterion for the stability of dividends is the rating of subsidiaries. If the quality and quantity of the cash flow balance are sufficient, subordination will not be expressed in terms of rating, and the rating of an insurance holding company will be consistent with the rating of the group. In contrast, if there is any issue with the quality and quantity of the cash flow balance, the rating of an insurance holding company will be determined by reflecting subordination according to the degree of dependence on subsidiaries with low ratings and the cash flow balance, subject to a ceiling of the highest rating of all the ratings of the subsidiaries.

2. Rating subsidiaries

As mentioned above, if there is no restriction on the cash flow balance, the rating of an insurance holding company will be consistent with the rating of its group. However, subsidiaries are a different matter. Separability remains. Different risk profiles are held. The duty of mutual support by and among subsidiaries is not provided in laws and ordinances. As a result, the ratings of subsidiaries will not immediately converge on the rating of an insurance holding company (overall group). The ratings of subsidiaries are based on an evaluation of profits and losses and financial conditions on a non-consolidated basis, and are determined by taking into account the effect of integration (the profit and loss effect and the effect of credit enhancement by a group).

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